

Report of Examination of

American Empire Insurance Company
Cincinnati, Ohio

As of December 31, 2011

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Columbus, Ohio
October 26, 2012

Honorable Mary Taylor
Lt. Governor/Director
State of Ohio
Department of Insurance
50 West Town Street
3rd Floor – Suite 300
Columbus, Ohio 43215

Dear Lt. Governor/Director:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), the Ohio Department of Insurance (“Department”) conducted an examination of

American Empire Insurance Company

an Ohio domiciled, stock, property and casualty insurance company, hereinafter referred to as the “Company.”

Scope of Examination

The Department last examined the Company as of December 31, 2006. The Department’s current examination covers the period of January 1, 2007 through December 31, 2011.

The Department, as the coordinating state regulator of the insurance company subsidiaries of American Financial Group, Inc. (“AFG”), led the multi-state coordinated examination that included representatives from the states of California, Delaware, Illinois, New York, Ohio and Texas.

The examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”). The Handbook requires that the Department plan and perform the examination to evaluate the Company’s financial condition and identify prospective risks including corporate governance, identify and assess inherent risks and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

For all years under examination, the Certified Public Accounting firm of Ernst & Young LLP provided an unqualified opinion on the Company’s financial statements based on Statutory Accounting Principles. The audited financial reports were reviewed during the examination.

Management and Control

Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date.

Name	Principal Occupation
Ronald J. Brichler	Executive Vice President, Great American Insurance Company
Gary J. Gruber	Executive Vice President, Great American Insurance Company
Karen Holley Horrell	Senior Vice President, Executive Counsel and Secretary, Great American Insurance Company
Donald D. Larson	President, Great American Insurance Company
Eve Cutler Rosen	Senior Vice President, General Counsel and Assistant Secretary, Great American Insurance Company
David J. Witzgall	Senior Vice President, Chief Financial Officer and Treasurer, Great American Insurance Company
Frederick J. Woebse	President and Chief Operating Officer, American Empire Surplus Lines Insurance Company

Officers

As of the examination date, the following principal officers were elected and serving in accordance with the Company's Bylaws:

Name	Title
Ronald J. Brichler	Chairman
Frederick J. Woebse	President and Chief Operating Officer
Leonard J. Mikulski	Senior Vice President
Larry S. Potrafke	Senior Vice President
David L. Blumberg	Vice President
Leo A. Haas	Vice President
T. Matthew Held	Vice President and Treasurer
Kathleen U. Kuczaj	Vice President
David A. Prell	Vice President
Vincent A. Sawma	Vice President
Dianne Williams	Vice President
Karen Holley Horrell	Secretary

Insurance Holding Company System

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. The Company is a wholly owned subsidiary of American Empire Surplus Lines Insurance Company ("AESLIC"), domiciled in Delaware, and an indirect wholly owned subsidiary of AFG, the ultimate controller person in the holding company system. Through its insurance company subsidiaries, AFG is engaged primarily in property and casualty insurance, focusing on specialized commercial products for businesses, and the sale of traditional fixed and indexed annuities and a variety of supplemental insurance products. The common stock of AFG is traded on the New York Stock Exchange.

Territory and Plan of Operations

The Company is licensed to transact business in forty-six states and the District of Columbia. However, during the examination period, the company had no direct premium written. The Company was utilized by management to write assumed casualty facultative reinsurance through reinsurance intermediaries from 1989 to 2003.

AESLIC, an excess and surplus lines carrier approved in all states except Delaware, and the Company participate in an inter-company pooling agreement. The effect of the pooling is to transfer all net insurance liabilities to AESLIC, which in turn cedes 10% of the net underwriting results to the Company.

The following table illustrates the Company's net premium written, reported in thousands, by line of business in 2011:

Line of Business	Net Premium	Percentage
Other liability – occurrence	\$ 2,288	65.6%
Commercial multiple peril	388	11.1%
Other liability – claims made	366	10.5%
Products liability - occurrence	178	5.1%
Commercial auto liability	104	3.0%
All other lines	<u>165</u>	<u>4.7%</u>
Total	<u>\$ 3,489</u>	<u>100.0%</u>

Reinsurance

The Company does not assume or cede a material amount of business other than through the inter-company pooling agreement.

Financial Statements

The financial condition and the results of its operations for the five-year period under examination as reported and filed by the Company with the Department and audited by the Company's external auditors are reflected in the following:

- Statement of Assets, Liabilities, Capital and Surplus
- Statement of Income
- Statement of Changes in the Capital and Surplus Account

**Statement of Assets, Liabilities, Surplus and Other Funds
December 31, 2011**

Assets

Bonds	\$ 30,327,836
Preferred stocks	1,460,950
Common stocks	145,450
Cash and short term investments	<u>538,339</u>
Subtotal, cash and invested assets	32,472,575
Investment income due and accrued	373,916
Uncollected premiums in course of collection	235,514
Amounts recoverable from reinsurers	320,334
Net deferred tax asset	823,460
Receivable from affiliates	19,901
Other receivables	<u>3,443</u>
Total assets	<u>\$ 34,249,143</u>

Liabilities

Losses	\$ 5,947,984
Reinsurance payable on paid losses and loss adjustment expenses	276,191
Loss adjustment expenses	2,060,428
Commissions payable	281,554
Other expenses	356,807
Taxes, licenses and fees	31,379
Current federal income taxes	198,897
Unearned premiums	1,477,123
Provision for reinsurance	72,534
Payable to affiliates	88,768
Retrospective premium payable	<u>12,791</u>
Total liabilities	<u>10,804,455</u>

Capital and Surplus

Additional admitted deferred tax asset	180,848
Common capital stock	3,100,000
Gross paid in and contributed surplus	16,100,000
Unassigned funds	<u>4,063,841</u>
Total capital and surplus	<u>23,444,689</u>
Total liabilities, capital and surplus	<u>\$ 34,249,143</u>

Statement of Income
As of December 31, 2011

Premiums earned	<u>\$ 3,434,782</u>
Losses incurred	(812,603)
Loss adjustment expenses incurred	179,085
Other underwriting expenses incurred	<u>951,118</u>
Total underwriting deductions	<u>317,600</u>
Net underwriting gain	<u>3,117,182</u>
Net investment income earned	1,613,044
Net realized capital losses	<u>(100,931)</u>
Net investment gain	<u>1,512,113</u>
Miscellaneous expense	<u>(1)</u>
Total other loss	<u>(1)</u>
Net income before federal income taxes	4,629,294
Federal income taxes incurred	<u>1,291,052</u>
Net income	<u>\$ 3,338,242</u>

Statement of Changes in the Capital and Surplus Account
(In thousands)

	2007	2008	2009	2010	2011
Capital and surplus, begin. of year	<u>\$34,501</u>	<u>\$25,639</u>	<u>\$23,637</u>	<u>\$22,739</u>	<u>\$24,229</u>
Net income	6,598	4,749	2,217	3,842	3,338
Change in net unrealized capital gains (losses)	(301)	(311)	641	(30)	(73)
Change in net deferred income tax	(297)	(164)	19	(370)	(175)
Change in nonadmitted assets	144	117	210	164	115
Change in provision for reinsurance	(6)	7	1	-	(71)
Dividends to stockholders	(15,000)	(6,400)	(4,400)	(2,000)	(3,800)
Aggregate write-ins	<u>-</u>	<u>-</u>	<u>414</u>	<u>(116)</u>	<u>(118)</u>
Net change in capital and surplus	<u>(8,862)</u>	<u>(2,002)</u>	<u>(898)</u>	<u>1,490</u>	<u>(784)</u>
Capital and surplus, end of year	<u>\$25,639</u>	<u>\$23,637</u>	<u>\$22,739</u>	<u>\$24,229</u>	<u>\$23,445</u>

Notes to Financial Statements

Investments

The Company's investments were in compliance with ORC Section 3925.08 and valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

Loss and Loss Adjustment Expense Reserves

The Company's Board of Directors appointed John L. Doellman, FCAS, MAAA, Vice President and Actuary, Great American Insurance Company, to render the Company's Statement of Actuarial Opinion ("Opinion"). Mr. Doellman prepared an Actuarial Report supporting the Opinion in connection with the preparation of the Company's December 31, 2011 Annual Statement.

The Delaware Department of Insurance retained Eugene Thompson, ACAS, MAAA, of INS Consultants, Inc., to perform an independent analysis of the AESLIC pool's gross, ceded and net loss and loss adjustment expense reserves, evaluated as of December 31, 2011. Based on his analysis, Mr. Thompson concluded that the AESLIC pool's reserves are reasonably stated.

Thomas Botsko, ACAS, MAAA, the Department's Chief Property and Casualty Actuary, reviewed the INS analysis and concurred with the conclusions.

Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2011, and is summarized as follows:

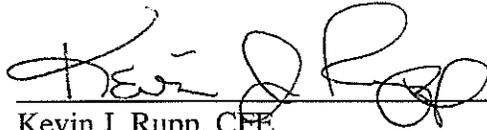
Total Admitted Assets	<u>\$34,249,143</u>
Liabilities	\$10,804,454
Capital and Surplus	<u>23,444,689</u>
Total Liabilities, Capital and Surplus	<u>\$34,249,143</u>

Acknowledgement

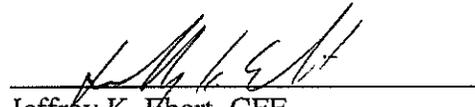
Appreciation is expressed for the assistance extended by the officers and employees of the Company during the course of this examination.

In addition to the aforementioned and undersigned, the following representatives of the Department participated in this examination: Mohammad A. Arif, AES, CFE, CISA, CIDM, CISSP; Thomas Botsko, FCAS; Ryan S. Gibson, CFE, FLMI; Aaron R. Hibbs, CFE, ChFC, CPA, FLMI; James H. Luke, CFE, CPA; and Larry G. Rice, AES, CFE, CISA, CPA.

Respectfully,



Kevin J. Rupp, CFE
Examiner-In-Charge
Ohio Department of Insurance



Jeffrey K. Ebert, CFE
Assistant Chief Examiner
Ohio Department of Insurance

Verification

As required by Section 3901.07 of the Ohio Revised Code, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2011.

Kevin J. Rupp 12/21/12 John L. Ebert 12/21/12
Examiner-In-Charge Date Assistant/Chief Examiner Date

State of Ohio
County of Franklin

Personally appeared before me the above named, Kevin J. Rupp, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 21 day of December, 2012.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2017
My Commission Expires

State of Ohio
County of Franklin

Personally appeared before me the above named Jeffrey K. Ebert, personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his knowledge and belief.

Subscribed and sworn to before me this 21 day of December, 2012.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2017
My Commission Expires