REPORT ON EXAMINATION

OF

MARATHON FINANCIAL INSURANCE COMPANY, INC.

A RISK RETENTION GROUP

AS OF

DECEMBER 31, 2014

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT OF EXAMINATION, made as of December 31, 2014 of the

MARATHON FINANCIAL INSURANCE COMPANY, INC. RRG

is a true and correct copy of the document filed with this Department.

Attest By: ______________________

Date: June 29, 2016

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 29th day of June, 2016.

____

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

841 Silver Lake Blvd., Dover, DE 19904-2465 • www.delawareinsurance.gov
(302) 674-7300 Dover • (302) 739-5280 fax • (302) 577-5280 Wilmington

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

REPORT OF EXAMINATION

OF THE

MARATHON INSURANCE COMPANY, INC. RRG

AS OF

DECEMBER 31, 2014

The above-captioned report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the company as reflected in the report.

This report is hereby accepted, adopted and filed as an official record of this Department.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 29th day of June, 2016

841 Silver Lake Blvd., Dover, DE 19904-2465 • www.delawareinsurance.gov
(302) 674-7300 Dover • (302) 739-5280 fax • (302) 577-5280 Wilmington

TABLE OF CONTENTS

SALUTATION

June 21, 2016

Honorable Karen Weldin Stewart, CIR-ML
Delaware Insurance Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Blvd.
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in the Certificate of Authority No. 15.050, an examination has been made of the affairs, financial condition and management of

MARATHON FINANCIAL INSURANCE COMPANY, INC., A RISK RETENTION GROUP

hereinafter referred to as the "Company" or "MFIC" and incorporated under the laws of the State of Delaware. The Company's registered office in the State of Delaware is located at 1105 North Market Street, Suite 1300, Wilmington, Delaware 19801. The administrative office of the Company is located at 1710 Corporate Crossing, Suite 1, O'Fallon, Illinois 62269. The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

We have performed our single-state examination of MFIC. The last examination covered the period of January 1, 2007 through December 31, 2009. This examination covers the period of January 1, 2010 through December 31, 2014.

We conducted our examination in accordance with the NAIC F*inancial Condition Examiners Handbook.* The Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company and evaluate system controls and procedures used to mitigate those risks. 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.

The examination report includes significant findings of fact, as mentioned in 18 Del. C. §321 and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusion, proprietary information, etc.) are not included within the examination report but separately communicated to other regulators and/or the Company.

SUMMARY OF SIGNIFICANT FINDINGS

The following significant findings were identified during the examination:

Funds Utilized as Credit for Reinsurance were Non-Compliant with Trust Requirements per 18 Del. Admin. Code §1003.

The Company records a credit for reinsurance for all funds held in loss reserve fund (LRF) accounts maintained by unauthorized, offshore Producer Owned Reinsurance Companies (PORC) as a participant to multiple 100% quota share reinsurance contracts. At year-end 2014, the total funds held in such accounts totaled $38.27 million. The examination determined that as of December 31, 2014, the majority of the funds were held in accounts that were not under a trust agreement or were held in accounts under a trust agreement that did not contain all required terms as per 18 Del. Admin. Code §1003. Due to non-compliance, the funds cannot be accounted for as collateral to support the reinsurance recoverables due from the unauthorized reinsurance companies. As a result of the disallowance by the examination, the Company's provision for reinsurance liability was materially increased. An increase in the provision for reinsurance is a direct reduction to unassigned funds (surplus). The exam calculated the increase to the provision for reinsurance to be $17.17 million, which corresponds to a $17.17 million reduction in surplus. Subsequent to the examination date, the Company began to implement measures to correct the noncompliant accounts, which dramatically reduces the provision for reinsurance liability.

The examination also determined that the Company was including encumbered assets within the total collateral utilized as credit for reinsurance. The Company's majority owner and administrator, Marathon Administrative Company (MAC), will infuse funds into the PORC Loss Reserve Fund (LRF) accounts if total funds are insufficient to pay claims for a particular period. Once PORC LRF balances return to a sufficient level, MAC will withdraw the loaned funds from the account. Such encumbered funds cannot be utilized as a credit for reinsurance per Trust Agreement terms and per 18 Del. Admin. Code §1003. The examination could not calculate the total amount of encumbered funds due to a lack of documentation and reconciliations.

Failure to Provide Complete and Accurate Data in accordance with 18 Del. C. §320 and Material Weaknesses in Internal Control over Financial Reporting were noted.

During the course of examination, the data provided by the Company which supported the premium, claim and commission amounts was found to be incomplete and inaccurate. Specifically, the following issues were found:

- Data records failed to capture all First Dollar (FD) premium written and ceded. Specifically, data on eight PORCs was inaccurately recorded as being under an Excess of Loss (XOL) Policy, instead of being a part of the existing FD policies.
- Data records inaccurately reported XOL premium amounts. Specifically, the Company reported the FD premium amounts instead of utilizing the agreed upon XOL premium rates.
- Data records erroneously included pre-2009 XOL policies within the FD information.
- Data was deleted and replaced during contract renewals.
- Data included contracts which were not covered by Company insurance policy terms.

Due to the vast discrepancies in data provided, the examination found it difficult to obtain valid, accurate and reliable information from the Company. While corrected information was utilized during the exam, results could vary materially if the data provided contains further errors not identified.

Additionally, due to the inaccurate and incomplete data files utilized by the Company, it was determined that financial reporting within the 2014 Annual Statement contained material misstatements. As such, material deficiencies in internal controls over financial reporting were identified throughout the examination for incomplete and inaccurate records and reporting of premium, claim and commission amounts.

The examination notes that certain aspects of the incorrect and incomplete data were also provided to the Appointed Actuary in the review of the reasonableness of the liabilities for loss and loss adjustment expense reserves and the unearned premium reserves.

COMPANY HISTORY

The Company was organized as a risk retention group under the laws of the State of South Carolina on January 30, 2001, and commenced business on November 1, 2001. There were four shareholders as of December 31, 2009 with Marathon Administrative Company, Inc. (MAC) holding 99.4%. The other three owners were Automotive Professionals, Inc. (API), United States Warranty Company (USWC) and Intercontinental Warranty Services, Inc. (IWSI). As a risk retention group, MFIC is subject to the federal Liability Risk Retention Act of 1986 (LRRA). Pursuant to the LRRA, all shareholders of the Company are required to be policyholders, and all policyholders are required to be shareholders.

In 2010, API redeemed its share certificate and is no longer a shareholder. API ceased writing new business in February 2007 and declared bankruptcy the same year.

On May 7, 2010, the Company redomesticated to the State of Delaware.

Capitalization

The Company is required to maintain a minimum capital and surplus of $1,000,000, which is the minimum amount required of a risk retention group under the insurance laws of the State of Delaware 18 Del. C. §6905(a). At year-end 2014, the Company reported $2,336,985 in policyholder surplus.

Chapter 65, 15 USCS Section 3901(4) (E) of the Federal Statutes indicates that a "Risk Retention Group" must have "as its owners only persons who comprise the membership of the Risk Retention Group and who are provided insurance by such group." Therefore, ownership is necessary to obtain insurance coverage from the Company.

The Company is authorized to issue 1,000 shares of Class A common stock. As of December 31, 2014, the Company has 502 shares issued and outstanding as follows:

Marathon Administrative Company, Inc.	500
Intercontinental Warranty Services, Inc.	1
Unites States Warranty Corporation	1
Total	502

The Company's outstanding Class A common stock has a stated value of $400 per share. Thus, common capital stock amounted to $200,800.

On September 7, 2012, MAC made a capital contribution to MFIC of $250,000 as a part of a change of Business Plan. The capital infusion was approved by the Department. Gross paid in and contributed surplus was $1,393,445 at the end of 2014.

API Bankruptcy

API declared bankruptcy in the second quarter of 2007. API's future liabilities are not anticipated to exceed the aggregate XOL attachment point. However due to the bankruptcy, updated data has been unattainable and thus, it is not known whether API has sufficient assets to cover future liabilities. Additionally, through policy endorsements for business written in eight states, the Company is required to pay all claims if API fails to perform within 60 days of a vehicle service contract (VSC) holder's submission of proof of loss to API's claims administrator.

In 2009, the Company entered into a settlement agreement with the API bankruptcy trustee, resulting in MFIC agreeing to continue to fund claims in the eight states associated with the noted endorsements and to pay $1,100,000. The Company paid the settlement amounts in three annual installments: $500,000 in 2010, $300,000 in 2011 and $300,000 in 2012.

The Company continues to pay claims due to the policy endorsements. The following amounts have been paid during the exam period relating to such.

2010:	$505,658
2011:	$395,437
2012:	$216,381
2013:	$101,593
2014:	$ 15,077

MANAGEMENT AND CONTROL

Pursuant to the Company's Certificate of Incorporation and bylaws, all corporate powers and its business property and affairs are managed by, or under the direction of the Board. Pursuant to the Company's bylaws, the Board shall consist of at least one (1) person and may not be greater than nine (9). The following persons were elected and serving as Directors of the Company at December 31, 2014:

Directors	Primary Business Affiliation
Allen Duane Kreke	President of the Company, Part Owner of MAC
John Shelby Bryan	Treasurer of Company, Part Owner of MAC
James Perry Bryan	Vice President of Company, Part Owner of MAC
Pamela Mae Rakers	Secretary of the Company
Richard Frederick Klumpp	Delaware Resident Director

The Officers of the Company are elected by the Board. The following Officers served as of December 31, 2014:

Officers	Title
Allen Duane Kreke	President
Amanda Marie Farmer	Chief Financial Officer
Pamela Mae Rakers	Secretary
James Perry Bryan	Vice President
John Shelby Bryan	Treasurer

During the exam period there were multiple changes in executive persons, including Board members and Officers of the Company. In particular there were numerous changes in the Chief Financial Officer position. It was found that the Department was not notified of all the changes as required. Therefore,

It is recommended that the Company notify the Department of any changes in its executive officers in accordance with 18 Del. Admin. Code 302 §11.1.

Corporate Records

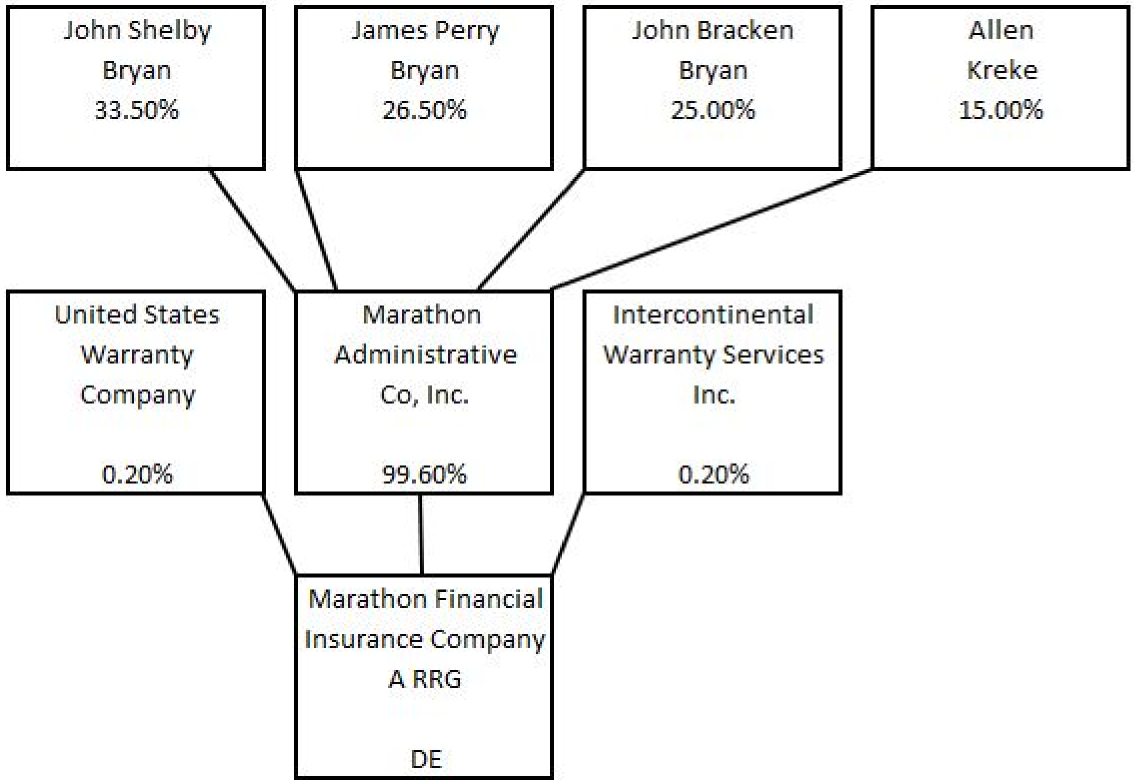
The recorded minutes and written resolutions of the Company's shareholders and Board of Directors (Board) were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events, including the authorization of investments as required by 18 Del. C. §1304 "Authorization; record of investments".

A review of the Insurance Holding Company Annual Registration Statement filings (Form B and Form C) made by and on behalf of the Company for all years under examination revealed that initially the Company was incorrectly reporting ownership and not reporting all material transactions as required by 18 Del. Admin. Code §1801. Upon notification by the Department, the Company corrected the filing during the examination period.

Insurance Holding Company System

The Company is a member of an insurance holding company system as defined pursuant to 18 Del. C. Chapter 50 "Insurance Holding Company System Registration". As the Company operates as a risk retention group, the Company is owned by shareholders whom are insureds of MFIC. There were three shareholders as of December 31, 2014 with MAC owning 99.6% of the Company's outstanding stock. MAC is owned by four individuals, all of whom are MFIC management and/or directors, with varying ownership percentages. MAC is also the majority owner of other affiliated insurance entities including Athens Financial Holdings Company, Inc. and Marathon Delaware RE, LLC.

The following is an organizational listing that reflects the identities and interrelationships between MAC and the Company as of December 31, 2014.



Management and Service Agreements

The following affiliated agreements for the Company were identified as being in effect as of December 31, 2014:

Fourth Amended and Restated Administrative Service Agreement

Originally effective January 2, 2007, amended three times in the period of 2009-2014, the agreement is between the Company and MAC whereby the Company agrees to pay for administrative services. As Marathon RRG has no employees, MAC provides sales and marketing, screening and processing applications, underwriting, billing and collecting premiums, warranty and service contract accounting, administering complaints and disputes, claims adjudication, producer audit and support, and such other business operations. The annual fee for such services is $150,000, but is waived until the Company’s capital and surplus reaches $3 million.

Tax Sharing Agreement

A Tax Sharing Agreement dated July 1, 2008 was put in place between the Company and MAC, where participating companies allocate their consolidated federal income tax liability. The agreement stipulates that any overpayment made by the Company of its liability computed on the separate return basis must be settled within 90 days of the filing of the consolidated income tax return, or when a refund is due on the consolidated return, within 90 days of the receipt of such refund.

The following other agreements were identified as being in effect as of December 31, 2014:

Captive Management Agreement

Effective April 15, 2008, the Company entered into an agreement with Wilmington Trust SP Services, Inc. (Wilmington Trust). Pursuant to the agreement, Wilmington Trust handled certain administrative services including financial reporting in return for an annual fixed fee. Subsequent to the exam period, the agreement with Wilmington Trust was terminated and a new captive manager was put in place in early 2016.

Custody Agreements

Effective October 21, 2009, the Company entered into a Custody Agreement with Raymond James and Associates. The agreement was updated and replaced with a new agreement on February 14, 2014.

Effective November 23, 2009, the Company entered into a Custody Agreement with Morgan Stanley Smith Barney. The agreement was amended March 6, 2014.

The Custody Agreements govern the terms and conditions pursuant to which each company will act as a custodian of various assets of the Company. The original agreements did not contain certain protective clauses as recommended by the NAIC Examiner’s Handbook. However, the subsequent amendments and updates did bring the agreements into compliance.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2014, the Company was licensed to transact business in the State of Delaware as a risk retention group. The Company is registered as a non-domiciled risk retention group in the District of Columbia and all states except Wisconsin and Minnesota.

The Company offers contractual liability insurance to its members. All members of MFIC are automobile warranty administrators/obligors (AOs) who write vehicle service contracts (VSCs). The coverage provided in the underlying VSCs varies for new and used cars. The coverage ranges from extended eligibility programs to product warranty contracts to powertrain contracts. Each program has various terms in years and mileage coverage.

The Company's purpose is to insure the contractual liabilities of the VSCs issued by the AOs. The VSCs ultimately insured by the Company are sold primarily through financial institutions, internet marketers (call centers/direct marketers) and through select automobile dealers (together, Program Producers). Each Program Producer has established PORCs in the Turks & Caicos Islands.

Prior to 2009, the Company provided aggregate XOL insurance policies for the VSC AOs. The reserves collected by each member were placed in a loss reserve fund for the payment of claims. Under the terms of the policies, in the event the VSC reserves collected by the AOs are insufficient, the Company was liable for the excess claims and refunds. The LRF assets are to be held in a trust for the benefit of the Company. At December 31, 2014, the LRF assets of IWSI were not held in trust, and thus, are not controlled by the Company.

Premium received by the Company for the XOL coverage was equal to a flat dollar amount per contract issued by the AOs. While the Company's policies provide for XOL coverage, an individual service contract holder has the right to make a direct claim against the Company in the event the AO fails to pay a valid service contract claim.

Effective January 1, 2009, the Company restructured its underwriting operations to providing first dollar coverage policies to MAC only, ceasing to write further XOL business and running off the program. The Company cedes all of the first dollar business under multiple 100% quota share reinsurance agreements to the third party Program Producer PORCs. Each of the PORCs is to establish trust accounts for the benefit of the Company.

The Company received first dollar premiums and ceded 100% of the premiums to the PORCs in exchange for a pre-determined ceding commission.

A revised Business Plan for the Company was submitted to the Department in 2012 and, undergoing various changes in implementation, was approved by the Delaware Captive Bureau in 2013 and by the traditional Department of Insurance in 2014. Under the approved Business Plan, the Company was to transition to an XOL carrier for MAC, while the PORCs that currently reinsure MFIC will replace it as first dollar insurers following their conversion to a series captive insurance company (SCIC) of Marathon Delaware RE, LLC (MDRe), a special purpose captive company domiciled in Delaware. MDRe was licensed in 2012 and owned by two classes of members, Class A and Class B. The sole Class A member is MAC. The Class B members are the participants in the various SCICs.

The SCICs would each hold the business and assets of the former PORC after the termination of its reinsurance contract with MFIC and the issuance of a first dollar policy. MFIC, in turn, is to issue an XOL policy that will pay on claims only to the extent that the SCIC failed to do so. Restructured this way, there is no reinsurance between the SCICs and MFIC. Instead, the XOL policies issued by MFIC to MAC stand parallel to the first dollar policy issued by the SCICs, acting as secondary coverage that kicks in only when primary coverage fails.

As of year-end 2014, only three PORCs were converted to licensed MDRe SCICs, all a part of the “Certified Car Care” dealer-owned business (together, CCC PORCs). The newly formed SCICs issued first dollar policies and respectively, MFIC then issued an XOL policy to MAC. All other PORCs remained domiciled in the Turks & Caicos and continued to provide reinsurance coverage for the first dollar policies that MFIC issued to MAC.

REINSURANCE

Assumed Reinsurance

The Company did not assume any reinsurance during the examination period.

Ceded Reinsurance

The Company cedes 100% of the first dollar liability premium from MAC to the Program Producer established PORCs through individual 100% quota share reinsurance agreements. Each of the 112 PORCs established at year-end 2014 are domiciled in the Turks & Caicos and are thus considered unauthorized reinsurers. Each PORC is to establish a reinsurance trust account where the Company is the beneficiary.

FINANCIAL STATEMENTS

The following financial statements are based on the financial statements as filed by the Company with the Delaware Department of Insurance and present the financial condition of the Company for the period ending December 31, 2014:

Statement of Assets
Statement of Liabilities, Surplus and Other Funds
Statement of Operations
Reconciliation of Surplus for the Period Since Last Examination

The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statement and should be considered an integral part of the financial statements.

MARATHON FINANCIAL INSURANCE COMPANY, INC. RRG
Statement of Assets

DECEMBER 31, 2014

	Assets	Non-Admitted Assets	Admitted Assets	Notes
Bonds	$ 2,175,118	$ 105,759	$ 2,069,359	**1**
Stocks	300,000		300,000	**2**
Cash	71,483		71,483	
Investment income due and accrued	3,625		3,625	
Premium Receivables	3,678,898		3,678,898	
Net deferred tax asset	219,081	122,412	96,669	**2,3**
Receivables from parent, subsidiaries and affiliates	853,445		853,445	**3**
Aggregate write-ins for other than invested assets	6,393	5,632	761	
Totals	$ 7,308,043	$ 233,803	$ 7,074,240	**7**

MARATHON FINANCIAL INSURANCE COMPANY, INC. RRG

Statement of Liabilities, Surplus, and Other Funds

DECEMBER 31, 2014

			Notes
Losses	$	25,000	**6**
Loss Adjustment Expenses		10,000	**6**
Taxes, licenses and fees		27,500	
Current Federal and Foreign Income Taxes		212,408	
Unearned Premiums		449,567	**3,7**
Advance Premium		43,485	
Ceded reinsurance premiums payable		3,968,030	**5**
Provision for Reinsurance		1,265	**4**
Unearned Ceding Commission		0	
Total Liabilities	$	4,737,255	
Common capital stock	$	200,800	
Gross paid-in and contributed surplus		1,393,445	
Unassigned funds (surplus)		742,740	
Surplus as regards policyholders		2,336,985	
Total Liabilities, Capital and Surplus	$	7,074,240	**7**

MARATHON FINANCIAL INSURANCE COMPANY, INC. RRG
Statement of Operations

DECEMBER 31, 2014

Underwriting Income		
Premiums earned	$ 634,578	
Losses incurred	15,078	
Other underwriting expenses incurred	110,033	
Net underwriting gain		$ 509,467
Investment Income		
Net investment income earned	$ 25,711	
Net investment gain or (loss)		$ 25,711
Other Income		
Miscellaenous Other Income	$ 1,835	
Total Other Income		$ 1,835
Net income before federal income taxes		537,013
Federal income taxes incurred		0
Net income		$ 537,013

MARATHON FINANCIAL INSURANCE COMPANY, INC. RRG
Reconciliation of Surplus for the Period since Last Examination

		Note
Surplus as regards policyholders, December 31, 2009	$ 2,332,879	
Gains and (losses) in surplus		
Net income	777,625	
Change in net unrealized capital gains	(520,613)	**2**
Change in net deferred income tax	(129,801)	
Change in nonadmitted assets	(233,803)	**1**
Change in provision for reinsurance	58,719	**4**
Capital Changes: Paid In	(400)	
Surplus Adjustments: Paid In	250,400	
Prior Year Audit Adjustments	(198,022)	
Change in surplus as regards policyholders	4,105	
Surplus as regards policyholders, December 31, 2014	$ 2,336,984	

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM EXAM

Analysis of Changes in Surplus

	Increase	Decrease		Note
Surplus at December 31, 2014 per Annual Financial Statement			$ 2,336,985	
Bonds		$ 157,632		**1**
Deferred Tax Asset	$ 3,072			**2**
Preferred Stock		89,543		**2**
Excess of Loss Premium Receivable		978,890		**3**
Unearned Excess of Losss Premium		402,542		**3**
First Dollar Ceding Commission Receivable	1,322,313			**3**
First Dollar Unearned Ceding Commission	493,380			**3**
Provision for Reinsurance	17,171,000			**4**
Net Decrease to Surplus			$ 17,162,518	
Surplus at December 31, 2014 after adjustment			(14,825,533)	

Summary of Reclassifications

Annual Statement Line Item	Balance per Annual Statement	Increase	Decrease	Adjusted Balance	Note
Ceded First Dollar Premium	$ (20,300,118)	$ 27,514,419		$ 7,214,301	**3**
Written First Dollar Premium	(20,300,118)	27,514,419		7,214,301	**3**
Prepaid Reinsurance	10,076,482	12,336,213		22,412,695	**3**
Unearned First Dollar Premium	10,076,482	12,336,213		22,412,695	**3**
First Dollar Claim Paid Recoverable	(753,551)	6,361,360		5,607,809	**3**
First Dollar Claim Paid	(753,551)	6,361,360		5,607,809	**3**
Incurred But Not Reported Recoverable	200,354	136,841		337,195	**3**
Incurred But Not Reported Claim Reserve	200,354	136,841		337,195	**3**
Ceded Reinsurance Premiums Payable	3,968,030		$ 289,132	3,678,898	**5**
Unearned Ceding Commission	-	289,132		289,132	**5**

COMMENTS ON FINANCIAL STATEMENT ITEMS

(Note 1) Bonds

The majority of the Company's security investments at year-end 2014 consisted of auction rate securities (ARS). ARS are municipal bonds, corporate bonds, and preferred stocks with interest rates or dividend yields that are periodically re-set through auctions, typically every 7, 14, 28 or 35 days. ARS are usually issued with stated intermediate to long-term maturities or in perpetuity; however, due to ARS's interest rate or dividend yield re-set feature, they are priced and traded as short-term instruments.

In 2008, the Financial Industry Regulatory Authority issued an Investor Alert on ARS due to the "freezing" or failure of the auction market. Additionally, the Securities and Exchange Commission and certain state attorneys general became involved in the ARS market and its failure, reaching settlements with major broker-dealers which included agreements to buy back the ARS from certain investors. To date, there remains some uncertainty in the ARS sector including but not limited to rate and dividend auctions failing, impaired liquidity, and repurchase offers at a discount.

The Company has valued these securities at cost/par at year-end 2014, classifying the securities as held-to-maturity due to their assessment of the positive intent and ability to hold criteria. The Company also maintains that such securities are not impaired.

At year-end 2014, the Company non-admitted $105,759 in bond assets due to the investment holdings not complying with limitations set by Chapter 13 of the Delaware Code. The Company maintained holdings in securities with a Securities Valuation Office rating of 5 or 6 over the 3% of total admitted assets limitation in accordance with 18 Del. C. §1308 (2).

In 2014, the Company failed to utilize correct bond ratings for certain securities. Additionally, the Company failed to non-admit its bond holdings in one issuer in amounts over 10% of assets. These errors caused further failure of compliance in asset limitations and thus, the examination determined that an additional $157,632 should be non-admitted.

Therefore,

It is recommended that the Company Comply with 18 Del. C. §1305 (1) and 18 Del. C. §1308 (b) (2) by modifying its investments or non-admitting amounts over allowable limits.

It is recommended that the Company utilize correct designations and ratings for its securities to ensure proper valuation and compliance with Delaware Code Chapter 13 limitations.

(Note 2) Preferred Stock

At year-end 2014, the Company maintained investment in one preferred stock, which it valued at $300,000. The Company improperly classified its preferred stock holding as held-to-maturity. Under ASC 320 Investments – Debt and Equity Securities, preferred stock cannot be classified as held-to-maturity as it has no maturity date and thus, must be classified as available-for-sale or trading. Under ASC 320-10-35-1, available-for-sale securities are measured at fair value, any unrealized holding gain/loss is to be excluded from earnings and reported in other comprehensive income until realized.

Upon review by a third party investment specialist, it was determined that the preferred stock was not stated at fair value at year-end 2014. Fair value was determined to be $210,457 at such time. Thus, the examination determined that the preferred stock value should be written down by $89,543. The unrealized loss increases the deferred tax asset by $30,445 and consequently surplus is reduced by $59,098.

Therefore,

It is recommended that the Company properly value its preferred stock at fair value in accordance with ASC 320-10-35.

Per Chapter 13 of the Delaware Code, the cost of investments in one stock in any one corporation shall not exceed 3% of the insurer's assets. The Company's original valuation of $300,000 in preferred stock exceeded this limit.

Therefore,

It is recommended that the Company comply with 18 Del. C. §1305 (3)(c) by modifying its investments or non-admitting amounts over allowable limits.

(Note 3) Material Misstatement of Premium, Claim and Commission Amounts

During the course of the examination, there were numerous deficiencies found in the accounts and records of the Company. The data utilized by the Company which supported the premium, claim and commission amounts was found to be incomplete and inaccurate. Specifically, the following issues were found.

1. Inaccurate reporting of 8 FD Policies as XOL business

The Company inaccurately reported the business relating to 8 FD policies and related 100% quota share reinsurance agreements as being converted to the XOL arrangement. At year-end 2014 the 8 PORCs had not executed signed termination documents, nor were premium and risk transferred to the SCICs. Instead, the PORC owners determined that re-domestication to the SCICs was not in their best interest and refused to go forward with execution of the Department approved arrangement. Due to the reporting and accounting differences between the FD and XOL arrangements, the inaccurate reporting of the 8 PORCs had material ramifications on the

2014 Annual Statement. Written premium, unearned premium, claims paid, loss reserve and commission amounts were materially misstated.

2. Inaccurate premium rates utilized for XOL business

The Company utilized inaccurate premium rates for the 2014 XOL business, utilizing the previous FD premium rates instead of the agreed upon set dollar XOL rates for related VSCs. This caused a material overstatement of premium amounts for the XOL business.

3. Inclusion of XOL business within first dollar detail

The Company included premium, claim and commission transactions related to pre-2009 XOL policies within the FD data. Specifically, it was found that business related to certain dealerships never switched to FD contracts, instead remaining with the XOL program. However, MFIC recorded transactions relating to such business in its financial statements from 2009 to 2014 as if it were FD business. Additionally, it was found that the Company was including pre-2009 business within FD data. As the Company restructured its underwriting operations from XOL to FD in 2009, the FD policy does not cover such business. This erroneous reporting affected the written premium, unearned premium, claims paid, loss reserve and commission amounts.

4. Inclusion of business not covered by MFIC first dollar policy

The Company recognized business written prior to the FD policy and the quota share agreement effective date. Such business is not covered under the FD policy as the policy applies only to business written during the policy term, which is not retroactive. This erroneous reporting affected the written premium, unearned premium, claims paid, loss reserve and commission amounts.

5. Replacement and deletion of data upon VSC renewal

During the exam period it was found that original contract data records were replaced for VSCs that were renewed under the same contract number rather than an additional record being created under a new contract number. Such replacement of data records creates errors in the completeness and accuracy of premium, commission and reserve amounts. The Company has corrected this practice subsequent to the exam, but the errors remain within the file.

The majority of the FD misstatements noted above will not directly impact surplus due to the 100% quota share reinsurance agreements. However, figures within the Exhibits and Schedules of the Annual Statement are misleading and materially misstated. Adjustments related to XOL premium, claims and commission do affect surplus as the Company does not cede any of this business. The examination determined the following adjustments were needed.

Account		Debit		Credit
Adjustments in FD Data				
Ceded FD Premium	$	27,514,419		
Written FD Premium			$	27,514,419
Prepaid Reinsurance	$	12,336,213		
Unearned FD Premium			$	12,336,213
Ceding Commission Receivable (Receivable from Parent)	$	1,322,313		
Ceding Commission Written (Revenue/ Surplus)			$	1,322,313
Change in Unearned Ceding Fee (Surplus)	$	493,380		
Unearned Ceding Commission			$	493,380
FD Claim Paid Recoverable	$	6,361,360		
FD Claims Paid			$	6,361,360
IBNR Recoverable	$	136,841		
IBNR			$	136,841
Adjustments in XOL Data				
Written XOL Premium (Surplus)	$	978,890		
XOL Premium Receivable (Receivable from Parent)			$	978,890
Unearned XOL Premium	$	402,542		
Deferred Tax Asset			$	27,373
Change in Unearned Premium (Surplus)			$	375,169

Therefore,

It is recommended that the Company properly and accurately report premium, claim, commission and reserve amounts. This includes accurately reporting such amounts as either First Dollar or Excess of Loss in accordance with the policies in effect.

It is recommended that the Company ensure its data files are complete and accurate. A thorough and comprehensive review should be performed to determine that the data being utilized in the files is appropriate, accurate and complete.

It is recommended that the Company accurately calculate Excess of Loss premium amounts by utilizing premium rates as indicated in the Excess of Loss policy.

It is recommended that Company management perform a review over yearly financial statements and results to ensure and verify that the amounts reported are not materially inaccurate or misleading.

Due to the vast discrepancies in data provided, the examination notes the difficulties in obtaining valid, accurate and reliable information from the Company. While corrected information was utilized during the exam, results could vary materially if the data provided contains further errors not identified.

Therefore,

It is recommended that the Company provide complete and accurate records upon examination as required by 18 Del. C. §320 and 18 Del. Admin. Code 301 §15.

(Note 4) Provision for Reinsurance

Per the Company's Business Plan filed with the Department, "Premiums ceded to the reinsurers are held in a trust account naming MFIC as the beneficiary. Trust Agreements are in compliance with NAIC and state trust account requirements and provide MFIC with ultimate control over the funds. The reinsurance trust structure provides MFIC and MFIC regulators assurance that the assets backing the independent actuary's loss reserve recommendations will be adequately protected and will be available in the future to pay the AO's obligation to consumers….Loss reserve funds must be maintained in the reinsurance trust in accordance with their respective loss reserve schedules."

The Company takes a credit for reinsurance for all funds held in the LRF accounts maintained by the unauthorized, offshore PORCS under the 100% quota share reinsurance agreements.

Under 18 Del. C. §6911(c), a risk retention group may take credit or a reduction from liability for the reinsurance of risks or portions of risks ceded to reinsurers only in accordance with subchapter III of Chapter 9. 18 Del. C. §912 defines the requirements of the funds being held, including funds held in trust for the ceding insurer. 18 Del. Admin. Code §1003, paragraph 11 further details the required conditions of such trust agreements.

During the review of the funds recorded as credit for reinsurance, it was determined that a majority of the funds were held in accounts that were not under a trust agreement or were held in accounts under a trust agreement that did not contain all required terms as per 18 Del. Admin. Code §1003. Due to the lack of compliance, the funds cannot be accounted for as collateral, which increases the provision for reinsurance in a material amount. An increase in the provision for reinsurance is a direct reduction to unassigned funds (surplus). The exam calculated the increase to the Provision for Reinsurance to be approximately $17,171,000 which corresponds to a $17,171,000 reduction in surplus.

It was found that subsequent to the examination date, the Company began to move funds into compliant collateral arrangements. This greatly reduces the provision for reinsurance liability in subsequent years.

Therefore,

It is recommended that the Company follow its Business Plan which is filed with the Department and maintain the loss reserve funds in trust accounts which meet NAIC and Delaware trust account requirements or maintain collateral in such a manner as would be allowed as a reduction from liability for reinsurance ceded. Such requirements are outlined in 18 Del. Admin. Code §1003, paragraph 10 and include the provision that funds should be held under the exclusive control of the ceding insurer.

It is recommended that the Company update the language in the existing trust agreements so that all terms are in accordance with 18 Del. Admin. Code §1003.
It is recommended that the Company not take a credit for reinsurance for risks ceded that are not in accordance with 18 Del. C. Subchapter III of Chapter 9 and per 18 Del. Admin. Code §1003. It is then recommended that the Company properly calculate the provision for reinsurance.

The examination also found that the Company was including encumbered assets within the total collateral utilized as credit for reinsurance. The encumbered assets were due to MAC loaning funds to the PORC LRF account in order to cover claim payments for a particular period. These funds would be subsequently repaid. Encumbered funds cannot be utilized as a credit for reinsurance per Trust Agreement terms and per 18 Del. Admin. Code §1003.

Additionally, the examination determined that the Company reported funds as being maintained in the LRF accounts which were inaccurate.

Therefore,

It is recommended that the Company not take a credit for reinsurance relating to MAC infused funds held in the PORC collateral accounts per 18 Del. Admin. Code §1003 as such funds are encumbered.

It is recommended that the Company ensure amounts reported as being held in the loss reserve funds are accurate. The Company should ensure reconciliations are performed so that all Exhibits and Schedules in the Annual Statement are accurate.

(Note 5) Unearned Ceding Commission

The Company presented unearned ceding commission on the 2014 Annual Statement as a part of ceded reinsurance premiums payable. Ceded reinsurance premiums payable is to be net of ceding commissions receivable per the *NAIC Annual Statement Instructions,* not combined with unearned ceding commissions. Due to this reporting, the Company improperly included unearned ceding commission amounts within the reinsurance schedules of the Annual Statement.

The reclassification adjustment does not directly affect surplus. However, the inclusion of unearned ceding commission within the reinsurance schedules does affect the provision for reinsurance calculation which impacts surplus.

Therefore,

It is recommended that the Company properly report unearned ceding commissions on the balance sheet and properly report ceded balances payable on reinsurance schedules in the Annual Statement, as required by the NAIC *Annual Statement Instructions*.

(Note 6) Loss and Loss Adjustment Expenses

INS Consultants, Inc. (INS) was retained to perform a detailed review of the Appointed Actuary's Actuarial Report as of December 31, 2014 in support of the carried reserves. INS' conclusions were based on information presented in the 2014 Annual Statement, the Statement of Actuarial Opinion (SAO) with a supporting Actuarial Report, and the Actuarial Opinion Summary. MFIC's 2014 Appointed Actuary is Ryan D. Hartman, FCAS, MAAA of GPW Actuarial Services, Inc. (GPWAS).

Loss and loss adjustment expenses (LAE) reserves are a relatively small part of the liabilities for insurers of typical vehicle service contract programs. The main reasons for this are that claims are well defined, repairs are made quickly and costs are completely determined within a relatively short period of time. Unearned premium reserves (UEPR) are significantly larger than the loss and LAE reserves. This can be seen in MFIC's carried reserves as of December 31, 2014.

Gross loss & LAE reserve	$ 235,354
Net loss & LAE reserve	$ 35,000
Gross unearned premium reserve	$ 10,076,481
Net unearned premium reserve	$ 449,567

The GPWAS indicated gross and net loss and LAE reserves evaluated as of December 31, 2014 are as follows.

Gross loss & LAE reserve	$ 274,387
Net loss & LAE reserve	$ 35,000
Gross unearned premium reserve	$ 10,354,510
Net unearned premium reserve	$ 449,567

GPWAS developed estimates for the loss and LAE reserves and UEPR. Estimates are derived by AO, program, contract year, type (new vs. used cars), and policy term. Each member's programs were separately analyzed to determine liability for future claims and LRF deficits. Given the nature of VSC business, the UEPR is the significant liability on MFIC's balance sheet as compared to the loss and LAE reserves.

INS performed various calculations to check the work presented in the GPWAS Actuarial Report and found no exceptions. INS procedures consisted of reviewing the Appointed Actuary's Actuarial Report and verifying that the applied methodologies and factor selections were reasonable. INS did not perform any independent analyses. The results of INS' review of the methodologies indicated GPWAS utilized standard actuarial procedures and they were appropriate. For the factor review, the selections by GPWAS also appeared to be reasonable.

In summary, listed are INS' findings.

- INS finds the assumptions and methodology utilized to estimate IBNR loss and LAE reserves to be reasonable.
- INS finds the assumptions and methodology utilized to estimate UEPR to be reasonable.
- Given the nature of VSC business, the UEPR is the significant liability on MFIC's balance sheet as compared to the loss and LAE reserves.
- INS performed various calculations to check the work presented in the GPWAS Actuarial Report and found no exceptions.
- INS reviewed the data issues as noted per examination, but did not evaluate the materiality of the data problems. INS concluded that while there likely is no impact on net reserve amounts, gross reserves could be impacted by the use of incorrect data.

(Note 7) Differences in GAAP and Statutory Financial Statement Presentation

Under 18 Del. C. §6907, captive insurance companies are to utilize GAAP. However, the approved NAIC Annual Statement Blank presents the financials in a statutory format. As a result, there are certain GAAP related assets and liabilities that might be inconsistent with, or not specifically provided for, with the statutory principles utilized in the reported Annual Statement.

The largest differences affecting the Company's financial presentation is the reporting of unearned premiums, ceded unearned premiums, IBNR reserves and reinsurance recoverables.

Under GAAP accounting, ceded unearned premiums are classified as an asset and unearned premium as a separate liability. The P&C Annual Statement Blank requires that ceded unearned premiums be deducted from unearned premiums, presenting a net amount. At year-end 2014, ceded FD unearned premiums and FD unearned premiums were reported at $10,076,482. The examination determined the FD unearned premiums and ceded premiums were $22,412,695.

Additionally under GAAP accounting, reinsurance recoverable on unpaid losses is classified as an asset and loss reserves as a separate liability. The P&C Annual Statement Blank requires that reinsurance recoverable on unpaid losses be deducted from loss reserves, presenting a net amount. At year-end 2014 ceded FD reinsurance recoverable and IBNR loss reserves were reported to be $200,354. The examination determined that FD reinsurance recoverable and IBNR reserves were $337,195.

GAAP does not require a provision for reinsurance liability. However, the P&C Annual Statement Blank requires a Schedule F, Part 5 to be completed with a calculation of liability for such provision. In 2014, the Company reported a provision for reinsurance of $1,265. The examination determined this provision should be $17,171,000.

SUBSEQUENT EVENTS

Migration of Collateral Funds into Compliant Trust Accounts

In 2015, the Company began to move reinsurance collateral into compliant holdings. The Company amended the non-compliant trust agreement in late 2015 so that all requirements of 18 Del. Admin. Code §1003 paragraph 11 were met. The non-compliant trust agreement accounted for $10.8 million of the 2014 examination calculated provision for reinsurance.

The Company also began to move funds into cash and security accounts under a funds withheld arrangement in late 2015 and early 2016, whereby MFIC controls the funds and has sole withdrawal rights. The reinsurance agreements with the PORCs are being amended to grant and discuss the funds withheld arrangement, which is allowed under 18 Del. Admin. Code §1003 paragraph 13. Additionally, certain funds were moved into new accounts under compliant trust agreements during this time frame.

While the Company is still in the process of ensuring all reinsurance collateral funds are held in a manner compliant with 18 Del. Admin. Code §1003, the subsequent compliance drastically reduces the provision for reinsurance liability in 2015 and 2016.

Change in Captive Manager

The Captive Management Agreement with Wilmington Trust was terminated as of year-end 2015. While Wilmington Trust assisted in the completion of the 2015 Annual Statement as required by the contract, further services were not provided. The Company appointed Charles Caronia to fulfill the role as captive manager, who is a Delaware approved captive manager.

As the terminated Captive Management Agreement with Wilmington Trust included financial reporting preparation and accounting expertise, the Company entered into an agreement in 2016 with GPW and Associates, Inc. to provide those services.

Change in Chief Financial Officer

In 2016, Ellen Huegen was appointed as the Chief Financial Officer. This appointment follows the changes in the CFO position in 2014 and 2012. The Department has not been appropriately notified of all such appointments and changes.

Business Plan Updates

As previously discussed, the Department approved a Business Plan change for the Company in 2013 and 2014, whereby the Company was to transition to an XOL carrier for MAC, while the PORCs that currently reinsure MFIC were to replace it as first dollar insurers following their conversion to a SCIC of MDRe. This Plan was not executed as planned, and only 3 of the PORCs converted to SCICs, signing appropriate documents for the execution of such transactions.

In 2015, the Company reported a company action level risk based capital ratio. Thus, a new Business Plan was submitted to the Department in 2016 and is currently undergoing review.

SUMMARY OF RECOMMENDATIONS

Management and Control

It is recommended that the Company notify the Department of any changes in its executive officers in accordance with 18 Del. Admin. Code 302 §11.1.

Accounts and Records of Premium, Claim and Commission Amounts

It is recommended that the Company properly and accurately report premium, claim, commission and reserve amounts. This includes accurately reporting such amounts as either First Dollar or Excess of Loss in accordance with the policies in effect.

It is recommended that the Company properly report unearned ceding commissions on the balance sheet and properly report ceded balances payable on reinsurance schedules in the Annual Statement, as required by the NAIC *Annual Statement Instructions*.

It is recommended that the Company accurately calculate Excess of Loss premium amounts by utilizing premium rates as indicated in the Excess of Loss policy.

It is recommended that the Company ensure its data files are complete and accurate. A thorough and comprehensive review should be performed to determine that the data being utilized in the files is appropriate, accurate and complete.

It is recommended that Company management perform a review over yearly financial statements and results to ensure and verify that the amounts reported are not materially inaccurate or misleading.

It is recommended that the Company provide complete and accurate records upon examination as required by 18 Del. C. §320 and 18 Del. Admin. Code 301 §15.

Investments

It is recommended that the Company Comply with 18 Del. C. §1305 (1), 18 Del. C. §1308 (b)(2) and 18 Del. C. §1305 (3) (c) by modifying its investments or non-admitting amounts over allowable limits.

It is recommended that the Company utilize correct designations and ratings for its securities to ensure proper valuation and compliance with Delaware Code Chapter 13 limitations.

It is recommended that the Company properly value its preferred stock at fair value in accordance with ASC 320-10-35.

Reinsurance

It is recommended that the Company follow its Business Plan which is filed with the Department and maintain the loss reserve funds in trust accounts which meet NAIC and Delaware trust account requirements or maintain collateral in such a manner as would be allowed as a reduction from liability for reinsurance ceded. Such requirements are outlined in 18 Del. Admin. Code §1003, paragraph 10 and include the provision that funds should be held under the exclusive control of the ceding insurer.

It is recommended that the Company update the language in the existing trust agreements so that all terms are in accordance with 18 Del. Admin. Code §1003.

It is recommended that the Company not take a credit for reinsurance for risks ceded that are not in accordance with 18 Del. C. Subchapter III of Chapter 9 and per 18 Del. Admin. Code §1003. It is then recommended that the Company properly calculate the provision for reinsurance.

It is recommended that the Company not take a credit for reinsurance relating to MAC infused funds held in the PORC collateral accounts per 18 Del. Admin. Code §1003 as such funds are encumbered.

SIGNATURE PAGE

In addition to the undersigned, Michael W. Morro, ACAS, MAAA, Actuary with INS Consultants, Inc. and James Call, CFE, Delaware Supervising Examiner participated in the examination.

Respectfully submitted,

Bethaney E Ryals

Bethaney Ryals, CFE, ACI
Examiner-In-Charge
State of Delaware