

Report of Examination of

Scottsdale Insurance Company
Columbus, Ohio

As of December 31, 2011

Table of Contents

Subject	Page
Salutation	1
Description of Company.....	1
Scope of Examination.....	1
Management and Control:	
Board of Directors	2
Officers	3
Insurance Holding Company System	3
Territory and Plan of Operations	3
Significant Operating Results	4
Reinsurance.....	4
Financial Statements:	
Statement of Assets, Liabilities, Capital and Surplus.....	6-7
Statement of Income	8
Statement of Changes in the Capital and Surplus Account	9
Notes to Financial Statements:	
Investments	9
Loss and Loss Adjustment Expense Reserves.....	9
Subsequent Events	9
Conclusion	10
Acknowledgement	10
Verification	11

Columbus, Ohio
December 14, 2012

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

Dear Madam:

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

Scottsdale Insurance Company

an Ohio domiciled, stock, property and casualty insurance company, hereinafter referred to as the (“Company.”) The Company is 100% owned by Nationwide Mutual Insurance Company (“NMIC.”) The examination was conducted at NMIC home office, located at One West Nationwide Boulevard, Columbus, Ohio.

Scope of Examination

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

The Department conducted the examination in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners 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.

The State of Ohio took the lead role to perform the coordinated exam of NMIC and affiliates and the States of Arizona, California, Indiana, Iowa, Michigan, Texas, Vermont and Wisconsin were all participants on the group examination.

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

For years covered by this examination, the certified public accounting firm of KPMG, LLP (“KPMG”) provided an unqualified opinion based on statutory accounting principles. Relevant work performed by KPMG during its annual audit of the Company was reviewed during the examination and incorporated into the examination work papers.

In addition, the following items were reviewed during the course of this examination:

1. Company history;
2. fidelity bonds and other insurance;
3. officers’, employees’, and agents’ welfare and pension plans;
4. growth of Company;
5. loss experience;
6. pending litigation; and
7. Articles of Incorporation and Bylaws.

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.

<u>Name</u>	<u>Principal Occupation</u>
Peter W. Harper	Vice-President and Treasurer – (Scottsdale Companies)
Michael D. Miller	President and Chief Operating Officer – (Scottsdale Companies)
Gary L. Tiepelman	Senior Vice-President – Underwriting – (Scottsdale Companies)
Doreen K. Reinke	Vice-President – Operations – (Scottsdale Companies)
Susan F. Wain	Senior Vice-President – Claims (Scottsdale Companies)

Officers

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

<u>Name</u>	<u>Title</u>
Michael D. Miller	President and Chief Operating Officer
Peter W. Harper	Vice-President and Treasurer
Robert W. Horner, III	Vice-President and Secretary
Randall L. Orr	Vice-President and Assistant Secretary

Insurance Holding Company System

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. NMIC and Nationwide Mutual Fire Insurance Company are the ultimate controlling parties of the insurance holding company system.

Territory and Plan of Operations

The Company is licensed to transact business in the states of Arizona, Delaware and Ohio. The Company is an approved surplus lines carrier in all other states.

The following schedule illustrates the Company's premium written in 2011 by line of business:

	Direct	Assumed	Ceded	Net	Percent
Private passenger auto liability	\$ -	\$164,913,619	\$ -	\$164,913,619	28.8%
Auto physical damage	6,884,558	177,551,561	69,705,625	114,730,494	20.0%
Homeowners multiple peril	61,273,586	108,764,689	66,251,243	103,787,032	18.1%
Commercial multiple peril	261,290,027	154,819,341	359,642,314	56,467,054	9.9%
Other liability – occurrence	418,408,585	379,194,380	763,271,479	34,331,486	6.0%
Commercial auto liability	37,587,873	251,388,530	258,157,612	30,818,791	5.4%
Farmowners multiple peril	2,486,777	11,647,152	3,101,249	11,032,680	1.9%
Workers' compensation	-	18,329,237	8,872,774	9,456,463	1.7%
Allied lines	102,015,156	20,766,765	114,190,482	8,591,439	1.5%
Group accident and health	-	8,496,558	-	8,496,558	1.5%
Other liability - claims-made	135,402,190	158,536,906	285,756,368	8,182,728	1.4%
Fire	38,959,774	16,395,438	48,417,513	6,937,699	1.2%
Inland marine	17,062,600	17,603,441	28,381,866	6,284,175	1.1%
Products liability - occurrence	14,499,852	12,254,810	23,783,805	2,970,857	0.5%
All others	<u>9,646,751</u>	<u>77,220,792</u>	<u>81,437,066</u>	<u>5,430,477</u>	<u>1.0%</u>
Totals	<u>\$1,105,517,729</u>	<u>\$1,577,883,219</u>	<u>\$2,110,969,396</u>	<u>\$572,431,552</u>	<u>100.0%</u>

Significant Operating Results

The Company reported the following net underwriting results, reported in thousands, during the examination period:

	2011	2010	2009	2008	2007
Premiums earned	<u>\$ 569,188</u>	<u>\$ 577,521</u>	<u>\$ 591,122</u>	<u>\$ 609,597</u>	<u>\$ 619,037</u>
Losses incurred	373,483	331,621	359,428	389,123	333,710
Loss adjustment expense incurred	64,488	59,757	62,372	66,407	65,366
Underwriting expense incurred	193,541	192,352	192,630	196,199	211,028
Aggregate write-in for underwriting deductions	<u>5</u>	<u>-13</u>	<u>28</u>	<u>0</u>	<u>160</u>
Total underwriting deductions	<u>631,517</u>	<u>583,717</u>	<u>614,458</u>	<u>651,729</u>	<u>610,264</u>
Net underwriting gain or (loss)	(\$ 62,328)	(\$ 6,195)	(\$ 23,336)	(\$ 42,132)	\$ 8,773
Pure loss ratio	65.6%	57.4%	60.8%	63.8%	53.9%
Loss adjustment expense ratio	<u>11.3%</u>	<u>10.4%</u>	<u>10.6%</u>	<u>10.9%</u>	<u>10.6%</u>
Loss ratio	76.9%	67.8%	71.4%	74.7%	64.5%
Underwriting expense ratio	33.8%	33.7%	33.0%	32.1%	33.9%
Policyholder dividend ratio	<u>0.1%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.1%</u>	<u>0.1%</u>
Combined ratio	<u>110.8%</u>	<u>101.5%</u>	<u>104.4%</u>	<u>106.9%</u>	<u>98.5%</u>

Reinsurance

There are thirty-two (32) insurance companies in the Nationwide Group and this excludes the recently acquired Harleysville companies. NMIC is the lead company and the pool administrator for an intercompany pooling agreement (“the Pool.”) The following intercompany pooling agreement became effective January 1, 2011. The companies, their state of domicile, and their pooling percentages are as follows:

Nationwide Mutual Insurance Company (OH)	83.7%
Nationwide Mutual Fire Insurance Company (OH)	11.3%
Scottsdale Insurance Company (OH)	4.0%
Farmland Mutual Insurance Company (IA)	<u>1.0%</u>
	100.0%

The following companies have a 0% pooling percentage:

Nationwide General Insurance Company (OH)
Nationwide Property and Casualty Insurance Company (OH)
Nationwide Affinity Insurance Company of America (OH)
Crestbrook Insurance Company (OH)
Allied Insurance Company of America (OH)
Victoria Fire & Casualty Company (OH)
Victoria Specialty Insurance Company (OH)
Victoria Select Insurance Company (OH)
Victoria National Insurance Company (OH)
AMCO Insurance Company (IA)
Allied Property & Casualty Insurance Company (IA)
Depositors Insurance Company (IA)
Nationwide Agribusiness Insurance Company (IA)
Victoria Automobile Insurance Company (IN)

The following insurance companies, including their state of domicile, cede 100% of their business to the Company through a 100% quota share reinsurance agreement and then the Company cedes to the above pool:

Freedom Specialty Insurance Company (OH)
Scottsdale Indemnity Company (OH)
Western Heritage Insurance Company (AZ)
Scottsdale Surplus Lines Insurance Company (AZ)

The Scottsdale companies write the most diverse book of business in the Nationwide Group, including brokerage and surplus lines. The Company participates in other reinsurance arrangements and less than 10% of premium is ceded to non-affiliates.

The examination noted that the Company has policies and procedures in place to comply with SSAP 62 and 63.

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
December 31, 2011**

<u>Admitted assets</u>	
Bonds	\$ 891,782,192
Common stocks	199,843,451
Mortgage loans – first liens	3,193,281
Cash and short-term investments	14,466,451
Securities lending reinvested collateral assets	<u>14,652,947</u>
Total cash and invested assets	1,123,938,322
Investment income due and accrued	9,052,347
Uncollected premiums and agents’ balances in the course of collection	166,745,426
Deferred premiums, agents’ balances and installments booked but deferred and not yet due	89,769,118
Amounts recoverable from reinsurers	166,225,695
Funds held by or deposited with reinsured companies	1,432
Current federal and foreign income taxes	4,796,659
Net deferred tax asset	36,746,828
Guaranty funds receivable or on deposit	1,034,544
Receivable from parent, subsidiaries and affiliates	141,928,910
Aggregate write-ins for other than invested assets	
Miscellaneous assets	<u>7,236,015</u>
Total admitted assets	<u>\$ 1,747,475,296</u>

**Statement of Liabilities, Capital and Surplus
December 31, 2011**

Liabilities

Losses	\$ 310,802,977
Reinsurance payable on paid losses and loss adjustment expenses	89,196,665
Loss adjustment expenses	66,904,127
Commissions payable, contingent commissions and other similar charges	14,869,803
Other expenses	3,806,406
Taxes, licenses and fees	2,981,913
Unearned premiums	224,670,185
Advance premium	4,580,490
Dividends declared and unpaid – Policyholders	251,061
Ceded reinsurance premiums payable	316,029,388
Funds held by company under reinsurance treaties	60,436
Amounts withheld or retained by company for account of others	5,136,430
Provision for reinsurance	3,321,518
Net adjustment in assets and liabilities due to foreign exchange rates	275
Payable to parent, subsidiaries and affiliates	3,424,606
Payable for securities	98,409
Payable for securities lending	14,828,900
Aggregate write-ins for liabilities	
Contingent suits	397,926
Loss based assessment	429,117
Reserve for state escheat payment	5,970,187
Miscellaneous liabilities	152,911
Funds held equity pools and associations	717
Pooling expense payable	<u>791,957</u>
Total liabilities	1,068,706,404

Capital and Surplus

Common capital stock	6,027,200
Aggregate write-ins for other than special surplus funds	
SSAP 10 DTA	10,073,643
Gross paid in and contributed surplus	143,973,300
Unassigned funds	<u>518,694,749</u>
Surplus as regards policyholders	<u>678,768,892</u>
Total liabilities, capital and surplus	<u>\$ 1,747,475,296</u>

Statement of Income
As of December 31, 2011

Premiums earned	<u>\$ 569,188,415</u>
Losses incurred	373,482,669
Loss adjustment expenses incurred	64,487,769
Other underwriting expenses incurred	193,540,993
Aggregate write-ins for underwriting deductions:	
Loss based assessment	<u>5,283</u>
Net underwriting loss	<u>(62,328,299)</u>
Net investment income earned	38,807,765
Net realized capital gains	<u>311,035</u>
Net investment gain	<u>39,118,800</u>
Net loss from agents' or premium balances charged off	(2,504,497)
Finance and service charges not included in premiums	6,914,565
Aggregate write-ins for miscellaneous income	
Contingent suit liability	106,161
Other income	<u>2,067,557</u>
Total other income	<u>6,583,786</u>
Income before dividends to policyholders and before federal income Taxes	(16,625,713)
Dividends to policyholders	<u>306,958</u>
Net income, after dividends to policyholders, after capital gains tax and before all other federal income taxes	<u>(16,932,671)</u>
Federal and foreign income taxes incurred	<u>(5,347,897)</u>
Net loss	<u>(\$ 11,584,774)</u>

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

<u>Capital and Surplus</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital & surplus, prior year end	<u>\$ 655,121</u>	<u>\$ 610,168</u>	<u>\$ 518,866</u>	<u>\$ 534,037</u>	<u>\$ 494,164</u>
Net income	(11,585)	30,293	27,792	9,473	46,717
Change in net unrealized capital gains or (losses) less capital gains tax	6,356	11,825	31,852	(19,359)	9,961
Change in net unrealized foreign exchange capital gain (loss)	(80)	113	131	-	-
Change in net deferred income tax	2,015	(1,005)	(2,655)	712	3,015
Change in non-admitted assets	14,201	3,250	9,437	(6,494)	(6,211)
Change in provision for reinsurance	12,370	1,177	21,961	(7,123)	(13,910)
Cumulative effect of change in accounting principles	-	-	-	-	301
Aggregate write-ins for gains and losses in surplus					
SSAP 10 DTA	<u>370</u>	<u>(700)</u>	<u>2,784</u>	<u>7,620</u>	-
Net change in capital and surplus	<u>23,647</u>	<u>44,953</u>	<u>91,302</u>	<u>(15,171)</u>	<u>39,873</u>
Capital and surplus, current year end	<u>\$ 678,768</u>	<u>\$ 655,121</u>	<u>\$ 610,168</u>	<u>\$ 518,866</u>	<u>\$ 534,037</u>

Notes to Financial Statements

Investments

The Company's investment portfolio consists primarily of investment grade bonds and is in compliance with Section 3925.08 of the ORC. The investments were 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 Leslie R. Marlo, FCAS, MAAA, of KPMG to render a Statement of Actuarial Opinion ("Opinion") on the total reserves. Ms. Marlo prepared an Actuarial Report supporting the Opinion in conjunction with the preparation of the Company's December 31, 2011 Annual Statement.

Thomas Botsko, ACAS, MAAA, the Department's Chief Property and Casualty Actuary, reviewed the Actuarial Report and performed other procedures as considered necessary to evaluate the loss and loss adjustment expense ("LAE") reserves. Mr. Botsko concluded the reserves fall within a reasonable range of reserve estimates at December 31, 2011.

Subsequent Events

There are no material subsequent events.

Conclusion

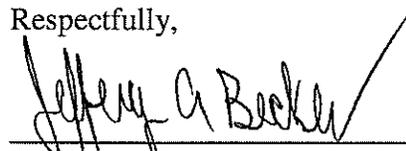
The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2011, and is summarized as follows:

Total Admitted Assets	<u>\$ 1,747,475,296</u>
Liabilities	1,068,706,404
Surplus as Regards Policyholders	<u>678,768,892</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$ 1,747,475,296</u>

Acknowledgement

In addition to the undersigned, the following representatives of the Department participated in this examination: Methuselah Nyangoro, CFE, CPA; Kim Somogyi, CPA; Edward Nagorny, CFE, CPA; Bryan Radecky, CPA; Patricia Severs, CPA; Mark Boston, CPA; Rick Rhoades, CPA (inactive); William Harrington, CFE, CPA (inactive); Thomas Botsko, ACAS, MAAA; Bradley Schroer; Vicky Hugo, AES, CISA, CPA and Roy Moster, AES, CISA, CPA.

Respectfully,



Jeffery A. Becker, CFE
Examiner-In-Charge
Office of Risk Assessment
Ohio Department of Insurance



David A. Cook, CFE
Assistant Chief Examiner
Office of Risk Assessment
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.

Jeffery A. Becker
Examiner-in-Charge

3/7/2013
Date

Elizabeth Chase
Assistant Chief Examiner

3/7/2013
Date

State of Ohio

County of Franklin

Personally appeared before me the above named, Jeffery A. Becker, 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 7 day of March, 2013.

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, David A. Cook, 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 7 day of March, 2013.

Elizabeth Chase

Notary Public **ELIZABETH CHASE**
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2017
My Commission Expires