Report of Examination of

Hallmark National Insurance Company
Fort Worth, Texas

As of December 31, 2013

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Columbus, Ohio
April 17, 2015

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

Hallmark National 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, 2008. The Department's current examination covers the period of January 1, 2009 through December 31, 2013.

Representatives of the Texas Department of Insurance ("TDI"), as the Coordinating State regulator of Hallmark Financial Services Group ("Hallmark") and its subsidiaries, led the multi-state coordinated examination. 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 corporate governance, identify and assess current and prospective risks, and evaluate the Company's system of 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 Statements of Statutory Accounting Principles ("SSAPs") 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 the last four years under examination, the Certified Public Accounting ("CPA") firm of Ernst & Young provided an unqualified opinion on the financial statements of the Company based on Statutory Accounting Principles. Representatives of the Department reviewed the independent auditors' reports and supporting work papers during the examination.

The CPA firm of KPMG provided an unqualified opinion based on statutory accounting principles for the first year of the period under examination. No disagreements or unresolved differences were noted to have existed between the Company and this predecessor CPA firm.

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
Gregory P. Birdsall	Chief Information Officer, Hallmark
Kevin T. Kasitz	Executive Vice President for Commercial Lines and Chief Operating Officer, Hallmark
Christopher J. Kenney	Senior Vice President of Accounting, Hallmark
Mark J. Morrison	President and Chief Executive Officer, Hallmark
Jeffrey R. Passmore	Senior Vice President and Chief Accounting Officer, Hallmark
Mark E. Schwarz	Executive Chairman and Director, Hallmark
Cecil R. Wise	Vice President Claims, Hallmark

Officers

As of the examination date, the following officers were serving in the designated position:

Name	Title
Kevin T. Kasitz	President
Jeffrey R. Passmore	Chief Financial Officer & Treasurer
Cecil R. Wise	Secretary
Christopher J. Kenney	Vice President
Mark J. Morrison	Executive Vice President

Insurance Holding Company System

The Company is a member of an insurance holding company system as defined in ORC Section 3901.32. The parent company, Hallmark Insurance Company, an insurance company domiciled in Arizona, owns 100% of the stock of the Company. Newcastle Partners, L.P., Mark E. Schwartz General Partner, through its 26.4% ownership of Hallmark, is the ultimate controlling person in the holding company system.

Territory and Plan of Operations

The Company is licensed to operate in twenty-five states and the Company is actively writing business in thirteen states. The Company writes mainly personal and commercial automobile insurance. The Company's products and services are distributed exclusively through the independent agency system. The Company reported the following underwriting results during the examination period:

	2013	2012	2011	2010	2009
Loss and LAE Ratio	72.4	71.9	80.8	*	75.8
Expense Ratio	33.7	26.6	24.5		27.9
Combined ratio	106.1	98.5	105.3		103.7

*-The Company had no premiums earned in 2010.

During 2013, the largest five states in terms of direct premium written were as follows: Kentucky $3,390,000 (32.4%); Oklahoma $2,250,000 (21.5%); Maryland $2,221,000 (21.2%); Tennessee $847,000 (8.1%); and Colorado $806,000 (7.7%). The following schedule illustrates the Company's direct premium written in 2013, by line of business:

Line of Business	Direct	Pct.
Private passenger auto liability	$ 6,807,601	65%
Commercial auto liability	1,041,580	10
Auto physical damage	1,565,426	15
All other lines	1,047,468	10
Totals	$10,462,075	100%

Reinsurance

Effective January 1, 2011, Hallmark entered into an intercompany reinsurance pooling agreement whereby the members contributed to and participated in all business earned on and after that date. The participants' pooling percentages at December 31, 2013 were as follows:

American Hallmark Insurance Company of Texas	29.8%
Hallmark Insurance Company	27.3
Hallmark Specialty Insurance Company	30.3
Hallmark National Insurance Company	12.6
	100.0%

In addition to participating in the intercompany reinsurance pooling arrangement, Hallmark assumes and cedes business to other insurers and reinsurers during the ordinary course of business under various contracts that cover individual risks or entire classes of business. Reinsurance is primarily assumed on a pro rata basis and ceded on an excess-of-loss basis.

The Company is not in compliance with SSAP No. 62, Paragraph 9 regarding multi-cedent reinsurance agreements. The legal entity affiliates participate in various third party multi-cedent reinsurance agreements. These agreements do not contain provisions describing how the balances associated with each agreement should be allocated among the cedents, nor is there a separate agreement to cover the allocation as required by SSAP No. 62, Paragraph 9.

Financial Statements

The financial condition and the results of its operations for the 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, Capital and Surplus
December 31, 2013

Bonds	$ 48,446,864
Preferred stocks	
Common stocks	1,942,220
Cash, cash equivalents, and short term investments	21,278,116
Subtotal, cash and invested assets	71,667,200
Investment income due and accrued	446,609
Uncollected premiums and agents' balances	(53,983)
Deferred premiums	2,179,262
Amounts recoverable from reinsurers	1,642,056
Current federal and foreign income tax recoverable	414,254
Net deferred tax asset	774,550
Total admitted assets	$ 77,069,948
Losses	$ 32,211,887
Loss adjustment expenses	7,159,446
Commissions payable, contingent commissions and other charges	46,699
Other expenses	43,268
Taxes, licenses and fees	(12,855)
Unearned premiums	17,679,711
Ceded reinsurance premiums payable	(274,765)
Payable to parent, subsidiaries and affiliates	76,238
Miscellaneous liabilities	(622,616)
Total liabilities	56,307,013
Common capital stock	2,400,000
Gross paid in and contributed surplus	20,600,000
Unassigned funds	(2,237,065)
Total capital and surplus	20,762,935
Total liabilities, capital and surplus	$ 77,069,948

Statement of Income
For the Year Ended December 31, 2013

Premiums earned	$ 45,416,659
Losses incurred	28,266,669
Loss adjustment expenses incurred	4,600,678
Other underwriting expenses incurred	15,317,518
Total underwriting deductions	48,184,865
Net underwriting (loss)	(2,768,206)
Net investment income earned	1,363,318
Net realized capital gains	6,258
Net investment gain	1,369,576
Net (loss) from agents' or premium balances charged off	(42,207)
Finance and service charges not included in premiums	428,015
Total other income	385,808
Net (loss) before federal income taxes	(1,012,822)
Federal income taxes incurred	(483,174)
Net income	$ (529,648)

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

	2013	2012	2011	2010	2009
Capital and surplus, prior year end	$ 21,207	$ 19,682	$ 10,000	$ 61,792	$ 65,454
Net income (loss)	(529)	(1,427)	(1,980)	7,153	1,464
Change in net unrealized capital gains (losses)	402	24	0	(681)	738
Change in net deferred income tax	(1,366)	1,224	669	(2,338)	61
Change in nonadmitted assets	549	(296)	(7)	434	575
Surplus adjustments-Paid in	0	2,000	11,000	(35,000)	0
Dividends to stockholders	0	0	0	(21,360)	(6,500)
Aggregate write-ins for gains in surplus	499	0	0	0	0
Net change in capital and surplus	(445)	1,525	9,682	(51,792)	(3,662)
Capital and surplus, current year end	$ 20,762	$ 21,207	$ 19,682	$ 10,000	$ 61,792

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 Richard Gibson, FCAS, MAAA, and Chief Actuary to render the Company's Statement of Actuarial Opinion ("Opinion"). Mr. Gibson prepared an Actuarial Report supporting the Opinion in connection with the preparation of the company December 31, 2013 Annual Statement.

Jennifer Wu, FCAS, MAAA, of TDI, reviewed the Actuarial Report and performed other procedures as considered necessary to evaluate the pooled reserves. On the basis of her analysis, Ms. Wu concluded the pooled reserves fall within a reasonable range of reserve estimates at December 31, 2013.

Intercompany Pooling

The Company was not in compliance with SSAP No. 63, paragraph 8 that requires underwriting results from voluntary pools to be "...accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable."

The Company and the other intercompany pool participants were netting intercompany payables on paid losses and loss adjustment expense against intercompany premiums receivable in their Annual Statement financial reporting. This resulted in offsetting understatements of reported 'Uncollected premiums and agents balances' and 'Reinsurance payable on paid losses and loss adjustment expenses' in the 2013 Annual Statement balance sheets of each of the pool participants. In addition, the understatements in 'Reinsurance payable on paid losses and loss adjustment expenses' was also reflected in the 2013 Annual Statement Schedule F - Part 1 (Assumed Reinsurance) of each of the pool participants.

Paragraph 9 of SSAP No. 63 directs that, "Underwriting results relating to intercompany pools shall be accounted for and reported as described in paragraph 8. While it is acceptable that intercompany pooling transactions be settled through intercompany arrangements and accounts, intercompany pooling transactions shall be reported on a gross basis in the appropriate reinsurance accounts consistent with other direct, assumed and ceded business."

The correct netting of the aforementioned accounts would have had the following effect on the Company's Statement of Assets, Liabilities, Capital and Surplus reflected in this report:

Uncollected premiums and agents' balances

$ (53,983)	Company reported balance at December 31, 2013
5,635,015	Adjustment
$5,581,032	Corrected Company balance at December 31, 2013

Reinsurance payable on paid losses and loss adjustment expenses

$ 0	Company reported balance at December 31, 2013
5,635,015	Adjustment
$5,635,015	Corrected Company balance at December 31, 2013

This incorrect reporting caused no effect on Capital and Surplus reported at December 31, 2013.

It appears that the Company has corrected this reporting in its 2014 Annual Statement reporting in its financial statements as of December 31, 2014. However, prior year reporting in the 2014 Annual Statement, representing financial statements as of December 31, 2013, were not retroactively adjusted to reflect the adjustments above. As there is no effect on surplus, this reporting was considered acceptable.

Subsequent Event

Effective November 20, 2014, the Company re-domesticated to Arizona.

Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2013, and is summarized as follows:

Total Assets	$ 77,069,948
Liabilities	56,307,013
Capital and Surplus	20,762,935
Total Liabilities, Capital and Surplus	$ 77,069,948

Acknowledgement

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

In addition to the undersigned, Stephen Bishel, CPA, of the Department, participated in this examination.

Respectfully,

Kevin J. Rupp, CFE
Examiner-In-Charge
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, 2013.

Examiner-In-Charge 4/30/15
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 30 day of April, 2015.

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