Examination Warrant Number 17-00308-11282-R1

# Report of Examination of

# Germantown Insurance Company
# Philadelphia, Pennsylvania

# As of December 31, 2017

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Harrisburg, Pennsylvania
October 15, 2018

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 17-00308-11282-R1, dated July 11, 2017, an examination was made of

**Germantown Insurance Company, NAIC Code: 11282**

a Pennsylvania domiciled multi-state Property and Casualty company, hereinafter referred to as the "Company" or "GIC." The examination was conducted at the Company's home office, located at 210 South Fourth Street, Philadelphia, Pennsylvania 19106.

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, 2012. This examination covered the five-year period from January 1, 2013 through December 31, 2017.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance 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. Statements were prepared by management and are therefore the responsibility of management. 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.

In 2013, the first year of this examination period, the certified public accounting firm ("CPA") Parente Beard, LLC ("PB") provided an unmodified audit opinion on the Company's year-end financial statements based on statutory accounting principles. On October 1, 2014, PB merged with Baker Tilly Virchow Krause, LLP ("BT"). As a result, the CPA firm of BT provided an unmodified audit opinion on the Company's year-end financial statements based on statutory accounting principles for the years 2014 through 2017. Relevant work performed by the CPA's, during their annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

The following companies were examined at the same time during the above examination:

| Company | State | NAIC Code |
|---|---|---|
| Philadelphia Contributionship Insurance Company | PA | 17914 |
| Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc. | PA | 17930 |

## HISTORY

The Company was incorporated under the laws of Pennsylvania on April 14, 1843. Originally, the Company was named Germantown, Roxborough, and Bristol Mutual Fire Insurance Company. On January 2, 1946, the Company converted to a stock company, changed its name to the Germantown Fire Insurance Company, commenced business, and was licensed by the Commonwealth of Pennsylvania Insurance Department. The current name, Germantown Insurance Company, was adopted on January 10, 1964. The Company was acquired by TPC in October of 1986, becoming a wholly owned subsidiary of TPC.

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 and Surety, (c)(2) Accident and Health, (c)(3) Glass, (c)(4) Other Liability, (c)(5) Boiler and Machinery, (c)(6) Burglary and Theft, (c)(7) Credit, (c)(8) Water Damage, (c)(9) Elevator, (c)(10) Livestock, (c)(12) Mine and Machinery, and (c)(13) Personal Property Floater.

## MANAGEMENT AND CONTROL

### CAPITALIZATION

As of the examination date, December 31, 2017, the Company's total capital was $50,114,217 consisting of 300,000 capital shares of issued and outstanding common stock with a par value of $12.00 per share amounting to $3,600,000; $1,800,792 in paid in and contributed surplus; and $44,713,425 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 $1,200,000 in capital and $600,000 in surplus. The Company has met all governing requirements throughout the examination period.

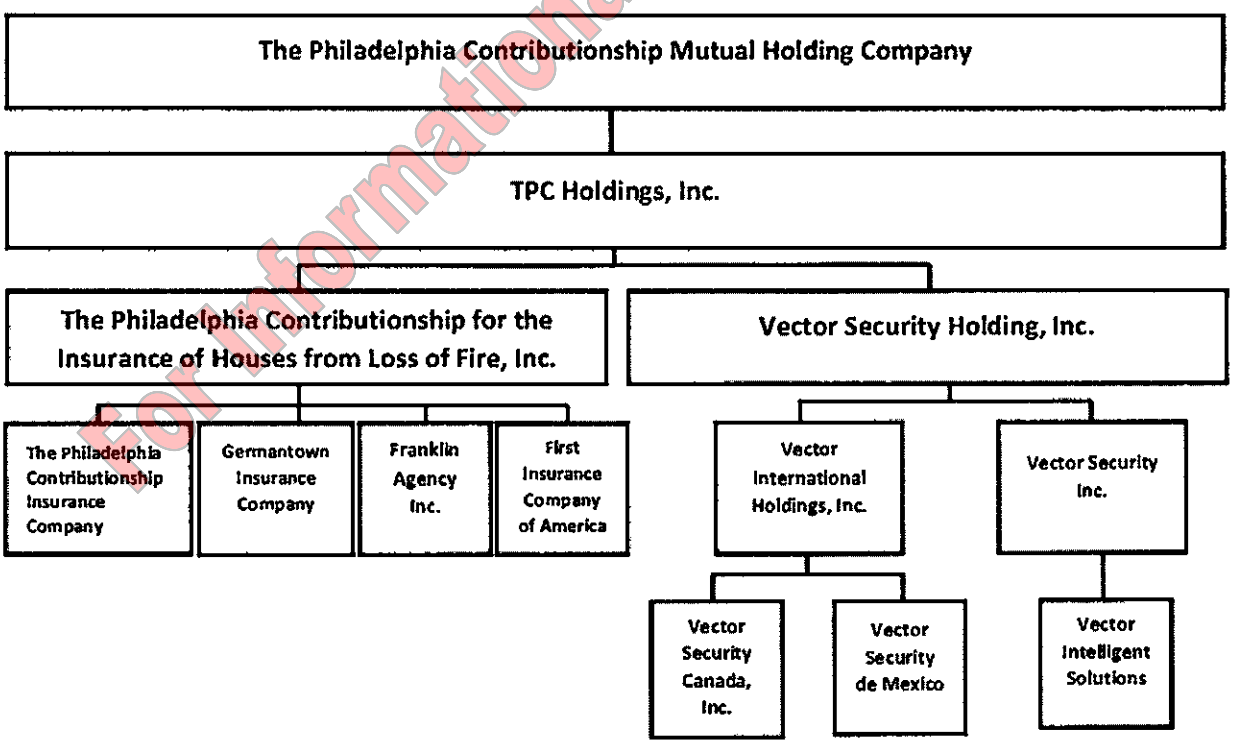
## STOCKHOLDER

The sole stockholder of the Company is its parent, TPC. No dividends were declared or paid to the stockholder during the period under examination.

## INSURANCE HOLDING COMPANY SYSTEM

The Company meets the requirements for filing an insurance holding company system registration statement, in compliance with 40 P.S. § 991.1404. The Company submitted all required registration filings to the Department during the examination period; the 2017 statement was filed on March 28, 2017 by the Company.

The Philadelphia Contributionship Mutual Holding Company ("MHC"), a mutual holding company, is named as the ultimate controlling person in the holding company system. Members of the holding company system as of December 31, 2017 include the following entities illustrated in the organizational chart and briefly described below:



TPC Holdings, Inc. ("SHC") is a stock holding company whose principal business is to hold the stock of The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc. (i.e. insurance group) and Vector Security Holdings, Inc. (i.e. security group). SHC is a wholly owned subsidiary of MHC.

TPC, a stock insurance company, is the longest tenured insurance carrier in the United States of America. The Company was licensed by the state of Pennsylvania and commenced business on March 25, 1752. The Company was incorporated under the laws of Pennsylvania on February 20, 1768. TPC underwrites perpetual fire and homeowners policies.

Effective December 30, 2009, TPC converted its form of ownership from a mutual company to a stock company within a mutual holding company structure. As a result, TPC is a wholly owned subsidiary of SHC.

PCIC, a stock insurance company, commenced business on March 24, 1960. PCIC is a wholly owned subsidiary of TPC. PCIC is the primary provider of term homeowners insurance within the holding company system.

Franklin Agency, Inc. is the captive insurance agency for the holding company system.

First Insurance Company of America is an inactive property and casualty company.

Vector Security Holdings, Inc. ("Vector") is the stock holding company for the non-insurance operations of the group. Vector entities sell and operate residential and business security systems and monitoring. Vector is a wholly owned subsidiary of SHC.

## 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, 2017:

| Name and Address | Principal Occupation |
|---|---|
| Scott M. Jenkins, Chairman<br>Rosemont, PA | President, S.M. Jenkins & Co.<br>General Partner, Jenkins Partners, L.P. |
| Bruce M. Eckert<br>Wyndmoor, PA | Founder<br>Eastern Insurance Holdings, Inc. |
| Ira H. Fuchs<br>Princeton, NJ | President<br>BITNET, LLC |
| Phoebe A. Haddon, J.D., LL.M.<br>Philadelphia, PA | Chancellor<br>Rutgers University-Camden |
| Harry E. Hill, III<br>Haverford, PA | Pres. & CEO, Empire Abrasive Equip. Co.<br>Pres. & CEO, Delaware Car Company |
| Ernest E. Jones, Esquire<br>Philadelphia, PA | President<br>Ejones Consulting, LLC |
| Andrew L. Lewis, IV<br>Haverford, PA | Consultant |
| Ronald J. Naples<br>Wynnewood, PA | Chairman Emeritus<br>Quaker Chemical Corporation |

| | |
|---|---|
| Alfred W. Putnam, Jr.<br>Ardmore, PA | Chairman Emeritus<br>Drinker Biddle & Reath LLP |
| Christina T. Webber<br>Bryn Mawr, PA | Former Pres., The Phila. Contributionship<br>Consultant |
| Marna C. Whittington, Ph.D.<br>Yorklyn, DE | Retired Investment Executive |

The Board is divided into four classes, with each class being as nearly equal in number as possible. The directors in each class are elected to serve a term of four years, until a successor is elected and qualified or until the director's earlier death, resignation or removal. The term of office of one class expires each year.

The Company has a conflict of interest policy that each director, officer, and employee is required to sign each year stating if they have any conflict of interest with the Company. The examiner noted that the Company is in compliance with their by-laws and no conflicts were noted during the examination period.

The composition of the Board meets the requirements of 40 P.S. § 991.1405(3)(i).

The Board may, by resolution adopted by a majority of the directors in office, establish one or more standing committees and, for such special tasks as circumstances warrant, one or more special committees.

## COMMITTEES

As of the examination date, December 31, 2017, the following committees, each consisting of three or more directors, were appointed by the Board and serving in accordance with the Company's by-laws:

**Investment Committee**

Andrew L. Lewis, IV, Chair
Scott M. Jenkins
Bruce M. Eckert
Phoebe A. Haddon
Christina T. Webber
Craig N. Johnson, until 02/2017
Marna C. Whittington

**Benefits/Compensation Committee**

Craig N. Johnson, Chair until 02/2017
Harry E. Hill, III, Chair
Ira H. Fuchs
Alfred W. Putnam, Jr.
Scott M. Jenkins
Ronald J. Naples
Christina T. Webber

**Audit Committee**

Marna C. Whittington, Chair
Ronald J. Naples
Bruce M. Eckert
Ira H. Fuchs
Harry E. Hill, III
Scott M. Jenkins

The Company shares directorates with affiliated insurance and non-insurance entities to gain efficiencies when performing overlapping Board processes. Thus, each committee noted above serves MHC, TPC, and PCIC, as well. SHC is only served by the Investment Committee.

Each committee is charged with various functions and shall consist of three or more directors. The following is a list of the committees and their responsibilities:

- Audit Committee – assists the Board of Directors in fulfilling its fiduciary responsibilities by serving as an informed and effective overseer of the Company's financial reporting process.
- Benefits/Compensation Committee – administers the Company's compensation and benefit programs.
- Investment Committee – oversees the investment policies of the Company, identifies and appoints investment managers, and monitors compliance with established investment policies and guidelines.

## OFFICERS

As of the examination date, December 31, 2017, the following officers were appointed and serving in accordance with the Company's by-laws:

| **Name** | **Title** |
|---|---|
| Robert G. Whitlock, Jr. | President and Chief Executive Officer |
| Kevin L. Tate | VP, Chief Financial Officer and Treasurer |
| Stacey M. Manzo | AVP and Corporate Secretary |

# 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 in compliance with the by-laws.
- The practice of ratifying the actions of the Company's directors and officers since the last meeting of stockholders was instituted at the 2018 stockholders' meeting.
- Quorums were present at all directors' meetings.
- The Company's officers were appointed at the Annual Organizational Meeting of the Board of Directors.
- The Company's investment transactions are approved quarterly by the Board.
- All directors attend Board meetings regularly.

- The Company's Board approves the reinsurance contracts, which control all resulting reinsurance transactions.

## ARTICLES OF AGREEMENT

No changes or amendments were made to the Company's Articles of Agreement during the examination period.

## BY-LAWS

No changes or amendments were made to the Company's by-laws during the examination period.



## SERVICE AND OPERATING AGREEMENTS

The Company is a party to various service and operating agreements, including an intercompany and tax sharing agreement. The following significant agreements were in place during the examination period:

### Cost Sharing Agreement

In 2009, the Company entered into a cost sharing agreement with PCIC and GIC since they share the same systems, employees, and facilities. The cost sharing agreement says the following:

- For third party goods and services purchased by a party for one affiliate, the allocation of costs is determined solely by the invoice from the third party.
- For third party goods and services purchased by a party for more than one affiliate, the allocation of costs is determined by: (i) an invoice directly from the third party providing the goods or services, and (ii) an allocation of costs developed by appropriate quantifiable measures supporting the goods received or services performed.

The examiners determined above agreement meets the standards of 40 P.S. § 991.1405(a)(l)(i). However, the expense distribution was not supported by objective analyses as required by SSAP 70, paragraph 9. The Company subsequently corrected this matter by documenting the underlying methodology.

### Tax Sharing Agreement

The Company files a consolidated federal income tax return with its affiliates. Allocation is based upon separate return calculations with current credit for net losses. The examiner noted that the agreement was in writing and approved by the Board. Each affiliate entity is required to make estimated tax payments to the parent company by the estimated tax payment due date. Any overpayment or refund due the Company is required to be paid by the Company within two days after the receipt of such overpayment or refund. However, the tax sharing agreement does not describe the actual participants of the agreement or their correct relationship to each other, primarily due to a reorganization conducted subsequent to the agreement's completion in 2007. The Company was notified of this deficiency and has sent the corrected agreement to the Department for review.

The examiners determined the above agreement meets the standards of 40 P.S. § 991.1405(a)(l)(i).

## REINSURANCE

### INTER-COMPANY POOLING AGREEMENT

Effective July 1, 2007, the Company began participating in an inter-company pooling arrangement ("Pooling Agreement") with the following affiliated entities; collectively the three companies are referred to as the "Pooled Companies":

| | | |
|---|---|---|
| PCIC ("Lead Company") | 17914 | 45% |
| GIC | 11282 | 25% |
| TPC | 17930 | 30% |

In accordance with the terms of the Pooling Agreement, all term insurance business (including Fire, Allied Lines, Homeowners Multiple Peril, Inland Marine, Workers' Compensation and Other Liability-Occurrence lines, but specifically excluding Perpetual Business and external Assumed Reinsurance) is subject to mutual reinsurance based on the fixed pooling percentages stated above.

In accordance with the terms of the Pooling Agreement, GIC cedes 100% of its net term insurance business to PCIC, and PCIC in turn retains its portion and cedes the remaining net term business to TPC and GIC according to the fixed pooling percentages stated above. All net term insurance premiums, losses, loss adjustment expenses, and underwriting expenses are subject to the Pooling Agreement. Accounts related to the Pooling Agreement are to be settled within forty-five (45) days after the end of each calendar month. At the inception of the Pooling Agreement, there were unearned premium, losses, and loss adjustment expense reserve portfolio transfers between the Pooled Companies.

Various reinsurance contracts are maintained by the Pooled Companies with non-affiliated insurers and reinsurers and all cessions by the Pooled Companies to non-affiliated insurers and reinsurers are made prior to ceding to the pool. No cession is made by the pool participants to non-affiliated insurers and reinsurers after pooling takes place.

The examiners determined the above agreement meets the standards of 40 P.S. § 991.1405.

### CEDED

The Company has multiple treaties in-place with various reinsurers on December 31, 2017. Reinsurance for the Pooled Companies is negotiated on a group basis. The reinsurance program is operated on a pre-pooled basis. Reinsurance recoverables due from unauthorized reinsurers were adequately funded through letters of credit or other collateral. All treaties contain an appropriate insolvency and arbitration clause.

**Personal Umbrella Liability Quota Share**

This treaty is underwritten by multiple reinsurers through Guy Carpenter & Company, LLC ("Guy Carpenter"). A brief synopsis of this treaty is shown below:

| | | |
|---|---|---|
| Reinsurer: | Swiss Reinsurance America Corporation | 40.0% |
| | The TOA Reinsurance Company of America | 22.5% |
| | Berkeley Re America | 10.0% |
| | Hannover Rück SE | 10.0% |
| | Markel Global Reinsurance Company | 10.0% |
| | Endurance Assurance Corporation | 5.0% |
| | Aspen Re America Incorporated | 2.5% |
| Type of Contract: | Quota Share | |
| Effective Date: | January 1, 2017 | |
| Term: | Annual (with an option to renew) | |
| Business Coverage: | Personal Umbrella Liability | |
| Company's Retention: | 10% of \$0 - \$1,000,000 (each policy and loss)<br>0% of \$1,000,000 - \$4,000,000 (each policy and loss) | |
| Limit of Liability: | 90% of \$0 - \$1,000,000 (Net Loss and LAE)<br>100% of \$1,000,000 - \$4,000,000 ("Net Loss") | |

**Property/Casualty Excess of Loss**

The Company has three layers of coverage which are underwritten by multiple reinsurers through Guy Carpenter. A brief synopsis of this treaty is shown below:

| Reinsurer | 1st Excess % | 2nd Excess % | 3rd Excess % | Workers Compensation (W/C) % |
|---|---|---|---|---|
| Farm Mutual Reinsurance Plan Inc. | 12.5% | 10.0% | 7.50% | 10.0% |
| Hannover Rück SE | | 20.0% | 17.5% | 15.0% |
| SCOR Reinsurance Company | 10.0% | 5.0% | 5.0% | 10.0% |
| Transatlantic Reinsurance Company | 12.5% | 10.0% | 7.5% | 10.0% |
| R+V Versicherung AG | | | 20.0% | |
| The Toa Reinsurance Company of America | 25.0% | 25.0% | 20.0% | 25.0% |
| Endurance | 10.0% | 5.0% | | |
| Various other companies | 30.0% | 25.0% | 22.5% | 30.0% |

| | |
|---|---|
| Type of Contract: | Excess of Loss |
| Effective Date: | January 1, 2017 |
| Term: | Annual (with an option to renew) |
| Business Coverage: | Various Property and Casualty (P&C) lines |

<u>Company's Retention</u>

| | |
|---|---|
| 1st Excess Layer | \$375,000 per Risk Property/\$375,000 per Occurrence Casualty |
| 2nd Excess Layer | \$600,000 per Occurrence |
| 3rd Excess Layer | \$1,100,000 per Occurrence |
| Limit of Liability | |
| 1st Excess Layer | \$225,000 per Risk Property (\$675,000 Occurrence Limit)<br>\$225,000 per Occurrence Casualty |
| 2nd Excess Layer | \$500,000 per Risk Property (\$6,000,000 Occurrence Limit)<br>\$500,000 per Occurrence Casualty |
| 3rd Excess Layer | \$3,000,000 per Risk Property (\$6,000,000 Occurrence Limit)<br>\$3,000,000 per Occurrence Casualty (W/C only), each Employee, each Occurrence |

In addition to the above excess of loss program, the Pooled Companies have access to a Facultative Reinsurance Program whereby coverage is available for risks above \$4,100,000.

**Catastrophe Excess ("CAT") Excess of Loss**

The Company has three layers of coverage under one treaty. The treaty is underwritten by multiple reinsurers through Guy Carpenter. A brief synopsis of this treaty is shown below:

| Reinsurer | 1st Excess % | 2nd Excess % | 3rd Excess % |
|---|---|---|---|
| General Insurance Company of India | 5.00% | 3.00% | 2.00% |
| American Agricultural Insurance Company | 5.00% | 4.00% | 2.00% |
| Amlin Bermuda Ltd. | 7.75% | 7.75% | 4.00% |
| AXIS Specialty Ltd. | 7.50% | 7.50% | 5.00% |
| Hannover Ruckversicherung AG | | 4.00% | 3.00% |
| Mapfre Reinsurance Corporation | 3.00% | 3.00% | 6.00% |
| Partner Re | 5.00% | 2.00% | 2.00% |
| R+V Versicherung AG | 11.00% | 11.00% | 11.00% |
| Qatar Reinsurance Co | 5.00% | 5.00% | 5.00% |
| Tokio Millennium Re Ltd. | 2.50% | 6.00% | 9.00% |
| Renaissance Reinsurance | 10.00% | 7.00% | 9.00% |
| Shelter Mutual Insurance | 4.00% | 2.00% | 8.00% |
| Various UW at Lloyd's of London | 8.75% | 9.00% | 12.25% |
| Various other companies | 25.50% | 28.75% | 21.75% |

The treaty was substantially the same during the examination period, except the fourth and fifth excess layers existing during the last examination were consolidated into the current three layers on July 1, 2014.

| | |
|---|---|
| Type of Contract: | CAT Excess of Loss |
| Effective Date: | July 1, 2017 |
| Term: | Annual (option to renew) |
| Business Coverage: | Property |
| Company's Retention | |
| 1st Excess Layer | \$15,000,000 per Occurrence |
| 2nd Excess Layer | \$30,000,000 per Occurrence |
| 3rd Excess Layer | \$70,000,000 per Occurrence |
| Limit of Liability | |
| 1st Excess Layer | \$15,000,000 per Occurrence |
| 2nd Excess Layer | \$40,000,000 per Occurrence |
| 3rd Excess Layer | \$70,000,000 per Occurrence |

**Equipment Breakdown/Service Line**

The Company writes equipment breakdown insurance for the convenience of its policyholders, ceding 100% of the premiums and losses to Mutual Boiler Re. The coverage incepted on February 1, 2010 with a limit of \$100,000. The Company added service line insurance as an addendum to the contract, ceding 100% of the premiums and losses. The coverage was added on March 1, 2016 with a maximum limit of \$15,000.

**Inland Flood**

The Company writes inland flood insurance for the convenience of its policyholders, ceding 100% of the premiums and losses to Munich Reinsurance America, Inc. The coverage incepted on September 26, 2016, with a maximum limit of \$100,000.

**Write Your Own ("WYO") Program**

The Company participates in the federal government's National Flood Insurance Program's ("NFIP") WYO Program, which allows property and casualty companies to write flood insurance on their paper. As a participant, the NFIP grants the Company an expense allowance for written policies and claims processing. Additionally, the NFIP reinsures 100% of the Company's underwriting losses. The Company offers flood insurance to applicants in Delaware, Georgia, and Maryland.

The Company's reinsurance intermediary, Guy Carpenter, is licensed by the Department as required by 40 P.S. § 321.2(a). The Company operates this program pursuant to a properly executed written authorization between the Company and Guy Carpenter as required by 40 P.S. § 321.3.

The Pooled Companies' ceded reinsurance contracts contain appropriate insolvency and arbitration clauses and meet the minimum risk transfer requirements of SSAP No. 62R.

## ASSUMED

The Company's only assumed reinsurance is its participation in the Pooling Agreement, as described above, and its participation in a property treaty which is in runoff.

## TERRITORY AND PLAN OF OPERATION

The Company is licensed in Delaware ("DE"), District of Columbia ("DC"), Georgia ("GA"), Maryland ("MD"), New Jersey ("NJ"), Pennsylvania ("PA"), and Virginia ("VA") with 56.0% being written in NJ, 31.3% being written in PA, 2.9% being written in DE, 9.5% being written in MD, and 0.3% being written in VA as of December 31, 2017.

The Company markets its products through approximately 650 agents and other producers. Policies are submitted electronically through the Company's agency website, TPCConnect.com. The Company's in-house agency, Franklin Agency, Inc., writes unsolicited business for clients who contact the company directly.

The Company targets urban risks (row homes, flat roofs, older-aged and lower valued) single or multi-family residences. They will also write homeowners and dwelling policies in suburban and rural areas in support of their retail agents that write in those areas. The Company writes the following lines of business:

| Line of Business | Direct and Assumed Premium | Ceded Premium | Net Written Premium | Percentage of Total |
|---|---|---|---|---|
| December 31, 2017 | | | | |
| Fire | $ 6,047,115 | $ 27 312 | $ 6,019,803 | 18.7% |
| Allied lines | 2,870,089 | 52,216 | 2,817,873 | 8 7% |
| Homeowners multiple peril | 65,491,786 | 44,295,433 | 21,196,353 | 65 7% |
| Inland marine | 745,846 | 525,947 | 219,899 | 0 7% |
| Workers' compensation | 24,748 | 28,774 | (4,026) | 0 0% |
| Other liability - occurrence | 2,005,353 | 3,977 | 2,001,378 | 6.2% |
| Totals | $ 77,184,937 | $ 44,933,669 | $ 32,251,278 | 100.0% |

## SIGNIFICANT OPERATING RATIOS AND TRENDS

The underwriting ratios summarized below are shown on an earned/incurred basis, and encompass the five-year period covered by this examination.

| | Amount | Percentage |
|---|---|---|
| Premiums earned | $ 152,212,935 | 100 0 % |
| Losses incurred | $ 94,658,317 | 62 2 % |
| Loss expenses incurred | 12,065,002 | 7.9 % |
| Other underwriting expenses incurred | 41,837,863 | 27.5 % |
| Net underwriting gain or (loss) | 3,651,753 | 2.4 % |
| Totals | $ 152,212,935 | 100.0 % |

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

| | | 2017 | | 2016 | | 2015 | | 2014 | | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|
| Admitted assets | $ | 98,229,920 | $ | 91,820,016 | $ | 90,125,179 | $ | 85,482,433 | $ | 84,536,295 |
| Liabilities | $ | 48,115,703 | $ | 44,845,958 | $ | 46,336,975 | $ | 43,240,871 | $ | 42,400,255 |
| Surplus as regards policyholders | $ | 50,114,217 | $ | 46,974,058 | $ | 43,788,204 | $ | 42,241,562 | $ | 42,136,040 |
| Gross premium written | $ | 77,184,937 | $ | 69,324,920 | $ | 67,109,867 | $ | 67,135,794 | $ | 64,162,006 |
| Net premium written | $ | 32,251,278 | $ | 30,745,295 | $ | 30,567,649 | $ | 30,947,111 | $ | 29,899,539 |
| Underwriting gain/(loss) | $ | 1,985,358 | $ | 1,377,183 | $ | (850,165) | $ | (2,593,351) | $ | 3,732,728 |
| Investment gain/(loss) | $ | 2,652,976 | $ | 2,496,541 | $ | 2,697,053 | $ | 2,529,532 | $ | 2,967,757 |
| Other gain/(loss) | $ | 77,466 | $ | 119,746 | $ | 79,317 | $ | 94,481 | $ | 91,130 |
| Net income | $ | 3,534,485 | $ | 3,085,409 | $ | 1,709,485 | $ | 512,507 | $ | 4,976,117 |

## PENDING LITIGATION

The Company was not involved in any pending litigation as of December 31, 2017. During the examination period, the Company prevailed in a premium tax litigation suit against the state of New Jersey.

## FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2017, 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, 2017

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| Bonds | $ 81,963,213 | $ 76,676,528 | $ 73,698,471 | $ 71,061,551 | $ 71,606,038 |
| Preferred stocks | 1,304,205 | 1,650,911 | 1,491,988 | 1,199,928 | 1,195,647 |
| Common stocks | 8,673 | 574 | 94,243 | 0 | 4,239 |
| Cash, cash equivalents, and short term investments | 1,970,831 | 4,559,988 | 4,656,369 | 3,341,122 | 926,584 |
| Receivable for securities | 0 | 0 | 0 | 0 | 0 |
| Subtotals, cash and invested assets | 85,246,922 | 82,888,001 | 79,941,071 | 75,602,601 | 73,732,508 |
| Investment income due and accrued | 633,423 | 615,413 | 671,714 | 628,951 | 633,500 |
| Premiums and agents' balances due | 4,512,897 | 2,174,624 | 1,986,798 | 2,009,600 | 2,009,518 |
| Amounts recoverable from reinsurers | 2,195,640 | 1,391,562 | 3,079,118 | 1,543,712 | 2,154,442 |
| Current federal and foreign income tax recoverable and interest thereon | 751,911 | 0 | 159,355 | 1,024,939 | 0 |
| Net deferred tax asset | 726,198 | 1,182,216 | 1,342,176 | 1,351,062 | 1,542,627 |
| Guaranty funds receivable or on deposit | 0 | 2 | 0 | 0 | 0 |
| Receivable from parent, subsidiaries and affiliates | 4,162,929 | 3,568,198 | 2,944,947 | 3,321,568 | 4,463,700 |
| Total | $ 98,229,920 | $ 91,820,016 | $ 90,125,179 | $ 85,482,433 | $ 84,536,295 |
| | | | | | |
| Losses | $ 16,068,979 | $ 16,676,944 | $ 16,478,414 | $ 16,366,298 | $ 16,336,002 |
| Reinsurance payable on paid loss and loss adjustment expenses | 1,727,018 | 1,288,743 | 1,936,677 | 1,568,596 | 1,178,428 |
| Loss adjustment expenses | 3,023,369 | 2,686,613 | 3,512,258 | 1,942,750 | 1,618,750 |
| Commissions payable, contingent commissions and other similar charges | 1,153,044 | 774,187 | 781,000 | 758,150 | 653,581 |
| Other expenses | 82,333 | 88,333 | 88,333 | 86,685 | 73,500 |
| Current federal and foreign income taxes | 0 | 428,688 | 0 | 0 | 357,574 |
| Unearned premiums | 18,706,225 | 17,705,654 | 17,396,752 | 17,657,418 | 17,186,106 |
| Ceded reinsurance premiums payable (net of ceding commissions) | 3,183,043 | 2,699,508 | 2,334,155 | 2,270,528 | 2,110,409 |
| Provision for reinsurance | 0 | 0 | 0 | 0 | 27,225 |
| Payable to parent, subsidiaries and affiliates | 3,547,064 | 2,495,174 | 3,713,390 | 2,559,260 | 2,858,680 |
| Payable for securities | 0 | 2,114 | 95,996 | 31,186 | 0 |
| Total liabilities | 48,115,703 | 44,845,958 | 46,336,975 | 43,240,871 | 42,400,255 |
| Common capital stock | 3,600,000 | 3,600,000 | 3,600,000 | 3,600,000 | 3,600,000 |
| Gross paid in and contributed surplus | 1,800,792 | 1,800,792 | 1,800,792 | 1,800,792 | 1,800,792 |
| Unassigned funds (surplus) | 44,713,425 | 41,573,266 | 38,387,412 | 36,840,770 | 36,735,248 |
| Surplus as regards policyholders | 50,114,217 | 46,974,058 | 43,788,204 | 42,241,562 | 42,136,040 |
| Totals | $ 98,229,920 | $ 91,820,016 | $ 90,125,179 | $ 85,482,433 | $ 84,536,295 |

# Comparative Statement of Income
# For the Year Ended December 31, 2017

| Underwriting Income | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| Premiums earned | $ 31,250,707 | $ 30,436,393 | $ 30,828,316 | $ 30,475,798 | $ 29,221,721 |
| Deductions: | | | | | |
| Losses incurred | 17,323,308 | 19,140,065 | 19,785,685 | 22,505,161 | 15,904,098 |
| Loss expenses incurred | 2,723,732 | 1,379,148 | 3,720,742 | 2,484,449 | 1,756,931 |
| Other underwriting expenses incurred | 9,218,309 | 8,539,997 | 8,172,054 | 8,079,539 | 7,827,964 |
| Total underwriting deductions | 29,265,349 | 29,059,210 | 31,678,481 | 33,069,149 | 25,488,993 |
| Net underwriting gain or (loss) | 1,985,358 | 1,377,183 | (850,165) | (2,593,351) | 3,732,728 |
| **Investment Income** | | | | | |
| Net investment income earned | 2,231,386 | 2,260,063 | 2,255,283 | 2,056,834 | 2,023,736 |
| Net realized capital gains or (losses) | 421,590 | 236,478 | 441,770 | 472,698 | 944,021 |
| Net investment gain or (loss) | 2,652,976 | 2,496,541 | 2,697,053 | 2,529,532 | 2,967,757 |
| **Other Income** | | | | | |
| Net gain or (loss) from agents' or premium balances charged off | (11,772) | (6,670) | (15,309) | (6,125) | (10,224) |
| Finance and service charges not included in premiums | 87,072 | 89,059 | 94,660 | 100,606 | 105,342 |
| Aggregate write-ins for miscellaneous income | 2,166 | 37,357 | (34) | 0 | (3,988) |
| Total other income | 77,466 | 119,746 | 79,317 | 94,481 | 91,130 |
| Net income before dividends to policyholders and before federal and foreign income taxes | 4,715,800 | 3,993,469 | 1,926,205 | 30,662 | 6,791,615 |
| Federal and foreign income taxes incurred | 1,181,315 | 908,060 | 216,720 | (481,845) | 1,815,498 |
| Net income | $ 3,534,485 | $ 3,085,409 | $ 1,709,485 | $ 512,507 | $ 4,976,117 |

# Comparative Statement of Capital and Surplus
# For the Year Ended December 31, 2017

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| Surplus as regards policyholders, | | | | | |
| December 31, previous year | $ 46,974,058 | $ 43,788,204 | $ 42,241,562 | $ 42,136,040 | $ 36,982,649 |
| Net income | 3,534,485 | 3,085,409 | 1,709,485 | 512,507 | 4,976,117 |
| Net unrealized capital gains or (losses) | 42,173 | 169,263 | (100,072) | (157,720) | 111,544 |
| Change in net deferred income tax | (504,196) | (173,576) | (72,423) | (184,107) | (218,212) |
| Change in nonadmitted assets | 67,697 | 104,758 | 9,652 | (92,384) | 308,888 |
| Change in provision for reinsurance | 0 | 0 | 0 | 27,226 | (24,946) |
| Change in surplus as regards policyholder for the year | 3,140,159 | 3,185,854 | 1,546,642 | 105,522 | 5,153,391 |
| Surplus as regards policyholders, | | | | | |
| December 31, current year | $ 50,114,217 | $ 46,974,058 | $ 43,788,204 | $ 42,241,562 | $ 42,136,040 |

# Comparative Statement of Cash Flow
# For the Year Ended December 31, 2017

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| **Cash from Operations** | | | | | |
| Premiums collected net of reinsurance | $ 30,989,982 | $ 30,922,823 | $ 30,654,078 | $ 31,107,145 | $ 28,019,662 |
| Net investment income | 2,610,150 | 2,662,100 | 2,587,389 | 2,364,456 | 2,439,997 |
| Miscellaneous income | 77,466 | 119,746 | 79,317 | 94,481 | 91,130 |
| Total income | 33,677,598 | 33,704,669 | 33,320,784 | 33,566,082 | 30,550,789 |
| Benefit and loss related payments | 18,297,076 | 17,901,912 | 20,840,897 | 21,473,966 | 11,772,632 |
| Commissions, expenses paid and aggregate write-ins for deductions | 11,232,426 | 10,751,606 | 10,298,789 | 10,122,233 | 9,689,549 |
| Federal and foreign income taxes paid (recovered) | 2,550,000 | 400,000 | (474,938) | 1,029,791 | 1,161,841 |
| Total deductions | 32,079,502 | 29,053,518 | 30,664,748 | 32,625,990 | 22,624,022 |
| Net cash from operations | 1,598,096 | 4,651,151 | 2,656,036 | 940,092 | 7,926,767 |
| **Cash from Investments** | | | | | |
| Proceeds from investments sold, matured or repaid: | | | | | |
| Bonds | 33,411,011 | 18,963,303 | 11,967,034 | 10,227,348 | 22,710,992 |
| Stocks | 755,828 | 192,341 | 804,509 | 292,844 | 612,909 |
| Net gain or (loss) on cash and short-term investments | 0 | 0 | (2,891) | 18,447 | 0 |
| Miscellaneous proceeds | 0 | 0 | 64,810 | 31,186 | 3,412 |
| Total investment proceeds | 34,166,839 | 19,155,644 | 12,833,462 | 10,569,825 | 23,327,313 |
| Cost of investments acquired (long-term only): | | | | | |
| Bonds | 38,590,497 | 21,718,354 | 14,676,473 | 9,699,373 | 29,124,240 |
| Stocks | 218,636 | 249,474 | 1,028,521 | 238,722 | 488,509 |
| Miscellaneous applications | 2,114 | 93,882 | 0 | 0 | 0 |
| Total investments acquired | 38,811,247 | 22,061,710 | 15,704,994 | 9,938,095 | 29,612,749 |
| Net cash from investments | (4,644,408) | (2,906,066) | (2,871,532) | 631,730 | (6,285,436) |
| **Cash from Financing and Miscellaneous Services** | | | | | |
| Other cash provided (applied): | | | | | |
| Other cash provided or (applied) | 457,155 | (1,841,466) | 1,530,743 | 842,716 | (6,561,826) |
| Net cash from financing and miscellaneous sources | 457,155 | (1,841,466) | 1,530,743 | 842,716 | (6,561,826) |
| **Reconciliation of cash and short-term investments:** | | | | | |
| Net change in cash and short-term investments | (2,589,157) | (96,381) | 1,315,247 | 2,414,538 | (4,920,495) |
| Cash and short-term investments: | | | | | |
| Beginning of the year | 4,559,988 | 4,656,369 | 3,341,122 | 926,584 | 5,847,079 |
| End of the year | $ 1,970,831 | $ 4,559,988 | $ 4,656,369 | $ 3,341,122 | $ 926,584 |

## 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, 2017, the Company's invested assets were distributed as follows:

| | | Amount | Percentage |
|---|---|---|---|
| Bonds | $ | 81,963,213 | 96.2 % |
| Preferred stocks | | 1,304,205 | 1.5 % |
| Common stocks | | 8,673 | 0.0 % |
| Cash | | 1,402,243 | 1.6 % |
| Cash equivalents | | 568,588 | 0.7 % |
| Totals | $ | 85,246,922 | 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 | $ | 71,472,241 | 87.2 % |
| 2 - high quality | | 6,429,962 | 7.8 % |
| 3 - medium quality | | 1,874,544 | 2 3 % |
| 4 - low quality | | 1,383,550 | 1.7 % |
| 5 - lower quality | | 780,416 | 1.0 % |
| 6 - Bonds near or in default | | 22,500 | 0.0 % |
| Totals | $ | 81,963,213 | 100 0 % |

| Years to Maturity | | Amount | Percentage |
|---|---|---|---|
| 1 year or less | $ | 6,838,902 | 8.3% |
| 2 to 5 years | | 31,295,982 | 38 2% |
| 6 to 10 years | | 24,819,647 | 30 3% |
| 11 to 20 years | | 11,928,849 | 14 6% |
| over 20 years | | 7,079,833 | 8.6% |
| Totals | $ | 81,963,213 | 100.0 % |

The investment portfolio has increased by about $14 million (20%) since 2012. Most of this was in Bonds ($18 million, a 27% increase) with a slight increase in Preferred Stock ($176 thousand, a 16% increase), offset by decreases in Cash and Short-Term Securities ($3.9 million, a 66% decrease).

The following investment managers are listed within the Company's Annual Statements for the years 2013 through 2017 as having the authority to make investment decisions on behalf of the Company: Zazove Associates manages the convertible stock and bond portfolio; and General Re – New England Asset Management ("GR-NEAM") manages the fixed income portfolio.

Wellspring Capital Advisors, LLC ("Wellspring") is the de facto Chief Investment Officer of the Company and provides portfolio performance and investment management oversight. Wellspring is responsible for reviewing and monitoring the performance and the investment activities of the investment managers for compliance to the investment guidelines established by the Board of Directors for each investment manager. Moreover, Wellspring prepares and presents quarterly reports of the entire investment portfolio's performance to the Company's management and Investment Committee.

The Company entered into a custodial agreement with PNC Bank, N.A., a national banking and financial services company organized under the laws of the United States of America, effective September 14, 2018. The custodial agreement complies with the standards for custodial agreements pursuant to 31 Pa. Code § 148a.3.

The Company has a written investment policy as required by 40 P.S. § 653b(b). The Company's investment policy includes a review of investments for Other Than Temporary Impairment. 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, 2017.

## LIABILITIES

## LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company reported net reserves in the amount of $16,068,979 for losses and $3,023,369 for loss adjustment expenses ("LAE") on the December 31, 2017 Annual Statement. These amounts represent the Company's share of losses in accordance with the terms of the Pooling Agreement.

Alan Pakula, ACAS, MAAA, Vice President, Chief Actuary and appointed actuary ("AA") provided a Statement of Actuarial Opinion ("Opinion") for the Company for years ending 2015 through 2017.

Christopher Tait, FCAS, MAAA of Milliman, Inc., served as the AA for the Company for years ending 2013 and 2014.

The change of AA, and the absence of any disagreements with the prior AA, were properly notified to the Department in July 2015.

For each year in the examination period, the AA issued an Opinion stating that the loss and LAE reserve amounts, "make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements."

To evaluate the accuracy and completeness of the data used by the actuary, the examiners and the independent auditors reviewed the controls over data compilation and tested samples of the data furnished to the actuary for use in generating the reserves. No unresolved exceptions were noted, and the data used by the actuary were therefore adjudged to be complete and accurate. The audit firm also utilized one of its own credentialed actuaries to assess the Pooled Companies' total reserves for unpaid losses and LAE as of December 31, 2017 and found the total amount to be reasonable.

Based on the procedures performed and the results obtained, the examination team obtained sufficient documentation to support the conclusion that the Company's net carried reserves for losses and loss adjustment expenses are reasonably stated as of December 31, 2017.

## SUBSEQUENT EVENTS

There were no reportable subsequent events through the date of this report.

# RECOMMENDATIONS

## PRIOR EXAMINATION

The prior examination report contained the following recommendation:

1. It is recommended that the Company begin reporting pooling percentages in its Annual Statement Schedule P, Column 34 or provide an explanation in Schedule P Interrogatory.

    - ***The Company complied by including an explanation in the Schedule P interrogatories and expanding the "Pooling" Note to the Financial Statements (# 26 in the 2017 Annual Statement) to explain that perpetual business is not included in the pooling agreement.***

## CURRENT EXAMINATION

As a result of the current examination, no recommendations are being made.

## CONCLUSION

As a result of this examination, the financial condition of Germantown Insurance Company, as of December 31, 2017, was determined to be as follows:

| | | Amount | Percentage |
|---|---|---|---|
| Admitted assets | $ | 98,229,920 | 100.0 % |
| Liabilities | $ | 48,115,703 | 49.0 % |
| Surplus as regards policyholders | | 50,114,217 | 51.0 % |
| Total liabilities and surplus | $ | 98,229,920 | 100.0 % |

Since the previous examination, made as of December 31, 2012, the Company's assets increased by $5,722,322, its liabilities decreased by $7,409,246, and its surplus increased by $13,131,568. This examination was conducted by Charles Albert, Pamela Roberts, and John Gaynard, CFE, with the latter two in charge.

Respectfully,

Melissa L. Greiner
Director
Bureau of Financial Examinations

Robert Woronko, CFE
Examination Manager

Pamela Roberts -cdd
Pamela Roberts
Examiner-in-Charge

John Gaynard -cdd
John Gaynard, CFE
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.