

# EXHIBIT A



**STATE OF TENNESSEE**  
**DEPARTMENT OF COMMERCE AND INSURANCE**

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**REPORT ON EXAMINATION**  
**OF**  
**DIRECT INSURANCE COMPANY**

**(NAIC # 37220)**  
**(NAIC Group # 1213)**

**NASHVILLE, TENNESSEE**

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**AS OF**  
**DECEMBER 31, 2015**

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Nashville, Tennessee  
May 17, 2017

Honorable Julie Mix McPeak  
Commissioner  
Tennessee Department of Commerce and Insurance  
500 James Robertson Parkway  
Nashville, Tennessee 37243

Dear Commissioner:

Pursuant to your instructions and in accordance with the Tennessee Code Annotated (“Tenn. Code Ann.”) § 56-1-408, regulations, and resolutions adopted by the National Association of Insurance Commissioners (NAIC), a full-scope financial examination and market conduct review as of December 31, 2015, has been made of the conditions and affairs of:

**DIRECT INSURANCE COMPANY**  
NAIC # 37220  
NAIC Group # 1213  
1281 Murfreesboro Pike # 150  
Nashville, Tennessee 37217

hereinafter generally referred to as the “Company” or “DIC” and a report thereon is submitted as follows:

## **INTRODUCTION**

This examination was arranged by the Tennessee Department of Commerce and Insurance (TDCI or “Department”) under rules promulgated by the NAIC. The examination commenced on July 11, 2016, and was conducted by duly authorized representatives of the TDCI. This examination was called through the NAIC’s Financial Examination Electronic Tracking System (FEETS). The examination of the Company was conducted as part of a coordinated examination with Direct General Insurance Company (Indiana), Direct National Insurance Company (Arkansas), Direct General Life Insurance Company (South Carolina), Direct General Insurance Company of Mississippi (Mississippi), and Direct General Insurance Company of Louisiana (Louisiana). Further description of the coordination effort between the states is discussed below under the heading “Scope of Examination.”

## SCOPE OF EXAMINATION

The last examination of the Company was made as of December 31, 2010. This examination covers the period from January 1, 2011, through December 31, 2015, and includes any material transactions and/or events occurring subsequent to the examination date which were noted during the course of examination.

The Company is part of the Direct General Insurance Group, with the State of Indiana as the group's lead state. A coordinated examination of the group was performed as of December 31, 2015, and led by the State of Indiana. There were no examination sub-groups. Other participating states were Arkansas, Louisiana, Mississippi, and South Carolina.

The examination was conducted in accordance with rules and procedures as prescribed by the statutes of the State of Tennessee, and in accordance with the NAIC *Financial Condition Examiners Handbook* ("Handbook"), as deemed appropriate. The examination was planned and performed to evaluate the financial condition of the Company, as of December 31, 2015. The examination sought to identify prospective risks by obtaining information about the Company, including its corporate governance, by identifying and assessing inherent risks within the Company, and by evaluating system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with statutory accounting principles and annual statement instructions.

During planning, all accounts and balances were considered to determine which key activities and accounts would be examined. The key activities included: Investments; Pricing/Underwriting; Reserving/Claims; Reinsurance Ceded; Related Party; and Capital and Surplus.

The Company's 2015 annual statement was compared with or reconciled to the corresponding general ledger account balances.

An examination of the Company's information technology general controls (ITGC) was conducted. The examination included a review of management and organizational controls, logical and physical security controls, system and program development controls, contingency planning controls, service provider controls, operations controls, processing controls, e-commerce controls, and network and internet controls.

A separate market conduct review was performed concurrently with the financial examination.

The Company's ultimate controlling parent, Elara Holdings, Inc., maintains an Internal Audit (IA) Department, which is charged with performing the IA function for all companies within the holding company system. IA activities focus on operational reviews with an emphasis on controls and compliance. The examiners reviewed the processes tested and requested the workpapers for specific processes which had been identified as significant to the key activities and sub-activities being examined. The workpapers were provided and were utilized, where appropriate.

The actuarial firm of Merlinos & Associates, Inc. was utilized in the examination review of the Company's loss reserves.

Ernst & Young, LLP (EY) was the Company's Certified Public Accountant (CPA) and independent auditor for the Company for all years under examination. The CPA's workpapers were reviewed for the 2015 audit and copies were incorporated into the examination, as deemed appropriate.

The Company provided a letter of representation certifying that management has disclosed all significant matters and records.

## **COMPLIANCE WITH PREVIOUS EXAMINATION FINDINGS**

The examination included a review to determine the current status of the comments and recommendations included in the previous report on examination, dated February 10, 2012, which covered the period from January 1, 2006, through December 31, 2010. The previous full-scope examination report as of December 31, 2010, contained one (1) comment and two (2) recommendations. It was determined that the Company has complied with all of the recommendations addressed in the prior examination report. Below is a description of the prior examination report's recommendations:

### **Previous Comment – IT User Access Modification:**

The Company's auditing firm, Ernst & Young, LLP, identified during their audit that no formal process for the transfer or modification of user access is in place. Managers notify System Administrators to add/remove/change access when a user transfers. Documentation around the modification was not retained.

A formal process for the transfer or modification of user access should be adopted and documentation should be retained for periodic review. The Company's IT Department should be involved in the development of the process so that proper security measures can be developed. Periodic review should be performed by business unit management and IT.

**Previous Recommendation – Reporting of Advance Premium:**

The Company is not properly reporting advance premiums in accordance with SSAP No. 53. The amounts are credited to a suspense account and offset against uncollected premiums. The amounts should be reported separately on the appropriate line item for advance premium.

It is recommended that the Company comply with SSAP No. 53 and Tenn. Code Ann. § 56-1-501(g) when completing the Annual Statement.

**Previous Recommendation – Cost Allocation Agreement:**

The Company's cost allocation agreement does not contain a specified due date for account settlements. In accordance with SSAP No. 96, transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be non-admitted. If a due date is not addressed by the written agreement, any uncollected receivable is non-admitted.

It is recommended that the Company amend the intercompany agreement to include a specified due date to comply with SSAP No. 96.

## **COMPANY HISTORY**

The Company was originally incorporated on November 8, 1990. The Charter of Incorporation was filed with the Tennessee Secretary of State (SOS) on April 10, 1991, and the TDCI issued a Certificate of Authority on April 11, 1991, which licensed the Company as a stock property and casualty insurer. The Company commenced business on April 12, 1991, as Direct Insurance Company.

At incorporation, the Company was authorized to issue forty thousand (40,000) shares of common capital stock with a par value of \$100 per share. Eleven thousand (11,000) shares were issued and outstanding at April 10, 1991. From that date through 1994, the Company continued to issue additional shares to various individuals, trusts and business entities until December 2, 1994, when all sixteen thousand, seven hundred ninety-four and one-half (16,794.5) outstanding shares were acquired by Direct Corporation, which was the name stated on the stock certificate. In 1996, the Company's parent company changed its name from Direct Corporation to Direct General Corporation (DGC). Effective December 31, 1996, the par value of the Company's stock was increased to \$150 per share. In the December 31, 1997, examination report, it was recommended that the name on the stock certificate be

amended to reflect the parent's correct name. On March 14, 2000, the aforementioned stock certificate was replaced with a new certificate to reflect the correct corporate name.

The Company writes non-standard private passenger automobile insurance in Tennessee and Arkansas. As of 2006, the Company ceased writing new business in Arkansas while continuing to renew existing customers. Affiliated insurance agencies sell the Company's products directly through neighborhood sales offices. The Company's products are also available for sale by phone and the internet. In 2007, the Company began writing hail crop and multi-peril crop insurance through NAU Country Insurance Company (NCIC), an unaffiliated company, under a managing general agent contract. This business was ceded one hundred percent (100%) to NCIC and was discontinued in 2009.

On December 17, 1998, the Company increased its surplus by \$2,000,000 to \$11,823,125, in the form of gross paid in and contributed surplus.

On March 31, 2007, Elara Holdings, Inc. acquired all of DGC's outstanding stock, the parent of the Company.

DIC's principal place of business and their books and records are located at its main office in Nashville, Tennessee.

## MANAGEMENT AND CONTROL

### MANAGEMENT

#### Directors

Management of the Company is vested in a Board of Directors ("Board") that is elected annually by the shareholder. The Board must consist of no less than two (2) nor more than twelve (12) directors, with the exact number to be fixed by the Board from time to time. Directors serve until the next annual meeting of the shareholders, and thereafter, until a successor has been elected.

The following persons were serving as directors of the Board, at December 31, 2015:

<u>Name</u>	<u>Principal Occupation</u>
John W. Mullen	Chairman, President and CEO
John F. Campbell	Executive Vice President and COO
John T. Hagely	Executive Vice President and CFO

## **Officers**

The Bylaws state that the Board will elect officers of the Company, which must include a Chairman, a Chief Executive Officer (CEO), a President, and a Secretary. The Company may also have one or more Vice-Presidents, a Treasurer, one or more assistant Secretaries, one or more assistant Treasurers, and such other officers as the Board shall from time to time deem necessary. Any two or more offices may be held by the same person, except the offices of President and Secretary. In addition, the Board designates either the Chairman or the President to be the CEO of the Company.

In accordance with the Company's Bylaws, the following officers were duly elected by the Board and served as officers of the Company, as of December 31, 2015:

<b><u>Name</u></b>	<b><u>Title</u></b>
John W. Mullen	Chairman, President and CEO
John F. Campbell	Executive Vice President and COO
John T. Hagely	Executive Vice President and CFO
Sharon K. Roberson	Senior Vice President, General Counsel & Secretary
Austin Bonn	Senior Vice President Store Sales Channel
Ann L. Davids	Senior Vice President and Chief Marketing Officer
Greg Hayes	Senior Vice President of Finance
Peter Hansen	Senior Vice President and Chief Claims Officer
William H. Smith, III	Senior Vice President Human Resources
Jonathan Walters	Senior Vice President and Chief Information Officer
Jeff Bankston	Vice President Program Management
Randy Chetko	Vice President Application Development
Marc DiGiacomo	Vice President Product Management
Kenneth Hampton	Vice President Operations and Customer Experience
Brian Hanrahan	Vice President Actuarial Group
Josh Jarrett	Vice President Product Management
Mike Neal	Vice President Audit and Casualty
Jose Rivas	Vice President Claims
Jobie G. Williams	Vice President and Treasurer
Constance A. Collins	Assistant Secretary
Robin Davis	Assistant Secretary
Kelly Gray	Assistant Secretary
Nicole James	Assistant Secretary

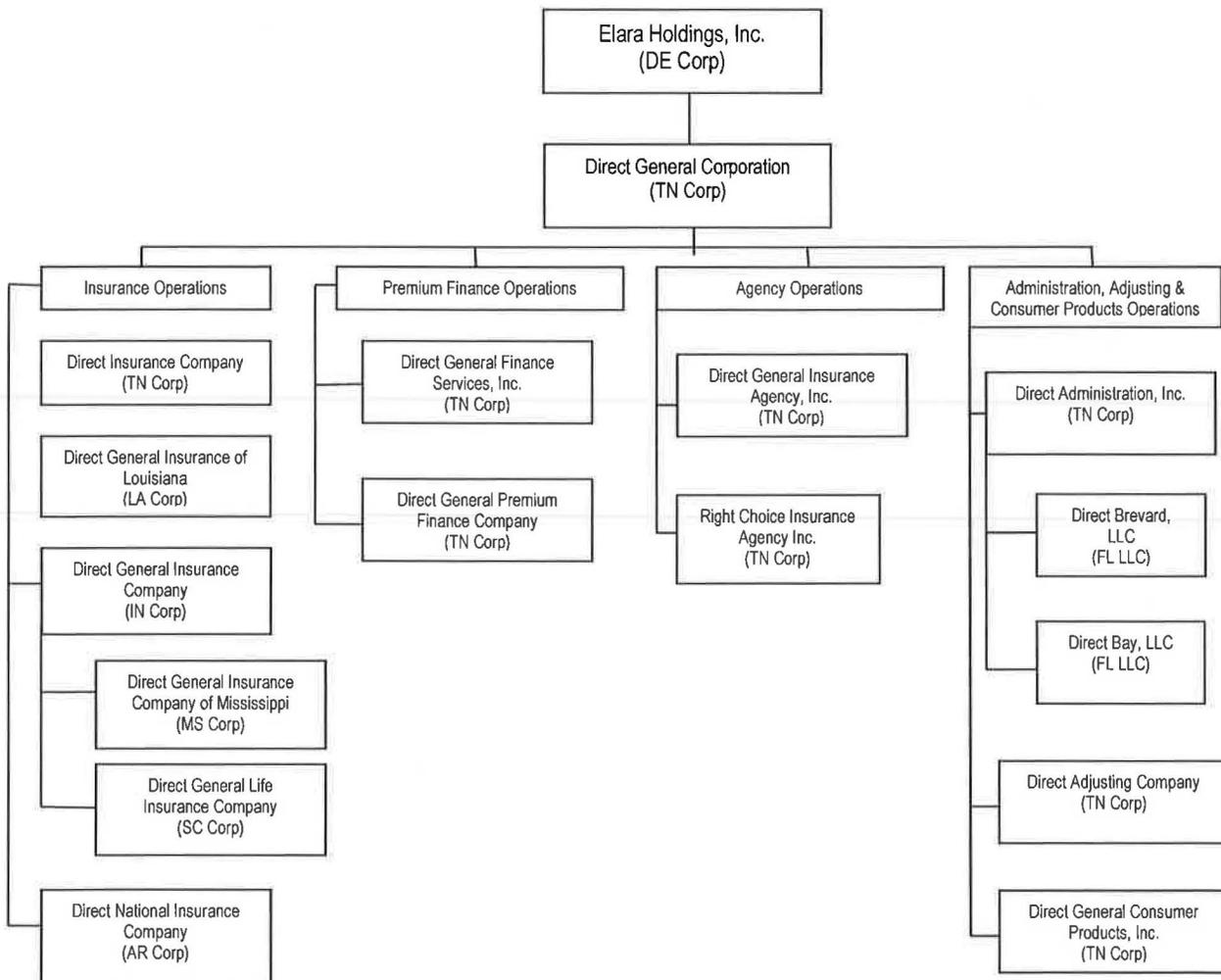
The Bylaws allow the directors to create one or more committees that may consist of a single member. The Bylaws state that all committees so created shall have such powers as the Board may delegate to such committee.

Investment transactions for the period under review were approved by the Board from quarterly reports of aggregate investment transactions.

**CONTROL**

At December 31, 2015, one hundred percent (100%) of the outstanding shares of the Company were owned by DGC. DGC, in turn, is wholly-owned by Elara Holdings, Inc., a Delaware corporation. Elara Holdings, Inc. was incorporated for the purpose of serving as the ultimate parent for the holding company system. The Elara Holdings, Inc., holding company system consists of one (1) subsidiary holding company, five (5) property/casualty insurers, one (1) life insurance company, two (2) premium finance companies, two (2) insurance agencies, one (1) administrative service company, one (1) adjusting company, and (1) one company that provides non-insurance consumer products and services.

**ORGANIZATIONAL CHART**



## **CONFLICTS OF INTEREST AND PECUNIARY INTERESTS**

The Company's parent, DGC, has a written policy on Business Conduct and Code of Ethics. According to this policy, directors, officers, and certain employees are required to complete a Policy on Business Conduct Annual Questionnaire. This questionnaire is used for all entities within the holding company system. Persons required to complete the certificate sign only one form regardless of the number of positions held throughout the group of companies. According to the policy, potential conflicts of interests, as discovered or reported, are submitted through complete disclosure of facts to the General Counsel. If the General Counsel determines a conflict exists, the transaction or situation should be submitted to an ad hoc committee of one or more senior officers designated by the CEO. Dependent upon the level of severity, recommended resolutions of potential conflicts must be approved by the Chairman of the Audit Committee, or upon recommendation of the Chairman, by the Board of the Company.

The questionnaires completed by management during the period under examination were reviewed, and no exceptions were noted.

## **DIVIDENDS**

In October 2014, the Company paid its sole shareholder an ordinary dividend in the amount of \$2.5 million. The Company reported the dividend declaration in accordance with TENN. CODE ANN. §56-11-205(e), which was accepted by the TDCI by letter dated October 10, 2014.

## **CORPORATE RECORDS**

The minutes of meetings of the Company's shareholders, Board, and committees were reviewed for the period under examination. The minutes were complete as to necessary detail and appeared to reflect adequately the acts of the respective bodies. The review of the minutes indicated that all investment transactions were approved by the Board.

## **Charter**

The original Charter of the Company was approved by the TDCI and became effective April 10, 1991. An Articles of Amendment was filed with the SOS on December 31, 1996, increasing the authorized stock par value. On April 1, 1997, an Articles of Amendment was filed with the SOS changing the statutory address and registered agent. An amended and restated Charter was filed with the SOS on July 3, 2000. Subsequently, the Charter was amended and restated, and approved by the TDCI on June 17, 2003. The amended and restated Charter was effective upon filing with the SOS on June 26, 2003.

The Company's Charter states the Board shall have the power to fill any vacancies to the Board until the next annual meeting of the stockholders. The Charter also gives the Board the power to elect all officers, to discharge officers, with or without cause, and such other powers as may be prescribed from time to time in the Company's Bylaws.

In addition to the above, the Company's Charter recites other general and specific powers in detail. They are usual in nature and consistent with statute.

### **Bylaws**

The Company's Bylaws were most recently amended on December 14, 2010. The Bylaws provide for an annual shareholders' meeting at which a Board is elected. The Bylaws call for the Board to designate a Chairman. Officers are elected by the Board annually at the first Board meeting after the annual shareholders meeting.

The current Bylaws are such as generally found in corporations of this type and contain no unusual provisions. They provide for the regulation of the business and for the conduct of the affairs of the Company.

## **AGREEMENTS WITH PARENT, SUBSIDIARIES, AND AFFILIATES**

The Company is a member of an insurance holding company system, as defined by Tenn. Code Ann. §§ 56-11-101, *et seq.* "Insurance Company Holding Act of 1986". The Company files a Holding Company Registration Statement annually, as required by Tenn. Code Ann. § 56-11-105. The required Forms B and C were filed on a timely basis. See "Comments and Recommendations" section later in this report.

The Company is a subsidiary of DGC, which owns one hundred percent (100%) of the Company's stock. DGC is one hundred percent (100%) owned by Elara Holdings, Inc. An organizational chart is in the "Control" section of this report.

### **Direct General Companies Intercompany Services and Cost Allocation Agreement (amended)**

On May 22, 2000, the TDCI approved the Direct General Companies Intercompany Services and Cost Allocation Agreement ("Cost Allocation Agreement") between the Company and its parent, DGC, and affiliated companies, whereby the entities share the costs of certain administrative, personnel, legal, accounting, tax, information systems, strategic planning, and other shared services. This agreement was in effect for the majority of the period under examination. On March 26, 2015, the Company filed an amendment to the agreement to incorporate the allocation of services and the updating of certain entities' legal names. The amended agreement was not disapproved by TDCI

and was deemed approved on April 26, 2015. Essentially, DGC, Direct Administration, Inc. (DAI), and Direct Adjusting Company, Inc. (DACI), provide these services to the Company and its affiliated insurers. The "other shared services" provided include appraisal, claims adjusting, claims payment, and other claims-related services.

As payment for these services, DGC, DAI, and DACI may "charge reasonable fees at arm's length rates based upon the allocation of the costs incurred in providing services pursuant to this Agreement." Written itemized invoices are submitted to the Company "periodically, but no less frequently than at the end of each calendar quarter" for payment. See "Comments and Recommendations" section later in this report. The Cost Allocation Agreement was amended and restated effective December 22, 2011, as well as amended by Amendment No. 1, dated as of May 15, 2014. The amended and restated agreement and Amendment no.1 were reported to the TDCI under Form D dated January 12, 2012, and March 26, 2015, respectively.

### **Premium Finance Settlement Agreement**

On August 28, 2006, the TDCI approved a Premium Finance Settlement Agreement between the Company and its affiliated premium finance companies (collectively, the "Direct Finance Companies"). The affiliated premium finance companies included, but were not limited to, Direct General Financial Insurance Services, Inc. and Direct General Premium Finance Company, both Tennessee corporations. Under this agreement, Direct Finance Companies' obligations to the Company are "in the nature of an account current settlement on an agency account" and consist of premiums that the Direct Finance Companies are obligated to remit to the Company. The Company's obligation to the Direct Finance Companies consists of refund premiums arising out of cancellations of insurance policies financed by the Direct Finance Companies for the Company's insureds. The agreement states that these obligations shall be offset against each other and the net settlement amount settled not less frequently than once a month. See "Comments and Recommendations" section later in this report.

### **Producer Agreements**

The Company was party to producer agreements with its affiliated insurance agencies, Direct General Insurance Agency, Inc. (DGIA) and Right Choice Insurance Agency, Inc. (RCIA). Through these agreements, the agencies performed various functions related to the solicitation and issuance of insurance policies on behalf of the Company and received commission amounts of up to fifteen percent (15%) of net written premiums as payment for services rendered. See "Comments and Recommendations" section later in this report.

On March 19, 2004, the TDCI approved the Producer Agreement between the Company and its affiliate, DGIA, a Tennessee corporation. The agreement grants the

independent agents certain authority in the binding and issuance of policies. Agents are authorized to collect, receive, and record premiums. Tennessee is the designated territory, and personal automobile is the class of insurance for which the agents are authorized to exercise the granted authority. DGIA handles sales through the Tennessee sales offices. An updated Producer Agreement updating the terms of agreement between DIC and DGIA was filed with TDCI on March 26, 2015, which was not disapproved and deemed approved on April 26, 2015.

The agreement may be revised by the Company by giving thirty (30) days' written notice to the agent. The agreement may be revised by mutual consent of the Company and the agent. The agreement may be terminated by either party by giving to the other written notice not less than thirty (30) days prior to such effective date of termination.

The Company has a Producer Agreement with affiliate RCIA, a Tennessee corporation, effective on November 1, 2005, and later amended on May 1, 2014. The TDCI approved the agreement on December 1, 2005. The agreement governs the property and casualty products that are produced for the Company by RCIA through telemarketing and internet sales.

The producer agreements are settled using the same allocation process as the Cost Allocation Agreement. The Company has no producer accounts outstanding as of December 31, 2015.

### **Tax Allocation Agreement**

Effective September 10, 1996, the Company became a party to a tax allocation agreement by and among DGC and its subsidiaries. The agreement applies to the taxable year ending December 31, 1995 and all subsequent periods. Under this agreement, DGC shall file a U.S. consolidated income tax return on behalf of the members of the holding company system. Payments shall be made to DGC by the subsidiaries within ten (10) days of receiving notice of such payment from DGC, and DGC shall return excess payments to the subsidiaries within ten (10) days after the date of filing of the consolidated return for such period.

A supplement to this agreement was made effective on November 9, 2000. Its purpose was to add new subsidiaries to the affiliated group, as defined in Internal Revenue Code Section 1504(a), and to provide for the addition of subsidiaries in the future. The agreement was amended and restated in 2012, as well as amended by Amendment No.1, as of May 1, 2014. These amendments were reported to the TDCI under Form D dated February 13, 2012, and March 26, 2015, respectively.

## FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured under certain insurance policies being carried by its parent, DGC. The following types of coverage were provided to the Company through various bonds and insurance policies as of December 31, 2015:

Fidelity Bond	General Liability
Fiduciary	Directors and Officers Liability
Automobile Liability	Errors & Omissions
E&O Professional Liability	Workers Compensation Liability
Commercial Property	Umbrella Liability

Minimum fidelity coverage suggested in the NAIC Handbook for an insurer of the Company's size and premium volume is \$500,000 to \$600,000. The Company had fidelity coverage that exceeded the minimum suggested coverage. Each policy was issued by an insurance company authorized to transact business in Tennessee.

## EMPLOYEE BENEFITS AND PENSION PLANS

The Company has no employees. All business functions are performed for the Company by DGC or an affiliate through the cost allocation agreement. Retirement and insurance benefits are provided through the cost allocation agreement.

## TERRITORY AND PLAN OF OPERATION

### TERRITORY

The Company is licensed to transact the business of property and casualty insurance in the states of Tennessee and South Carolina, and is licensed to transact property, casualty (excluding workers' compensation) and marine insurance in the state of Arkansas. Certificates of Authority for each jurisdiction were reviewed and found to be valid.

The following table shows the premiums by state for the year ending December 31, 2015, as reported in Schedule T of the Company's Annual Statement.

### SCHEDULE T – PREMIUMS AND SERVICE CHARGES

<u>State or District</u>	<u>Direct Premiums Written</u>	<u>Finance and Service Charges Not Included in Premiums</u>
Arkansas	\$505,316	\$49,725
Tennessee	<u>63,901,852</u>	<u>4,504,143</u>
<b>TOTALS</b>	<u>\$64,407,168</u>	<u>\$4,553,868</u>

## PLAN OF OPERATIONS

The Company writes non-standard private passenger automobile insurance in Tennessee and Arkansas. Affiliated insurance agencies sell the Company's products directly through neighborhood sales offices. See "Comments and Recommendations" section later in this report. Additionally, the Company uses internet and telemarketing through an affiliate to produce business. During the period under examination, the Company transitioned the majority of its policies sold from financing by an affiliated premium finance company to installment billing by the Company.

## **GROWTH OF COMPANY**

The following exhibit depicts certain aspects of the growth and financial history of the Company for the period subject to this examination, according to its annual statements as filed with the TDCI:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>	<u>Gross Premiums Written</u>
2015	\$80,449,630	\$55,462,491	\$24,987,139	\$64,407,168
2014	\$73,593,252	\$48,834,210	\$24,759,042	\$57,551,059
2013	\$73,475,884	\$48,553,629	\$24,922,255	\$54,709,802
2012	\$68,354,381	\$47,669,736	\$20,684,645	\$51,129,412
2011	\$64,848,191	\$47,433,422	\$17,414,769	\$49,149,826

## **LOSS EXPERIENCE**

The loss ratios on the Company's property and liability business for the years indicated were as follows:

<u>Auto Liability</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net incurred claims	\$27,635,819	\$21,179,345	\$18,396,039	\$24,082,163	\$23,088,534
Net premiums earned	\$39,985,059	\$36,201,265	\$35,028,812	\$34,117,548	\$33,732,179
Loss experience ratio	69.1%	58.5%	52.5%	70.6%	68.4%

<b><u>Auto Physical</u></b>					
<b><u>Damage</u></b>	<b><u>2015</u></b>	<b><u>2014</u></b>	<b><u>2013</u></b>	<b><u>2012</u></b>	<b><u>2011</u></b>
Net incurred claims	\$13,770,934	\$9,811,207	\$9,862,965	\$10,010,199	\$11,585,771
Net premiums earned	\$21,347,513	\$19,031,044	\$17,572,686	\$16,229,105	\$16,832,772
Loss experience ratio	64.5%	51.6%	56.1%	61.7%	68.8%

## **REINSURANCE AGREEMENTS**

### **Reinsurance Assumed**

The Company does not assume any business.

### **Reinsurance Ceded**

The primary intent of the Company's reinsurance agreements is to manage the Company's overall exposure to loss at or below the capacity of its capital resources.

The Company maintained joint reinsurance agreements with all property and casualty members of the Direct General Group. Effective January 1, 2015, the Company entered into a property catastrophic excess loss reinsurance treaty that provides a limit of \$8 million of coverage in excess of \$2 million retention on gross losses and the co-participation is five percent (5%). The treaty covers in force, new, and renewed private passenger automobile physical damage business with the maximum value per vehicle covered of \$75,000.

The major reinsurers and their percentage participation for 2015 are summarized below:

Endurance Specialty Insurance Ltd.	30.0%
QBE Reinsurance Corporation	15.0%
R V Versicherung AG	7.5%
XL Re Ltd.	10.0%
Lloyd's Underwriter Syndicate No. 2001 (AML)	13.5%
Lloyd's Underwriter Syndicate No. 2010 (MMX)	9.0%
Lloyd's Underwriter No. 2987 (BRT)	15.0%

The reinsurance agreements were found to contain acceptable clauses for insolvency and arbitration. The Company's reinsurance agreements appear to transfer risk in accordance with Statement of Statutory Accounting Principles (SSAP) No. 62 and NAIC guidelines.

## LITIGATION AND CONTINGENT LIABILITIES

From the examination data made available, it appears that the only matters of law in which the Company was involved during the period under review were those arising in the normal course of business. The outcomes of such actions are not expected to have a material effect on the financial position of the Company.

## STATUTORY DEPOSITS

In compliance with statutory and other requirements, the Company maintained deposits with the jurisdictions or custodians named below, as of December 31, 2015.

The following are deposits with states where special deposits are for the benefit of all policyholders, claimants, and creditors of the Company:

<u>Jurisdiction</u>	<u>Book/Adjusted Carrying Value</u>	<u>Fair Value</u>
Tennessee – Department of Insurance	\$1,886,091	\$1,939,050
Subtotal	<u>\$1,886,091</u>	<u>\$1,939,050</u>

The following are deposits with jurisdictions where special deposits are not for the benefit of all policyholders, claimants, and creditors of the Company:

<u>Jurisdiction</u>	<u>Book/Adjusted Carrying Value</u>	<u>Fair Value</u>
Arkansas – Department of Insurance	\$399,778	\$400,860
Subtotal	<u>399,778</u>	<u>400,860</u>
<b>Grand Total</b>	<u><b>\$2,285,869</b></u>	<u><b>\$2,339,910</b></u>

Deposits with all jurisdictions or custodians, above, were verified by direct correspondence with the custodians of such deposits.

## ACCOUNTS AND RECORDS

Tenn. Comp. R. & Regs. 0780-01-65-.08(4) states that no partner or other person responsible for rendering a report by a certified public accounting firm may act in that capacity for more than five (5) consecutive years. The Company is audited annually by Ernst & Young, LLP (EY) and is in compliance with this regulation.

During the course of the examination, certain balances were tested and amounts were traced from the Company's trial balance to the annual statement. All of the Company's

investment securities were confirmed with the custodian of such securities as of the date of this examination. All annual statements for the period under examination were reviewed for completeness and adequacy of disclosure. The Company's risk-based capital filings were reviewed. These test checks and reviews revealed no material discrepancies.

The Company's books and records are located in Nashville, Tennessee.

## **MARKET CONDUCT ACTIVITIES**

A market conduct review was made of the Company, as of December 31, 2015, in conjunction with this examination. There were no significant findings or recommendations resulting from the market conduct review. The following market conduct areas were reviewed:

### **Operations and Management Standards**

The Company maintains a written privacy statement. It is supplied to its policyholders annually in compliance with Tenn. Comp. R. & Regs. 0780-1-72-.06.

### **Complaint Handling Standards**

The Company maintains a log for complaints that have been received from insureds, complainants, or other interested third parties such as the Better Business Bureau or attorneys. Inquiries made to consumer services and a review of complaints indicated no regulatory concerns related to complaint handling during the examination period.

### **Marketing and Sales Standards**

The Company has an advertising program that includes television, radio, billboards, printed flyers, and the internet. Advertising materials were reviewed with no material exceptions noted.

A sample of one hundred twenty (120) policy applications and files was reviewed to verify material documents were maintained as required. Of those one hundred twenty (120), an original signature was not verifiable on three (3) applications. Of those three (3), two (2) had original signatures verified on their renewal application, while the third did not renew and had no claims associated with the policy for the year.

### **Producer Licensing Standards**

The Company primarily writes business through agents who are employees of the holding company with only a small percentage of agents who are independent of the

holding company. As noted earlier in this report, the Company has no employees and producer activities for the Company are performed under related party agreements.

Agent licensing records were selected for review during the examination. All selected agents were verified as being appropriately licensed by the state.

### **Underwriting and Rating Standards**

The Company writes non-standard automobile insurance that generally provides basic limits coverage as follows:

- Bodily Injury: \$25,000 per person/\$50,000 per occurrence
- Property Damage: \$25,000
- Additional limits: \$50,000/\$100,000 and \$100,000/\$300,000 for bodily injury and \$50,000/\$100,000 for property damage, and uninsured/underinsured motorist coverage are available, as are various endorsements, such as towing, rental car coverage and accidental death benefits. Discounts are given for renewals, prior insurance, multi-car policies, homeownership and senior citizens.

The current rates and policy forms were duly filed with and approved by the TDCI.

### **Claims Review**

A sample of claims reviewed during the examination indicated that claims were paid in accordance with policy provisions and settlements were promptly made upon receipt of proper evidence of the Company's liability.

## **SUBSEQUENT EVENTS**

There were events subsequent to the examination date and prior to the completion of field work that were considered material events requiring disclosure in this report.

### **National General Holdings Corp. Acquisition**

On November 1, 2016, National General Holdings Corp. (NGHC) completed its acquisition of Elara and DGC. This included all subsidiaries in the Elara Holdings, Inc. Group. NGHC is a Delaware Corporation and its principal executive offices are located at 59 Maiden Lane, 38th Floor, New York, New York 10038. It is a specialty personal lines insurance holding company and has a financial strength rating of A- (excellent) from A.M. Best. This acquisition adds a direct marketing distribution channel to NGHC's core non-standard auto business and expands its presence in this product market in the southeast.

On or about November 1, 2016, each board of directors of the insurance entities within the Direct General Group was replaced by directors appointed by NGHC, with the exception of Gregory L. Thomas, the Indiana resident director for Direct General Insurance Company. Except for certain changes in executive management, there are no anticipated changes to the existing business plan.

### **Reinsurance Agreement**

Effective January 1, 2017, the five (5) property & casualty company subsidiaries of DGC (“Ceding Companies”) entered into a Reinsurance Agreement with Integon National Insurance Company (“Integon National”) and National General Management Corp. The Ceding Companies cede and transfer to Integon National, which reinsures and assumes as its own obligation, one hundred percent (100%) of the Ceding Companies’ respective in force business as of, and subsequent to, the effective date.

### **Management Services Agreement**

Effective November 1, 2016, the six (6) insurance company subsidiaries of DGC (“Companies”) entered into a Management Services Agreement with National General Management Corp. (“Administrator”). The Administrator will provide certain underwriting duties, claims services, actuarial services, policyholder services, accounting, information technology, and certain other administrative functions. The Administrator acts as underwriting manager for the Companies, in particular, to underwrite, rate, quote, bind, accept, and reject insurance risks. The compensation for providing the services is based upon actual cost without a profit factor built into that cost. Indirect and shared expenses are allocated in accordance with a method of cost allocation in conformity with SSAP No. 70.

### **Tax Allocation Agreement**

Effective November 1, 2016, the six (6) insurance company subsidiaries of DGC entered into a consolidated tax allocation agreement with NGHC. Each company’s liability for all tax payments or entitlements to federal, state or local tax refunds is based upon the amount of its tax liability or entitlement to a refund as calculated on a separate return basis and recorded accordingly in the corresponding period.

### **Asset Management Agreement**

Effective November 1, 2016, the six (6) insurance company subsidiaries of DGC entered into an Asset Management Agreement with All Insurance Management Limited (AIM), a Bermuda corporation. AIM performs investment management services on behalf of each company in accordance with each company’s Investment Guidelines.

### **Custodial Agreement**

Effective December 16, 2016, the Company entered into a custodial agreement with JPMorgan Chase Bank, N.A. The custodial agreement includes an Accounting Services Rider effective on the same date. The custodial agreement and rider were reviewed and found to be in compliance with Tenn. Comp. R. & Regs. 0780-01-46, which governs custodial agreements and the use of clearing corporations. On January 27, 2017, the Company transferred its assets from U.S. National Bank to JP Morgan Chase Bank, N.A.

## FINANCIAL STATEMENTS

There follows a statement of assets, liabilities, and a summary of operations as of December 31, 2015, together with a reconciliation of capital and surplus for the period under review, as reported by the Company in its 2015 Annual Statement.

	<u>Assets</u>	<u>Non-Admitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$33,331,384		\$33,331,384
Common stocks	3,806,080		3,806,080
Real estate:			
Properties occupied by company	121,116		121,116
Cash and short-term investments	5,632,571		5,632,571
Receivables for securities	293		293
Investment income due or accrued	299,225		299,225
Premiums and considerations:			
Uncollected premiums and agents balances in the course of collection	5,127,703		5,127,703
Deferred premiums not yet due	29,091,045		29,091,045
Net deferred tax asset	2,985,404	\$141,625	2,843,779
Receivables from parent and affiliates	<u>196,434</u>	<u>          </u>	<u>196,434</u>
<b>Totals</b>	<u>\$80,591,255</u>	<u>\$141,625</u>	<u>\$80,449,630</u>

**LIABILITIES, SURPLUS, AND OTHER FUNDS**

Losses		\$18,789,306
Reinsurance payable on paid losses and loss		(828)
Loss adjustment expenses		651,707
Commissions payable		69,908
Other expenses		109,493
Taxes, licenses, and fees		147,750
Current federal income taxes		57,553
Unearned premiums		32,049,657
Advance premium		89,414
Ceded reinsurance premiums payable		6,043
Remittances and items not allocated		7,664
Payable to parent, subsidiaries, and affiliates		1,380,218
Payable for securities		<u>2,104,606</u>
Total Liabilities		\$55,462,491
Common capital stock	\$2,519,175	
Gross paid in and contributed surplus	11,823,125	
Unassigned funds (surplus)	<u>10,644,839</u>	
Surplus as regards policyholders		<u>\$24,987,139</u>
<b>Totals</b>		<u><b>\$80,449,630</b></u>

## STATEMENT OF INCOME

<b>Premiums earned</b>		\$61,332,572
Losses incurred	\$41,406,753	
Loss adjustment expenses incurred	6,817,233	
Other underwriting expenses incurred	<u>17,302,288</u>	
<b>Total underwriting deductions</b>		<u>65,526,274</u>
<b>Net underwriting gain (loss)</b>		(4,193,702)
Net investment income earned	1,133,762	
Net realized capital gains	<u>5,087</u>	
<b>Net investment gain</b>		1,138,849
Net gain (loss) from agents' or premium balances charged off	(2,615,426)	
Finance and service charges not included in premiums	4,553,868	
Aggregate write-ins for miscellaneous income	<u>1,140,868</u>	
<b>Total other income</b>		<u>3,399,305</u>
Net income before dividends to policyholders and federal income taxes		<u>344,452</u>
Net income after dividends to policyholders and before federal income taxes		344,452
Federal and foreign income taxes incurred		<u>54,799</u>
<b>Net Income</b>		<u>\$289,653</u>

**CAPITAL AND SURPLUS ACCOUNT**

	<b><u>2015</u></b>	<b><u>2014</u></b>	<b><u>2013</u></b>	<b><u>2012</u></b>	<b><u>2011</u></b>
Surplus as regards policyholders December 31, previous year	<u>\$24,759,042</u>	<u>\$24,922,255</u>	<u>\$20,684,645</u>	<u>\$17,414,769</u>	<u>\$18,788,575</u>
Net income	\$289,653	\$2,515,892	\$3,611,753	\$795,658	\$554,309
Change in net unrealized capital gains or (losses)	(217,275)	(239,098)	302,479	253,835	(205,167)
Change in net deferred income tax	148,002	96,532	7,204	115,970	(85,432)
Change in non-admitted assets	7,717	(36,539)	316,174	2,202,515	(1,637,516)
Cumulative effect of changes in accounting principles	-0-	-0-	-0-	(98,102)	-0-
Dividends to stockholders	<u>-0-</u>	<u>(2,500,000)</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Net change in surplus as regards policyholders for the year	<u>228,097</u>	<u>(163,213)</u>	<u>4,237,610</u>	<u>3,269,876</u>	<u>(1,373,806)</u>
Surplus as regards policyholders December 31, current year	<u>\$24,987,139</u>	<u>\$24,759,042</u>	<u>\$24,922,255</u>	<u>\$20,684,645</u>	<u>\$17,414,769</u>

## ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS

Total Capital and Surplus

\$24,987,139

Total capital and surplus, as established by this examination, equals the amount reported by the Company in its December 31, 2015, Annual Statement. There were no changes made to any asset or liability items as a result of our examination performed as of December 31, 2015.

## COMMENTS AND RECOMMENDATIONS

The following list presents a summary of comments and recommendations noted in this report:

### Comments

None.

### Recommendations

#### 1. Producer Agreement, Direct General Companies Intercompany Services and Cost Allocation Agreement, and Premium Finance Settlement Agreement

Premium for business produced by DGIA for the Company is deposited and recorded in the bank account of RCIA. Subsequently, daily, RCIA advanced funds to DGC, DAI, and various affiliated insurance companies. Management stated during the examination that the transfers continued in 2016 and ended October 31, 2016.

The annual Form B Holding Company Registration Statement filed with the TDCI by Elara Holdings, Inc. for examination years 2011 through 2015 did not disclose such transfers of funds among affiliates and therefore was in violation of Tenn. Code Ann. § 56-11-105(b)(1)(A). Furthermore, such transfers of funds should have been documented in an intercompany agreement filed with and approved by the TDCI in accordance with Tenn. Code Ann. § 56-11-105(b)(3).

The Company was not in compliance with Tenn. Code Ann. § 56-11-106(a)(2), which states that material transactions may not be entered into unless the insurer has notified the Commissioner in writing of its intention to enter into such transaction at least thirty (30) days prior thereto, or such shorter period as the Commissioner may permit, and the Commissioner has not disapproved the transaction within that period. Management did not provide any evidence of the existence of an intercompany agreement governing

such initial deposits of premiums and subsequent transfers of funds and had no evidence of filing such an agreement with the Department.

It is noted that the intercompany agreements discussed above between the Company and its affiliates during the examination period are no longer in effect due to the acquisition of Elara Holdings, Inc., by National General Holdings Corp. on November 1, 2016. See the "Subsequent Events" section of this report for a description of intercompany agreements currently in effect.

It is recommended that DIC and affiliates file complete and accurate information with the TDCI on an on-going basis and remain in compliance with each of the statutes cited above.

It is recommended that the Company comply with the provisions of all approved intercompany agreements.

## CONCLUSION

The customary insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of Direct Insurance Company.

In such manner, it was determined that as of December 31, 2015, the Company had net admitted assets of \$80,449,630, and liabilities, exclusive of capital, of \$55,462,491. Thus, there existed for the additional protection of the policyholders the amount of \$24,987,139, in the form of common capital stock, gross paid-in and contributed surplus, and unassigned funds (surplus). Tenn. Code Ann. §§ 56-2-114 and 56-2-115 require an insurer of this Company's type to maintain a minimum capital of \$1,000,000 and minimum surplus of \$1,000,000. Therefore, the Company maintains capital and surplus in excess of the amounts required pursuant to Tenn. Code Ann. §§ 56-2-114 and 56-2-115, as of December 31, 2015.

The courteous cooperation of the officers and employees of the Company, extended during the course of the examination, is hereby acknowledged.

In addition to the undersigned, Jean Adams-Harris, CFE, CPA, CISA, AES, MCM, of Johnson Lambert LLP, as well as individuals from Noble Consulting Services, Inc., and Lewis & Ellis, Inc., participated in this examination.

Respectfully submitted,



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Richard Foster, CFE  
Examiner-in-Charge  
Johnson Lambert LLP  
Representing the State of Tennessee

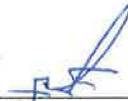


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Bryant Cummings, CFE  
Assistant Chief Examiner  
Tennessee Department of Commerce and Insurance

# AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of Direct Insurance Company located in Nashville, Tennessee, dated May 17, 2017 and made as of December 31, 2015, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and the facts therein set forth are true to the best of his knowledge, information and belief.



Richard Foster, CFE  
Examiner-in-Charge  
Johnson Lambert LLP  
Representing the State of Tennessee

State Pennsylvania

County Allegheny

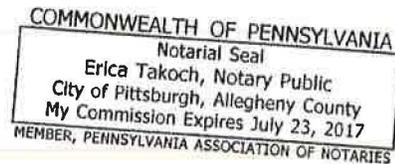
Subscribed to and sworn before me

this 28<sup>th</sup> day of June, 2017

Erica Tanoel

(NOTARY)

My Commission Expires: 7/23/2017



# AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of Direct Insurance Company located in Nashville, Tennessee, dated May 17, 2017 and made as of December 31, 2015, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and the facts therein set forth are true to the best of his knowledge, information and belief.

  
Bryant Cummings, CFE, MCM  
Examiner-in-Charge  
State of Tennessee

State Tennessee

County Davidson

Subscribed to and sworn before me

this 28<sup>th</sup> day of June, 2017

Mindy C. Walker  
(NOTARY)

My Commission Expires: 7.6.2020



# **EXHIBIT B**

**DIRECT INSURANCE COMPANY**  
1281 Murfreesboro Road ♦ Nashville, Tennessee 37217  
Phone: 615.399.4700 ♦ Fax: 615.366.3722

June 28, 2017

E. Joy Little  
Director of Financial Examinations/Chief Examiner  
Tennessee Department of Commerce and Insurance  
500 James Robertson Parkway  
Nashville, TN 37243-1135

**RE: Report of Examination – Direct Insurance Company**

Dear Ms. Little:

We hereby acknowledge receipt of the final Report of Examination for **Direct Insurance Company**. By signing below, we indicate acceptance of the report.

Sincerely,



**Donald Bolar**  
Chief Accounting Officer