Examination Warrant Number 15-00012-40258-R1

# Report of Examination of

# AIG Assurance Company
Harrisburg, PA

## As of December 31, 2015

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Harrisburg, Pennsylvania
May 26, 2017

Honorable Joseph DiMemmo, CPA
Deputy Insurance Commissioner
Commonwealth of Pennsylvania
Insurance Department
Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 15-00012-40258-R1, dated May 4, 2015, an examination was made of

**AIG Assurance Company,**
**NAIC Code: 40258**

a Pennsylvania domiciled multi-state, property and casualty company, hereinafter referred to as the "Company" or "AAC". The examination was conducted at the Company's office, located at 80 Pine Street, 10th Floor, New York, NY 10038.

A report of this examination is hereby respectfully submitted.



## SCOPE OF EXAMINATION

The Pennsylvania Insurance Department ("Department") has performed an examination of the Company, which was last examined as of December 31, 2010. This examination covered the five-year period from January 1, 2011 through December 31, 2015.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Department and the National Association of Insurance Commissioners ("NAIC") *Financial Condition Examiners Handbook* ("Handbook").

The Handbook requires that the Department plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company, evaluate system controls and procedures used to mitigate those risks, and review subsequent events. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with statutory accounting principles.

The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, in accordance with 40 P.S. § 323.5(a), and general information about the Company and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

For each year during the period under examination, the certified public accounting firm of PricewaterhouseCoopers ("CPA") provided an unmodified audit opinion on the Company's year-end financial statements based on statutory accounting principles. Relevant work performed by the CPA, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

The AIG PC US Insurers ("AIG PC US") consists of fourteen insurance companies, twelve of which participate in an intercompany pooling agreement as described in the "Service and Operating Agreements" section. The following member companies of the group were examined at the same time as the Company:

| Company and State of Domicile | NAIC Code |
|---|---|
| AIG Property Casualty Company (PA) | 19402 |
| The Insurance Company of the State of Pennsylvania (PA) | 19429 |
| National Union Fire Insurance Company of Pittsburgh, Pa. (PA) | 19445 |
| Eaglestone Reinsurance Company (PA) | 10651 |
| Lexington Insurance Company (DE) | 19437 |
| American Home Assurance Company (NY) | 19380 |
| Commerce and Industry Insurance Company (NY) | 19410 |
| AIU Insurance Company (NY) | 19399 |
| New Hampshire Insurance Company (IL) | 23841 |
| Illinois National Insurance Co. (IL) | 23817 |
| Granite State Insurance Company (IL) | 23809 |
| AIG Specialty Insurance Company (IL) | 26883 |
| AIG Insurance Company-Puerto Rico (PR) | 31674 |

## HISTORY

The Company was incorporated on September 26, 1946, under the laws of New Hampshire. Operations were conducted under the title New Hampshire Indemnity Company, Inc.

On June 7, 1991, the Company applied for and received a license in Pennsylvania under the name American Global Insurance Company. Effective December 22, 1993, the Company redomesticated from New Hampshire to Pennsylvania.

The Company changed names two other times and effective October 1, 2013, the name of the Company was changed to AIG Assurance Company.

The Company is currently authorized to transact those classes of insurance described in 40 P.S. § 382, (b)(1) property and allied lines, (b)(2) inland marine and physical damage, (b)(3) ocean marine, (c)(1) fidelity & surety, (c)(2) accident & health, (c)(3) glass, (c)(4) other liability, (c)(5) boiler & machinery, (c)(6) burglary & theft, (c)(7) credit, (c)(8) water damage, (c)(9) elevator, (c)(10) livestock, (c)(11) auto liability, (c)(12) mine & machinery, (c)(13) personal property floater, and (c)(14) workers' compensation.

## MANAGEMENT AND CONTROL

### CAPITALIZATION

As of the examination date, December 31, 2015, the Company's total capital was $32,543,689, consisting of 120,000 capital shares of issued and outstanding common stock with a par value of $25 per share amounting to $3,000,000; $1,504,820 in gross paid in and contributed surplus; and $28,038,869 in unassigned funds ("surplus").

The Company's minimum capital and minimum surplus requirements for the types of business for which it is licensed, pursuant to 40 P.S. § 386, is $2,350,000 in capital and $1,175,000 in surplus. The Company has met all governing requirements throughout the examination period.

### STOCKHOLDERS

The ultimate controlling entity is American International Group, Inc. ("AIG"). No parent entity or publicly held entity owns 10% or more of the stock of AIG.

All dividends have been approved to the extent required and paid within the existing regulatory guidelines. The Company paid the following dividends to its parent during the examination period:

| Year | Amount |
|---|---:|
| 2015 | $0 |
| 2014 | 13,000,000 |
| 2013 | $0 |
| 2012 | $0 |
| 2011 | $0 |
| Total | $13,000,000 |

### INSURANCE HOLDING COMPANY SYSTEM

The Company meets the requirements for filing an insurance holding company system registration statement as directed by 40 P.S. § 991.1404, Registration of Insurers. Pursuant to this requirement, an Insurance Holding Company System Registration Statement and various amendments thereto, have been timely filed with the Department for the period under examination.

AIG is a holding company group that consists of two reportable 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 reportable segments.

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

AIG is named as the ultimate controlling entity in the system. The following depicts a partial organizational structure of AIG as of December 31, 2015 (all ownership is 100% unless otherwise noted):

- American International Group, Inc.
    - AIG Capital Corporation
    - AIG Financial Products Corp.
    - United Guaranty Corporation
    - AIUH LLC
        - AIG Property Casualty Inc.
            - AIG Claims, Inc.
            - AIG PC Global Services, Inc.
            - AIG Property Casualty International, LLC
            - AIG Property Casualty U.S., Inc.
                - AIG Assurance Company
                - AIG Property Casualty Company ("APCC")
                - AIG Specialty Insurance Company ("ASIC")
                - AIU Insurance Company ("AIU")
                - American Home Assurance Company ("AHAC")
                - Commerce and Industry Insurance Company ("C&I")
                - Eaglestone Reinsurance Company ("Eaglestone")
                - Granite State Insurance Company ("GSIC")
                - Illinois National Insurance Co. ("INIC")
                - Lexington Insurance Company ("Lexington")
                - National Union Fire Insurance Company of Pittsburgh, Pa. ("NUFIC")
                - New Hampshire Insurance Company ("NHIC")
                - Risk Specialists Companies Insurance Agency, Inc.
                - The Insurance Company of the State of Pennsylvania ("ISOP")

As of December 31, 2016, AIG had a new management structure consisting of three reportable segments as well as an Other Operations category:

1. The **Commercial** reportable segment is comprised of two operating segments: Property & Special Risks and Liability & Financial Lines;
2. The **Consumer** reportable segment is comprised of four operating segments: Life, Health & Disability; Group Retirement; Individual Retirement; and Personal Insurance;
3. The **Legacy** reportable 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 reportable segments, and includes (among other things) the operations of United Guaranty Corporation[1], Institutional Markets, AIG Parent, certain service companies, and intercompany eliminations.



## BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of the examination date, December 31, 2015:

| Name and Address | Principal Occupation |
|---|---|
| James Bracken<br>New York, New York | Commercial Chief Financial Officer<br>American International Group, Inc. |
| Joseph Daniel Cook<br>Ruxon, Maryland | Deputy Chief Financial Officer,<br>AIG Property & Casualty<br>American International Group, Inc. |
| Jeremy David Edgecliffe-Johnson<br>Chester Springs, Pennsylvania | President U.S. Commercial 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 & Risk Consulting<br>American International Group, Inc. |
| Kevin Timothy Hogan<br>Berkeley Heights, New Jersey | Executive Vice President and<br>Chief Executive Officer of Consumer<br>American International Group, Inc. |
| Robert Scott Higgins Schimek<br>Newtown, Pennsylvania | Executive Vice President and Chief<br>Executive Officer of Commercial<br>American International Group, Inc. |

All directors are elected annually at the stockholder meeting and are elected to serve a term of one year. These elections appear to have been held in compliance with the Company's by-laws.

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

AIG has established a Code of Conduct for use and guidance of its employees, including officers of AIG, which addresses, among other things, disclosure of any potential conflicts between their personal interests and the interests of AIG, or any of its subsidiaries. Since 2005, all officers and employees are required to recertify compliance with the Code of Conduct on an annual basis.

## COMMITTEES

As of the examination date, December 31, 2015, the Company did not have any committees. During the examination period, the Audit Committee of the Board of Directors of AIG Property Casualty Inc. ("AIG PC"), an indirect holding company of the Company, served as the statutory audit committee of the Company.

Certain significant decisions appear to be made at the AIG level. Presentations, updates and reports are given for the AIG Audit Committee, Chief Financial Officer updates, Compensation and Management Resources Committee, Nominating and Corporate Governance Committee, Risk Capital Committee and Technology Committee.

At the legal entity level, the Board meeting minutes reflect that the board of directors regularly hold joint meetings with AIG PC, AIG PC US and each of the AIG PC US insurers listed above other than AIG Insurance Company – Puerto Rico. The meetings discuss a comprehensive set of topics related to the monitoring and oversight of business operations.

## OFFICERS

As of the examination date, December 31, 2015, the following officers were appointed and serving in accordance with the Company's by-laws:

| **Name** | **Title** |
|---|---|
| Robert Scott Higgins Schimek | Chief Executive Officer, President, and Chairman of the Board |
| Joseph Daniel Cook | Chief Financial Officer and Senior Vice President |
| Lawrence James Moloney | Vice President and Statutory Controller |
| Tanya Evelyn Kent | Secretary |
| Douglas Sean Andrews | Executive Vice President |
| James Bracken | Executive Vice President |
| Jeremy David Edgecliffe-Johnson | Executive Vice President |
| Stephen Joseph Grabek | Executive Vice President |
| Kimberly Margaret Hanna | Executive Vice President |
| Kevin Timothy Hogan | Executive Vice President |
| Ralph William Mucerino | Executive Vice President |
| Christopher Louis Sparro | Executive Vice President |
| David John Valzania | Executive Vice President |
| Richard Carl Woollams | Executive Vice President |
| Richard Albert Brassington | Senior Vice President and Actuary |
| Jeremiah Hourihan | Senior Vice President |

| | |
|---|---|
| James Emmett Mostofi | Senior Vice President |
| Amy Elisabeth Stern | Senior Vice President |

## CORPORATE RECORDS

### MINUTES

A compliance review of corporate minutes revealed the following:

- The Annual Meetings of the Company's stockholder were held in compliance with its by-laws.
- The stockholder elects directors at such meetings in compliance with the by-laws.
- Quorums were present at all directors' meetings.
- The Company's investment transactions are approved quarterly by the Board.
- All directors attend Board meetings regularly.
- The Company Board meeting's minutes approve certain reinsurance contracts.

### ARTICLES OF INCORPORATION

The Company's Articles of Incorporation were amended effective on October 1, 2013 to reflect the name change of the Company to AIG Assurance Company.

### BY-LAWS

The Company's by-laws were amended effective on October 1, 2013 to reflect the Company's name change to AIG Assurance Company.

## SERVICE AND OPERATING AGREEMENTS

**Inter-Company Pooling Agreement**

The AIG PC US Combined Pool ("Combined Pool") was formed by the execution of an Inter-Company Pooling Agreement ("Pooling Agreement") effective January 1, 2014. The Pooling Agreement establishes a "pool" in which participants share a fixed percentage of underwriting assets, liabilities, income and expenses. The pool members ("Pooled Companies") and pooling percentages as of December 31, 2015, are as follows:

- NUFIC – 30%
- Lexington Insurance Company – 30%
- American Home Assurance Company – 30%
- Commerce and Industry Insurance Company – 5%

- AIG Property Casualty Company – 5%
- The Insurance Company of the State of Pennsylvania – 0%
- New Hampshire Insurance Company – 0%
- AIG Specialty Insurance Company – 0%
- AIG Assurance Company – 0%
- Granite State Insurance Company – 0%
- Illinois National Insurance Co. – 0%
- AIU Insurance Company – 0%

Effective January 1, 2016, the Pooling Agreement was amended to reduce the pool percentage of C&I from 5% to 0% and increase the pool percentage of AHAC from 30% to 35%.

Effective January 1, 2017, the Pooling Agreement was amended to reduce the pool percentage of APCC from 5% to 0% and increase the pool percentage of NUFIC from 30% to 35%.

**Service and Expense Agreement**

Pursuant to the provisions of a Service and Expense Agreement effective February 1, 1974, as amended, among AIG and certain subsidiaries, AIG and its subsidiaries may provide various services to such subsidiaries at cost, including, but not limited to, advertising, accounting, actuarial, tax, legal, data processing, office space and payroll. Additional affiliates have been added to this agreement by amendments over the years.

**Tax Sharing Agreement**

The Company files a consolidated U.S. federal income tax return with AIG and its affiliates. The Pooled Companies entered into a tax allocation agreements effective January 1, 2012, ("Tax Sharing Agreement"), which replaced a similar tax sharing agreement effective January 1, 2010. Under the 2012 Tax Sharing Agreement, the Pooled Companies continue to cash settle on a separate return liability theory and are able to utilize separate company attributes to reduce their tax liability to AIG. The Tax Sharing Agreement provides one specific exception from separate return tax liability relating to transactions involving assets of the individual Pooled Companies. With respect to any sale or exchange of assets within the consolidated U.S. 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. Finally, in contrast to the prior tax sharing agreement, the 2012 Tax Sharing 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.

**Investment Advisory Agreement**

The Company entered into Amended and Restated Investment Advisory Agreement with AIG Asset Management (U.S.), LLC ("AMG") effective July 1, 2011, as amended from time to time, whereby AMG provides investment advisory and management services with respect to certain investment portfolios of the Pooled Companies. The agreement gives AMG discretionary authority to buy, sell and manage the investments in these portfolios, and to exercise certain of the powers the Company may possess with respect to such investments. Investment transactions will be made in accordance with stated investment objectives of the Company and subject to guidelines established by the Company, as communicated to AMG in writing from time to time. Within these guidelines, AMG 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. AMG may also select, retain, oversee and terminate other investment managers of the Company.

**Administrative Services Agreement**

The Company and other AIG subsidiaries entered into an Administrative Services Agreement ("ASA") with AIG Shared Services - Business Processing, Inc. then known as AIG Business Processing Services, Inc. and Integra Business Processing Solutions, Inc. and hereinafter ("AIGSS-BPI") effective May 7, 2007. Effective June 16, 2008, the ASA was amended to add certain entities as additional parties thereto. The ASA was terminated effective July 1, 2010, with respect to the parties added June 16, 2008, as a result of the sale of the parties to a non-affiliate. Effective December 1, 2009, the ASA was assigned by AIGSS-BPI to an affiliate, AIG Shared Services Corporation (Philippines) (formerly Chartis Technology and Operations Management Corporation (Philippines) and AIU Technology and Operations Management Corporation). The Company consented to the assignment. There was no change to the terms and conditions of the ASA.

On September 30, 2013, AIG PC Global Services, Inc. ("AIG PC GS") entered into Master Agreements for Professional Services with AIGSS-BPI, AIG Shared Services Corporation ("AIGSS"), and AIG Shared Services (M) Sdn Bhd, which effectively replaced the 2007 agreement in that services provided by such entities to AIG PC GS under the 2013 agreements may be passed on to U.S. based AIG PC US insurance companies by AIG PC GS (pursuant to the 1974 AIG Service and Expense Agreement). AIG PC GS entered into a Master Intra-Company Data Services Agreement with AIG Offshore Services, Inc. effective May 1, 2015.

**Master Reinsurance Allocation Agreement**

The Company and other AIG subsidiaries entered into a Master Reinsurance Allocation Agreement ("Allocation Agreement") effective February 29, 2008. The Allocation Agreement was entered into to satisfy the requirement of Statements of Statutory Accounting Principles ("SSAP") No. 62 that reinsurance agreements with multiple cedants be subject to written allocation agreements. The Allocation Agreement, which applies to new and renewal reinsurance agreements incepting on or after January 1, 2007, describes the methods by which the parties allocate and report premium and losses under multiple cedant reinsurance contracts.

The Allocation Agreement does not amend any existing pool agreement and does not affect the rights of the parties to the agreement or any of their affiliates under any reinsurance contract. The parties simultaneously entered Amendment 1 to the Allocation Agreement that removed a party that should not have been included in the Allocation Agreement. The 2008 Agreement was superseded by a Master Reinsurance Allocation Agreement, effective April 1, 2016, which sets forth the method for allocating premium and losses under multiple cedant reinsurance agreements incepting on or after April 1, 2016.

**Claims Services Agreement**

The Company and other AIG subsidiaries entered into a Claims Services Agreement with AIG Claims, Inc. ("AIG Claims") effective July 15, 2012, whereby AIG Claims will provide claims administration services on behalf of the Company. The Claims Services Agreement was amended effective 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.

**Master Intra-Company Services Agreement**

The Company and other AIG subsidiaries entered into a Master Intra-Company Services Agreement with AIG Global Services, Inc. ("AIG GS") effective December 1, 2015, whereby AIG GS will provide network connectivity, application hosting, data process related services and other IT-related infrastructure services to the Company.

The aforementioned agreements appear to meet the fair and reasonable standards of 40 P.S. § 991.1405(a)(1).



## REINSURANCE

### POOLING AGREEMENT

The Company participates in the Pooling Agreement described in the "Service and Operating Agreements" section of this report. Under the Pooling Agreement, the Pooled Companies share in the underwriting results of the participating insurers on a predetermined basis. Although the pool member that issues an insurance policy retains its direct liability to the policyholders, the other pool participants are liable (directly or indirectly) to the issuing pool participant as reinsurer for their respective share of such issuing pool participant's obligations under such policy. NUFIC is the lead company in the Pooling Agreement and assumes all direct and assumed business from the other pool participants and combines premiums, assets and liabilities, including the provision for reinsurance, along with its own direct and assumed business. NUFIC retains its pool share of such pooled business and reinsures or retrocedes the remainder of the pooled business to the other Pooled Companies in accordance with their pool share.

The Pooled Companies and their pooling percentages as of December 31, 2015, were as follows:

| Pool Company | State of Domicile | Pool% |
|---|---|---|
| National Union Fire Insurance Co. of Pittsburgh, Pa. | Pennsylvania | 30% |
| American Home Assurance Company | New York | 30% |
| Lexington Insurance Company | Delaware | 30% |
| Commerce and Industry Insurance Company | New York | 5% |

| | | |
|---|---|---|
| AIG Property Casualty Company | Pennsylvania | 5% |
| AIG Specialty Insurance Company | Illinois | 0% |
| AIG Assurance Company | Pennsylvania | 0% |
| Granite State Insurance Company | Illinois | 0% |
| Illinois National Insurance Co. | Illinois | 0% |
| New Hampshire Insurance Company | Illinois | 0% |
| The Insurance Company of the State of Pennsylvania | Pennsylvania | 0% |
| AIU Insurance Company | New York | 0% |
| **Total Pool** | | **100%** |

Effective January 1, 2016 and again January 1, 2017, the Pooling Agreement was amended and restated with respect to certain company participation percentages, which is further described in this section under the caption "Subsequent Events".

## CEDED

### Global Reinsurance Division Organization

External treaty reinsurance is placed by the Global Reinsurance Division ("GRD"). Reinsurance officers within the GRD are aligned with specific Profit Centers and are responsible for:

- Optimizing structure and placement of external treaty reinsurance for Product Lines and Corporate Reinsurance (e.g., corporate catastrophe program)
- Reinsurance Credit, through the Reinsurance Credit Department, which monitors the financial condition of reinsurers and sets limits on the exposure AIG is willing to take with prospective reinsurers; GRD also manages the third-party collateral process
- Managing all reinsurance broker and reinsurance market relationships
- Collaboration with Internal Reinsurance

Treaty reinsurance is placed as necessary to support AIG's risk appetite, both on an individual occurrence and aggregate basis including catastrophic exposure. An exception to using reinsurance to manage risk appetite is reinsurance ceded through certain captive programs.

AIG PC US maintains extensive reinsurance programs placed with U.S. domestic, international and offshore reinsurers. Reinsurance strategies have been established to support management initiatives. 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 $10.0 billion for a 1 in 250-year event.

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 U.S., Canada, Caribbean, and Mexico. For a catastrophic event, AIG retained the first $3.0 billion and had $2.5 billion of reinsurance protection and $1.0 billion of additional coverage through a worldwide aggregate treaty providing second event coverage. 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.

## Lines of Business Protected by Reinsurance

1. Corporate Property Catastrophe
2. Global Property
3. Commercial Casualty
4. Specialty
5. Global Marine
6. Financial Lines
7. Consumer
8. Other Personal Lines
9. International Life - Health

## ASSUMED

The Combined Pool's assumed premium includes premiums reinsured by NUFIC from the other Pooled Companies and premiums assumed from other AIG affiliates. NUFIC's assumed premiums are retroceded to the other participants in the Combined Pool according to their participation percentages.

Assumed business from third party reinsurers and regulatory pools are not material to the Combined Pool's assumed gross premium written.

## Risk Transfer

All significant reinsurance contracts reviewed by the exam team contain the appropriate insolvency and arbitration clauses. All significant reinsurers reviewed by the exam team are licensed or authorized to conduct business in Pennsylvania.

All significant reinsurance contracts reviewed by the exam team appear to meet the required transfer of risk provisions as noted in SSAP No. 62R.

## Subsequent Events

Subsequent to December 31, 2015, the Company received regulatory approval of the Second Amended and Restated Inter-Company Pooling Agreement, effective January 1, 2016, with revisions to the pooling percentages as follows: C&I decreasing from 5% to 0% and AHAC increasing from 30% to 35%.

The Company received regulatory approval to amend this agreement again, effective January 1, 2017, to reduce the pool percentage of APCC from 5% to 0% and increase the pool percentage of NUFIC from 30% to 35%.

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

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.

## TERRITORY AND PLAN OF OPERATION

The Company is licensed in 42 states and the District of Columbia. The Company is not licensed in Alabama, California, Maine, Massachusetts, Minnesota, New Jersey, New York or Vermont.

AIG conducts its property and casualty operations through multiple line companies writing substantially all Commercial (casualty, property, specialty and financial liability) and Consumer (accident & health and personal lines) both domestically and abroad. Property casualty products are primarily distributed through a network of independent retail and wholesale brokers, and through an independent agency network.

For the Commercial segment, coverages offered include:

- **Casualty:** Products include general liability, commercial automobile liability, workers' compensation, excess casualty and crisis management insurance products. Casualty also includes risk-sharing and other customized structured programs for large corporate and multinational customers;
- **Property:** Products include commercial, industrial and energy-related property insurance products and services that cover exposures to man-made and natural disasters, including business interruption;
- **Specialty:** Products include aerospace, environmental, political risk, trade credit, surety and marine insurance, and various small and medium sized enterprises insurance lines, and
- **Financial:** Products include professional liability insurance for a range of businesses and risks, including directors and officers liability ("D&O"), fidelity, employment practices, fiduciary liability, cybersecurity risk, kidnap and ransom, and errors, and omissions insurance ("E&O").

For the Consumer segment, coverages offered include:

- **Accident and Health**: Products include voluntary and sponsor-paid personal accident and supplemental health products for individuals, employees, associations and other organizations as well as a broad range of travel insurance products and services for leisure and business travelers. Accident and Health ("A&H") products are distributed through various channels, including agents, brokers, affinity partners, airlines and travel agents, and

- **Personal Lines**: Products include automobile and homeowners insurance, extended warranty, and consumer specialty products, such as identity theft and credit card protection. Products are distributed through various channels, including agents, brokers and direct marketing. Personal Lines also provides insurance for high net worth individuals offered through AIG Private Client Group, including auto, homeowners, umbrella, yacht, fine art and collections insurance.

The following schedule presents the Company's gross, ceded and net premium writings for 2015 by line of business and the percentage that each line of business bears to the total net written premium:

| Line of Business | Direct and Assumed Premium | Ceded Premium | Net Written Premium | Percentage of Total |
|---|---|---|---|---|
| **December 31, 2015** | | | | |
| Homeowners multiple peril | $ (54) | $ (54) | $ 0 | 0 0% |
| Workers' compensation | 20,647,209 | 20.647.209 | 0 | 0 0% |
| Other liability - occurrence | 425,704 | 425.704 | 0 | 0 0% |
| Other liability - claims-made | 1,178,282 | 1.178.282 | 0 | 0 0% |
| Products liability - occurrence | 69,793 | 69.793 | 0 | 0 0% |
| Commercial auto liability | 226,670 | 226.670 | 0 | 0 0% |
| Auto physical damage | 48,778 | 48.778 | 0 | 0 0% |
| Burglary and theft | 5,767 | 5.767 | 0 | 0 0% |
| Totals | $ 22.602.149 | $ 22.602.149 | $ 0 | 100 0% |

Workers' compensation is the largest line of business constituting 91.4% followed by other liability 7.1% and the remaining 1.5% distributed over all other lines. The five states with the largest volume of direct written premiums are Texas (27.1%), Kentucky (11.8%), Pennsylvania (8.8%), Maryland (7.9%), and Tennessee (6.2%).

## SIGNIFICANT OPERATING RATIOS AND TRENDS

There are no underwriting ratios shown since, as noted above, the Company ceded all of its direct and assumed writings into the Combined Pool and did not assume any business from the Combined Pool for the five (5) year period covered by this examination.

The Company reported the following financial information, net underwriting, investment, and other gains or losses during the period under examination:

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Admitted assets | $ 34,285.083 | $ 33.184.342 | $ 44,117.058 | $ 44,748 491 | $ 42.772.237 |
| Liabilities | $ 1,741.394 | $ 1,250 672 | $ 1,149.428 | $ 2.096 885 | $ 920.899 |
| Surplus as regards policyholders | $ 32.543 689 | $ 31,933.670 | $ 42,967 630 | $ 42 651.606 | $ 41.851 338 |
| Gross premium written | $ 22,602.149 | $ 31.113.411 | $ 23 168 785 | $ 37 820.409 | $ 111.552.543 |
| Investment gain/(loss) | $ 768.309 | $ 1 299.977 | $ 1 083 428 | $ 1.082.220 | $ 1.448.178 |
| Other gain/(loss) | $ (100) | $ (9 000) | $ (2.987) | $ 0 | $ 0 |
| Net income | $ 521.310 | $ 1.032.528 | $ 794 971 | $ 852.385 | $ 1 365.251 |

## PENDING LITIGATION

Pending litigation and other commitments and contingencies as disclosed in the Company's Annual Statement footnotes were reviewed and no significant discrepancies or omissions were noted. Company counsel has provided a representation identifying pending material litigation.

## FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2015, and the results of its operations for the five-year period under examination, are reflected in the following statements *:

Comparative Statement of Assets, Liabilities, Surplus and Other Funds;
Comparative Statement of Income;
Comparative Statement of Capital and Surplus; and
Comparative Statement of Cash Flow

*Note: Some financials shown in this report may contain immaterial differences to those reported in the Company's filed Annual Statements due to rounding errors.

# Comparative Statement of Assets, Liabilities, Surplus and Other Funds
# As of December 31,

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Bonds | $ 32,019,468 | $ 27,132,269 | $ 40,702,033 | $ 40,972,911 | $ 36,323,382 |
| Cash, cash equivalents, and short term investments | 369,964 | 4,657,153 | 2,892,495 | 2,849,629 | 6,141,873 |
| Other invested assets | 600 | 600 | 600 | 600 | 600 |
| Receivable for securities | 0 | 0 | 0 | 0 | 26,922 |
| Subtotals, cash and invested assets | 32,390,032 | 31,790,022 | 43,595,128 | 43,823,140 | 42,492,777 |
| Investment income due and accrued | 223,589 | 198,636 | 290,386 | 314,538 | 274,992 |
| Current federal and foreign income tax recoverable and interest thereon | 22,620 | 20,548 | 0 | 0 | 0 |
| Receivable from parent, subsidiaries and affiliates | 1,648,842 | 1,175,136 | 231,544 | 610,813 | 4,468 |
| Total | $ 34,285,083 | $ 33,184,342 | $ 44,117,058 | $ 44,748,491 | $ 42,772,237 |
| | | | | | |
| Taxes, licenses and fees | $ 0 | $ 2,964 | $ 1,700 | $ 0 | $ 0 |
| Current federal and foreign income taxes | 0 | 0 | 15,310 | 246,218 | 410,258 |
| Net deferred tax liability | 960,852 | 1,045,555 | 954,560 | 495,398 | 453,599 |
| Payable to parent, subsidiaries and affiliates | 759,983 | 202,153 | 177,858 | 1,355,269 | 57,042 |
| Aggregate write-ins for liabilities | 20,559 | 0 | 0 | 0 | 0 |
| Total liabilities | 1,741,394 | 1,250,672 | 1,149,428 | 2,096,885 | 920,899 |
| Common capital stock | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 |
| Gross paid in and contributed surplus | 1,504,820 | 1,504,820 | 1,504,820 | 1,504,820 | 1,504,820 |
| Unassigned funds (surplus) | 28,038,869 | 27,428,850 | 38,462,810 | 38,146,786 | 37,346,518 |
| Surplus as regards policyholders | 32,543,689 | 31,933,670 | 42,967,630 | 42,651,606 | 41,851,338 |
| Totals | $ 34,285,083 | $ 33,184,342 | $ 44,117,058 | $ 44,748,491 | $ 42,772,237 |

## Comparative Statement of Income
## For the Year Ended December 31,

| Underwriting Income | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Premiums earned | 0 | 0 | 0 | 0 | 0 |
| **Investment Income** | | | | | |
| Net investment income earned | 872,088 | 1,018,575 | 1,096,892 | 1,065,520 | 1,057,975 |
| Net realized capital gains or (losses) | (103,779) | 281,402 | (13,464) | 16,700 | 390,203 |
| Net investment gain or (loss) | 768,309 | 1,299,977 | 1,083,428 | 1,082,220 | 1,448,178 |
| **Other Income** | | | | | |
| Aggregate write-ins for miscellaneous income | (100) | (9,000) | (2,987) | 0 | 0 |
| Total other income | (100) | (9,000) | (2,987) | 0 | 0 |
| Net income before dividends to policyholders and before federal and foreign income taxes | 768,209 | 1,290,977 | 1,080,441 | 1,082,220 | 1,448,178 |
| Federal and foreign income taxes incurred | 246,899 | 258,449 | 285,470 | 229,835 | 82,927 |
| Net income | $ 521,310 | $ 1,032,528 | $ 794,971 | $ 852,385 | $ 1,365,251 |

# Comparative Statement of Capital and Surplus
# For the Year Ended December 31,

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Surplus as regards policyholders, | | | | | |
| December 31 previous year | $ 31,933,670 | $ 42,967,630 | $ 42,651,606 | $ 41,851,338 | $ 40,852,574 |
| Net income | 521,310 | 1,032,528 | 794,971 | 852,385 | 1,365,251 |
| Change in net deferred income tax | 84,703 | (93,654) | 651 | (29,262) | (48,942) |
| Change in nonadmitted assets | 0 | 1,015,483 | (19,784) | (10,318) | (2,188) |
| Dividends to stockholders | 0 | (13,000,000) | 0 | 0 | 0 |
| Aggregate write-ins for gains and losses in surplus | 4,006 | 11,683 | (459,814) | (12,637) | (315,357) |
| Change in surplus as regards policyholder for the year | 610,019 | (11,033,960) | 316,024 | 800,268 | 998,764 |
| Surplus as regards policyholders, | | | | | |
| December 31 current year | $ 32,543,689 | $ 31,933,670 | $ 42,967,630 | $ 42,651,606 | $ 41,851,338 |

# Comparative Statement of Cash Flow
# For the Year Ended December 31,

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| **Cash from Operations** | | | | | |
| Net investment income | $ 962,423 | $ 1,252,357 | $ 1,283,081 | $ 1,179,372 | $ 1,260,286 |
| Total income | 962,423 | 1,252,357 | 1,283,081 | 1,179,372 | 1,260,286 |
| Commissions, expenses paid and aggregate write-ins for deductions | 3,064 | 7,736 | 1,288 | 0 | 0 |
| Federal and foreign income taxes paid (recovered) | 325,730 | (702,586) | 540,515 | 414,898 | 0 |
| Total deductions | 328,794 | (694,850) | 541,803 | 414,898 | 0 |
| Net cash from operations | 633,629 | 1,947,207 | 741,278 | 764,474 | 1,260,286 |
| **Cash from Investments** | | | | | |
| Proceeds from investments sold, matured or repaid: | | | | | |
| Bonds | 5,251,714 | 2,027,409 | 6,414,049 | 11,019,765 | 23,304,999 |
| Miscellaneous proceeds | 0 | 0 | 0 | 26,922 | 0 |
| Total investment proceeds | 5,251,714 | 2,027,409 | 6,414,049 | 11,046,687 | 23,304,999 |
| Cost of investments acquired (long-term only): | | | | | |
| Bonds | 736,917 | 1,069,937 | 6,314,320 | 15,795,354 | 26,287,669 |
| Other invested assets | 0 | 0 | 0 | 0 | 200 |
| Miscellaneous applications | 0 | 0 | 0 | 0 | 9,125 |
| Total investments acquired | 736,917 | 1,069,937 | 6,314,320 | 15,795,354 | 26,296,994 |
| Net cash from investments | 4,514,797 | 957,472 | 99,729 | (4,748,667) | (2,991,995) |
| **Cash from Financing and Miscellaneous Services** | | | | | |
| Other cash provided (applied): | | | | | |
| Dividends to stockholders (paid) | 0 | 220,724 | 0 | 0 | 0 |
| Other cash provided or (applied) | (9,435,615) | (919,297) | (798,141) | 691,949 | 906,243 |
| Net cash from financing and miscellaneous sources | (9,435,615) | (1,140,021) | (798,141) | 691,949 | 906,243 |
| **Reconciliation of cash and short-term investments:** | | | | | |
| Net change in cash and short-term investments | (4,287,189) | 1,764,658 | 42,866 | (3,292,244) | (825,466) |
| Cash and short-term investments | | | | | |
| Beginning of the year | 4,657,153 | 2,892,495 | 2,849,629 | 6,141,873 | 6,967,339 |
| End of the year | $ 369,964 | $ 4,657,153 | $ 2,892,495 | $ 2,849,629 | $ 6,141,873 |

## SUMMARY OF EXAMINATION CHANGES

There were no examination changes to the preceding financial statements as filed with regulatory authorities over the review period.

## NOTES TO FINANCIAL STATEMENTS

### ASSETS

### INVESTMENTS

As of December 31, 2015, the Company's invested assets were distributed as follows:

| | Amount | Percentage |
|---|---|---|
| Bonds | $ 32,019,468 | 98.8 % |
| Cash | 349,459 | 1.1 % |
| Short-term investments | 20,505 | 0.1 % |
| Other invested assets | 600 | 0.0 % |
| Totals | $ 32,390,032 | 100.0 % |

The Company's bond and short-term investment portfolio had the following quality and maturity profiles:

| NAIC Designation | Amount | Percentage |
|---|---|---|
| 1 - highest quality | $ 28,072,988 | 87.6 % |
| 2 - high quality | 3,966,985 | 12.4 % |
| Totals | $ 32,039,973 | 100.0 % |

| Years to Maturity | Amount | Percentage |
|---|---|---|
| 1 year or less | $ 10,436,876 | 32.6 % |
| 2 to 5 years | 10,611,765 | 33.1 % |
| 6 to 10 years | 6,368,870 | 19.9 % |
| 11 to 20 years | 4,622,462 | 14.4 % |
| Totals | $ 32,039,973 | 100.0 % |

The Company's investment portfolio consists of a mix of securities with the highest concentration in industrial and miscellaneous bonds (49%), government bonds (23.9%) and U.S. special revenue bonds (18.3%). The short term securities were liquid.

The Company's custodial agreement is in compliance with 31 Pa. Code § 148a.3.

The Company did not have any ownership in affiliated companies.

The Company has a written investment policy as required by 40 P.S. § 653b(b). The investment policy is reviewed and approved on an annual basis by the Board of Directors. The Company was following its investment policy at December 31, 2015.

## LIABILITIES

## LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company reported reserves in the amounts of $0 for losses and $0 for loss adjustment expenses ("LAE") on the December 31, 2015 Annual Statement. These amounts represent reserves held in accordance with the terms of the Pooling Agreement described above.

Richard A. Brassington, ACAS, MAAA, Senior Vice President and Actuary of the Company, has been the appointed actuary for the company since July 28, 2014. David Gelinne, FCAS, MAAA, Company officer served as the appointed actuary for years-ending 2013 and 2012. Mark Scully, FCAS, MAAA, Company officer served as the appointed actuary for year-ending 2011. The Department received the appropriate no disagreement letters with each change in appointed actuary. Such changes in the appointed actuary were made due to actuaries terminating their employment with AIG.

For each year in the examination period, the appointed actuary issued a Statement of Actuarial Opinion concluding that the Company's reserves made a reasonable provision for all unpaid losses and LAE obligations of the Company.

In order for the examination team to get a comfort level with the Company's reserving processes and estimates, the Department retained the actuarial services of both INS Consultants, Inc. ("INS") and Oliver Wyman to review the pricing and reserving activities on this risk focused examination. INS's scope focused on risk identification and effectiveness of risk mitigating strategies employed by the Company. Oliver Wyman was retained to complete an independent reserve analysis and conduct substantive procedures to support the residual risk assessments for the Company's reserving activities.

Oliver Wyman tested the AIG reporting segments of the Combined Pool that presented the most volatility and found that the reserves carried by the Company as of December 31, 2015 were inadequate. This was substantiated by AIG's announcement on February 3, 2017, that the total amount of the 2016 year-to-date adverse development charge for its non-life business was $5.8 billion, with approximately $4.9 billion of this charge relating to reporting segments within the Combined Pool. Given the amount of material strengthening taken by the Company in 2016, the Department decided no financial statement adjustments would be required.

Other than changes to the Pooling Agreement as previously discussed, there have been no significant changes to the Company's reserving methodology since the last examination.



## SUBSEQUENT EVENTS

The following events were noted to have occurred subsequent to the December 31, 2015 examination date through the date of the report of examination and have been deemed significant for disclosure by the Department:

1. **Return of Capital**

During 2016, AIG announced and/or completed a series of transactions, some still pending regulatory approval, aimed at increasing AIG's focus on core operations. A portion of the proceeds from these transactions has also been used to fund the shareholder capital return announced by AIG on January 26, 2016. AIG's efforts included but were not limited to the sale of its Advisor Group, the sale of United Guaranty Corp., the sale of AIG Taiwan Insurance Company, Ltd., and the sale of its interest in Ascot Underwriting Holdings Ltd. AIG entered into several agreements with Fairfax Financial Holdings Limited, to sell its local commercial and consumer insurance operations in Argentina, Chile, Colombia, Uruguay, Venezuela, and Turkey. Under the agreements, Fairfax will also acquire renewal rights for the portfolio of local business written by AIG's Central and Eastern European ("CEE") operations in Bulgaria, Czech Republic, Hungary, Poland, Romania, and Slovakia, and assume AIG's CEE operation assets and employees. In addition, AIG entered into an agreement with FWD Group, which is the insurance arm of Pacific Century Group, to sell AIG Fuji Life Insurance Company, Limited. As of May 4, 2017, AIG had returned approximately $18.1 billion to its shareholders.

2. **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 was $5.8 billion. Approximately $4.9 billion of this reserve charge relates to reporting segments within the Combined Pool.

3. **CEO Resignation and New CEO Appointed**

On March 9, 2017, AIG announced that Mr. Peter Hancock, President and Chief Executive Officer ("CEO"), 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 that Brian Duperreault has been appointed its new President, CEO and Director effective May 14, 2017.

4. **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.

5. **Redomestication of Pooled Companies**

Effective December 31, 2016, the Company and The Insurance Company of the State of Pennsylvania, both domiciled in Pennsylvania as of December 31, 2015, redomesticated to Illinois.

## RECOMMENDATIONS

## PRIOR EXAMINATION

The prior examination report contained no report recommendations.

## CURRENT EXAMINATION

There are no report recommendations as a result of this examination.

## CONCLUSION

As a result of this examination, the financial condition of AIG Assurance Company, as of December 31, 2015, was determined to be as follows:

| | Amount | Percentage |
|---|---|---|
| Admitted assets | $ 34,285,083 | 100 0 % |
| Liabilities | $ 1,741,394 | 5 1 % |
| Surplus as regards policyholders | 32,543,689 | 94 9 % |
| Total liabilities and surplus | $ 34,285,083 | 100.0 % |

Since the previous examination, made as of December 31, 2010, the Company's assets decreased by $6,923,856, its liabilities increased by $1,385,029, and its surplus decreased by $8,308,885, and the Company paid dividends in the amount of $13,000,000 to its stockholders.

This examination was conducted by David Hughes, Michael Lisowski, Elizabeth McGarry, Gerald Hickey, CFE, and various INS examination and actuarial staff, including but not limited to, George Lentini, CISA, GCFE and Don Gaskill, CFE with the latter in charge.

Respectfully,

Melissa L. Greiner
Director
Bureau of Financial Examinations

Shannon Hopkins
Shannon Hopkins, CFE -cdd
Examination Manager

Don Gaskill
Don Gaskill, CFE -cdd
Examiner-in-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However, the CFE designation is the only designation recognized by the NAIC for the purposes of directing statutory Association examinations of insurance companies