

SOUTH DAKOTA DIVISION OF INSURANCE

MARKET CONDUCT EXAMINATION REPORT

OF

RELIAMAX SURETY COMPANY

NAIC Code 12623
2300 E. 54th Street North
Sioux Falls SD 57104

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SALUTATION

June 21, 2013

Honorable Merle Scheiber
Insurance Director
State of South Dakota
445 E. Capitol Avenue
Pierre, South Dakota 57501

Dear Director Scheiber:

In compliance with the instructions contained in the Order for Examination, dated May 12, 2011 and pursuant to statutory provisions including SDCL Ch. 58-3, a Market Conduct Examination has been conducted regarding the affairs and practices of:

RELIAMAX SURETY COMPANY

ReliaMax Surety Company is incorporated under the laws of the State of South Dakota. This examination consisted of three phases. An on-site phase, an off-site phase and an interview phase. The on-site phase of the examination was conducted at the following Company location:

2300 E. 54th Street North, Sioux Falls, South Dakota 57104

The off-site examination phase was performed at the offices of the South Dakota Division of Insurance, hereinafter referred to as the "Division" and other appropriate locations.

The interview phase was performed at the various offices of banks, credit unions and other lending organizations through which the surety bonds were written.

The report of examination thereon is respectfully submitted.

FOREWORD

ReliaMax Surety Company is only licensed to conduct insurance business in South Dakota. The purpose of this examination is to determine if ReliaMax Surety Company has violated South Dakota law by insuring financial institutions, mostly credit unions, in other states for private student loan programs. This report is based on the gathering of facts through the examination of documents and interviews. The examiners conclude that ReliaMax Surety Company is in violation of South Dakota law by transacting insurance in another state. The examiners recommend that the Company become licensed or operate legally on a surplus lines basis, or obtain written consent for any other business model, in each appropriate jurisdiction or cease business in those jurisdictions.

SCOPE OF EXAMINATION

The Director of the South Dakota Division of Insurance has authority to perform this examination pursuant to, but not limited to, SDCL §§ 58-2-22, 58-3-1 & 58-4-44. This examination of ReliaMax Surety Company (hereinafter ReliaMax or Company) began on July 5, 2011 and covers the period of January 1, 2006 through May 15, 2011, unless otherwise noted.

This examination focuses on a review of compliance of the company's activities with South Dakota statutes and administrative rules. In conducting this examination, primary sources of information include the Company responses to the Coordinators Handbook, the Company responses to Information Requests and interviews of financial institutions, and related organizations. Included in this review are documents from underwriting, rates and forms, producer licensing, marketing and sales, company operations and management, policy holder services, claims and complaints.

This examination has been performed in accordance with Market Regulation standards established by the Division and examination procedures established by the NAIC. Failure to identify or criticize improper or noncompliant business practices in the state or other jurisdictions does not constitute acceptance of such practices.

EXECUTIVE SUMMARY

The examiners state that ReliaMax is in violation of SDCL § 58-6-2 that provides that the Company may not:

... transact insurance in another state or country unless it holds a subsisting certificate of authority issued to it by the director authorizing it to transact the same kinds of insurance in this state...

The Company lists 35 states and the District of Columbia as places where institutions reside that paid premium in 2011.

ReliaMax is a South Dakota insurance company in the business of issuing surety bonds that insure the repayment of private student loans. However, ReliaMax insures financial institutions, mostly credit unions, in many states. The Company lists 259 insured financial institutions, with 257 being outside of the state. Credit Unions account for 248 insured institutions. ReliaMax has represented that it is the only company in the United States that provides this insurance product.

Transaction documents between financial institutions and ReliaMax state that agreements are entered in South Dakota. However, almost all of the direct business contacts with financial institutions are handled by telephone, electronic communication, or delivery service such as the U.S. mail. Original applications, surety bonds and other originating documents are delivered to credit unions for execution at its location, not in South Dakota. This constitutes the transaction of insurance business. Other actions of the Company also indicate insurance transactions by the Company in other states.

Servicing organizations provide information about ReliaMax to financial institutions, mostly credit unions. There are two credit union service organizations (CUSOs) that were interviewed for this examination. The CUSOs interviewed for this examination are in New York City and Washington, D.C. These CUSOs handle the administrative functions required to service student loans. While both CUSOs have programs which allow credit unions to purchase surety bonds directly from ReliaMax. The CUSO programs also have set criteria, including a program manual describing the responsibilities of credit unions, CUSOs, and ReliaMax.

Premium invoices are generated from the Company in South Dakota and sent to credit unions or CUSOs located out of state. Money is transferred by check or electronic transfer from bank accounts located in other states to ReliaMax. Claim documentation originates with the credit union and claim payments are generally sent from South Dakota to the credit union in another state.

The examination revealed seven meetings with insureds or service organizations in out-of-state locations. Other meetings have taken place at national trade shows. The Company lists 111 out-of-state trips for various reasons, including meetings with servicing organizations and attendance at trade shows. Some of these trips are related to the transacting of insurance by either continuation of existing programs or contact with newly acquired business.

The practices identified in this examination extend to other jurisdictions. The Company is directed to take immediate corrective action to demonstrate its ability and intent to conduct business according to the South Dakota insurance laws and regulations. The

Company is instructed to come into compliance with all jurisdictions in which it does insurance business.

SOUTH DAKOTA LAW

SDCL § 58-6-2 states, in the relevant part:

No insurers shall from offices or by personnel of facilities located in this state ...
transact insurance in another state or country unless it holds a subsisting
certificate of authority issued to it by the director authorizing it to transact the
same kinds of insurance in this state...

COMPANY PROFILE

I. Overview of the Business Model

ReliaMax is a South Dakota insurance company in the business of issuing surety bonds that insure the repayment of student loans. In the event of default, the Company will pay the financial institution the balance of the loan and engage in collection efforts.

ReliaMax is a wholly-owned subsidiary of ReliaMax Insurance Company. The Company was incorporated under the laws of the State of South Dakota on June 27, 2006. It commenced writing business on July 7, 2006 with the acquisition and merger of HEMAR Insurance Corporation of America (HEMAR Ins. Co.).

HEMAR Ins. Co. was a wholly owned subsidiary of SallieMae. SallieMae is a government student loan program which began privatizing in 1997. HEMAR Ins. Co. primarily insured loans that were eventually held by SallieMae but also held some assets in its private portfolio. In 2005, SallieMae made a business decision to integrate HEMAR Ins. Co.'s functions into other areas of the organization.

ReliaMax acquired the private HEMAR Ins. Co. portfolio with a principal balance of approximately \$32 million in outstanding student loans. In addition, ReliaMax acquired historical data, proprietary models, and systems that HEMAR Ins. Co. had developed. Key personnel from HEMAR Ins. Co. management team joined ReliaMax.

A 2010 independent company audit states that ReliaMax held 29,307 loans valued at \$357,677,000. Default loans owned by the Company after the payment of claims to credit unions was valued at \$413,000 with an accrued interest of \$67,000.

II. Premium and Claims

The collection of premium varies, occurring at the inception of a student loan in a one-time payment or in split payments occurring at both the loan's inception and the time of repayment. Although there are variations, the typical one-time premium payment is in the range of 4%-7% of the value of the loan at the time of the loan. The split payment is typically in the range of 1%-2% at the time of the loan with an additional 1%-7% at time of repayment.

The Company lists 35 states and the District of Columbia as places where the institutions reside that paid premium in 2011. These locations are:

Alabama	Michigan
Arkansas	Minnesota
California	Montana
Colorado	North Carolina
Connecticut	New Hampshire
Delaware	New Jersey
Florida	New Mexico
Georgia	New York
Hawaii	Ohio
Iowa	Oklahoma
Idaho	Oregon
Illinois	Pennsylvania
Indiana	South Dakota
Louisiana	Tennessee
Maine	Texas
Maryland	Virginia
	Washington
	Wisconsin
District of Columbia	Wyoming

The Company provided the following information for premiums and taxes paid to South Dakota (There was no new business or written premiums for 2006 to 2008):

2009:	Premium Written	Premium Tax
Credit Unions	\$2,147,769	\$25,234
Banks	\$ 0	\$ 0
Other	\$ 225,440	\$ 2,649
TOTAL	\$2,373,209	\$27,883

2010:	Premium Written	Premium Tax
Credit Unions	\$6,078,814	\$74,471
Banks	\$ 2,311	\$ 28
Other	\$1,182,961	\$14,492
TOTAL	\$7,264,086	\$88,991

Paid claim totals by year and state are as follows:

	OH Insureds	FL Insureds	NJ Insureds	TOTAL
2006:	\$136,089.25	\$ 0	\$ 0	\$136,089.25
2007:	\$150,317.10	\$ 0	\$ 0	\$150,317.10
2008:	\$ 0	\$ 0	\$ 0	\$ 0
2009:	\$ 46,779.88	\$ 0	\$ 0	\$ 46,779.88
2010:	\$ 81,423.44	\$ 15,914.33	\$ 1,769.54	\$ 99,107.31
2011:	\$194,616.54	\$ 15,487.15	\$ 42,821.56	\$252,925.25 (May 15, 2011)

HOW RELIAMAX CONDUCTS BUSINESS

Reliamax insures student loans that are provided by financial institutions, primarily from credit unions that are not located in South Dakota. The Company lists 259 insureds with 257 being outside of South Dakota. The number and types of insureds are as follows:

- Credit Unions: 248
- Banks: 6
- Other: 5

In general terms, a credit union becomes a member of a credit union service organization for the purpose of facilitating student loan programs, though CUSOs are formed for other purposes. There are also other origination and servicing organizations that assist financial institutions in the student loan business.

The purpose of a CUSO is to facilitate the private student loan program of a credit union by providing outsourcing services for loan administration.

Generally, a borrower will apply for student loans through a credit union's electronic portal. After the loan is approved and disbursed to the CUSO for handling, all subsequent loan administration is handled by a CUSO. Once loans are disbursed, a CUSO handles payments to the school or student. Student repayments are also channeled through CUSOs. Fees are charged for services by CUSOs to credit unions.

When joining the CUSO, a credit union may be referred to ReliaMax to have the loans insured. In some cases the credit union retains the right to self-insure, with the option of purchasing a surety contract. In other cases, a CUSO has established a program for the credit union to join. In some cases, ReliaMax and the CUSO have agreed that ReliaMax be the backup loan servicer in the event that the servicing provider becomes insolvent.

The majority of direct contacts with insureds is operational in nature and handled by telephone, electronic communication, or delivery service such as the U.S. mail. The insurance contract, known as the surety bond, and other original documents are delivered generally by U.S. mail. A credit union will sign the insurance contract in its location and provide copies to ReliaMax as required. Claims are handled without face-to-face contact with ReliaMax. The Company engages in 3 claim related activities: pre-claim assistance, claim payment, and post-default collection. In the pre-claims area, the lender refers delinquent accounts that have become 60 days past due. The Company will make attempts to bring the account current by contacting the borrower. If the loan remains in default, then the lender can file a claim for payment any time between 150 and 210 days of delinquency. The Company usually pays claims within (30) days. Once a claim is paid to a lender, the Company takes the lender's position to institute post-default collection procedures.

THE COMPANY'S POSITION

The Company contends that they only do business in the State of South Dakota with insureds that are located in other states in accordance with the other states' statutes and laws regarding direct procurement and industrial insured exemptions. ReliaMax also states that they do not contact prospective insureds to attempt to sell insurance or encourage them to apply for insurance, and that initiation of all contact is made by a prospective insured contacting ReliaMax. The Company refers to this business model as Direct Procurement. A number of the Company documents make statements which advise the insured of how the Company operates. For example, one of the application forms state, in part:

NOTICE

As a condition of obtaining the surety insurance coverages requested of ReliaMax Surety Company, the undersigned hereby acknowledge and agree as follows:

1. ReliaMax Surety Company is a licensed insurance company in the State of South Dakota.
2. The surety insurance being applied for is not generally available except from ReliaMax Surety Company in the State of South Dakota.
3. ReliaMax Surety Company is not authorized to issue insurance in any state including the domicile state of the Applicant except the State of South Dakota.
4. This insurance will not be subject to or regulated by the domicile state of the Applicant unless it is South Dakota
5. I am applying for insurance coverage from ReliaMax Surety Company voluntarily.
6. Any insurance agreement with ReliaMax Surety Company will be accepted and entered into in the State of South Dakota and will be subject to the laws of South Dakota.
7. I agree to deliver all required premiums to ReliaMax Surety Company in the State of South Dakota.
8. I understand ReliaMax shall process all claims in the State of South Dakota.
9. I have been provided with the copies of the forms of surety agreements and related materials. I understand that such forms may change from time to time as authorized by the laws of the State of South Dakota.
10. I voluntarily submit to the jurisdiction and venue of the State of South Dakota.

Another example found in a surety bond states as follows:

{CREDIT UNION NAME}, hereby accepts the terms and conditions of this Surety Bond as of the issue date identified above. {CREDIT UNION NAME} further acknowledges

that this agreement is accepted and entered into in the State of South Dakota and will be subject to the laws of South Dakota. {CREDIT UNION NAME} agrees to deliver all required premiums to ReliaMax Surety Company in the State of South Dakota.

The only complaint noted by the Company was a request from the South Dakota Division of Insurance to discontinue use of a flyer regarding its position on this out-of-state licensing matter. The Company complied with this request.

CONTACT WITH OTHER STATES

The Company lists 259 insured financial institutions as contacts with 257 contacts outside of South Dakota. Credit Unions account for 248 of the total insured institutions.

The Company provided 7 instances where face-to-face meetings occurred in South Dakota with insureds or service organizations. The Company also provided a list of business trips that includes 111 out-of-state trips from 2007 to May 2011. The listing includes 7 meetings directly with insured financial institutions or CUSOs in out-of-state locations.

ReliaMax states that the credit unions are either invoiced for premium directly by ReliaMax or they are invoiced indirectly through a CUSO. Invoices are generally delivered by mail to the credit unions. The credit unions pay premiums by checks that are mailed to ReliaMax in South Dakota or by electronic transfers. However, one CUSO indicated that it originated the billing of premiums for ReliaMax due to the complexity of the arrangements between its credit unions.

Documents are sent by ReliaMax to its insureds located in other states. Documents include the initial application, bonds, and other documents to be executed by the insured before the documents are returned to South Dakota. Claim payments are generally sent to insureds that are located out-of- state.

During the course of the examination, 12 financial institutions and 2 CUSOs were interviewed. All of these institutions and CUSOs are located outside of South Dakota. The institutions are located in Delaware, Florida, Indiana, Iowa, Maryland, Massachusetts, New Jersey, Pennsylvania, and Virginia. The CUSOs, which are not parties to the surety contracts, are located in Washington, DC and New York City. These interviews revealed

that the following meetings, as confirmed by the Company, took place outside of South Dakota on or about the following dates:

1. Feb. 18, 2010: Meeting in Alexandria, VA for the purpose of reviewing a credit union's servicing system and for the credit union to provide a demonstration to ensure that it met all of the requirements.

2. August 27-30, 2010: Meeting at trade show in a social setting in Palm Beach, FL with servicing organizations relating to loan processing, servicing, and plans for expanding knowledge about the program.

3. September 13, 2010: Meeting with a bank in Iowa relating to the processes involved in originating loans under the program.

4. Oct. 5, 2010: Meeting with an insured credit union in Indianapolis, IN to obtain input and suggestions for the possible development of a new private loan consolidation program for medical school graduates that was never launched.

5. Jan. 29, 2011: Meeting at a financial institution in Marlborough, MA for the purpose of updating all parties on the program for the next academic year and discussing operational and procedural questions about the program.

6. May 3, 2011: Meeting with a CUSO at a trade show in New York to discuss a pending regulatory action in the State of Washington.

7. Nov. 28, 2011: Meeting in New Jersey with the Board of Directors of a CUSO regarding a number of matters including an update on the State of Washington administrative action, feedback relating to the market conduct examination, information on

the private loan market and how it compares to the federal loan program, and a review on forbearance policy and how it is used to assist delinquent borrowers.

Reliamax states that it has presented two webinars at the request of a CUSO on November 3, 2009 and April 23, 2010. Since the details were handled by the CUSO, ReliaMax stated it has no information about the attendees. ReliaMax states that it was their understanding that attendees would be representatives of credit unions in the CUSO and insureds of ReliaMax.

VIOLATIONS AND RECOMMENDATIONS

Violation #1: The Company transacts insurance in other states in which it has no license in violation of SDCL § 58-6-2. The Company obtains the executed insurance applications from institutions in other states. Premiums are remitted from locations in other states. Claims originate and are reported to the Company from other states. Claim payments are made by the Company to insured financial institutions in these other states. The Company has made numerous out-of-state trips to insured institutions, loan servicing organizations and trade shows.

Recommendation #1: The examiners recommend that the Company become licensed or operate legally on a surplus lines basis, or obtain written consent for any other business model, in each appropriate jurisdiction or cease business in those jurisdictions.

CONCLUSION

This Report is respectfully submitted to the South Dakota Division of Insurance. The courtesy and cooperation of the officers and employees of the Company is acknowledged.

The Examination was completed by examiners Cyndy Campbell, Joe Cohen and Ron Poplos.

A handwritten signature in black ink that reads "Cyndy Campbell". The signature is written in a cursive, flowing style.

Cyndy Campbell
Examiner-in-Charge
INS Regulatory Insurance Services, Inc.