

Report of Examination of

Colony Specialty Insurance Company
Columbus, Ohio

As of December 31, 2014

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Columbus, Ohio
April 28, 2016

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

Colony Specialty 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, 2011. This examination covers the period of January 1, 2012, through December 31, 2014.

Representatives of the Virginia Bureau of Insurance, as the coordinating state regulator of the insurance company affiliates of Colony Insurance Company, led the multi-state coordinated examination that included representatives from the Department. 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 Company’s financial condition, assess corporate governance, identify current and prospective risks of the Company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer’s surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management’s compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company’s financial statements.

The examination report includes significant findings of fact, as mentioned in Section 3901.07 of the ORC and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g. subjective conclusion, proprietary information, etc.),

are not included within the examination report but separately communicated to other regulators and/or the Company.

For all years under examination, the Certified Public Accounting firm of Ernst & Young LLP provided an unqualified opinion based on Statutory Accounting Principles. Representatives of the Department reviewed the independent auditors' reports and supporting work papers 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
Arthur G. Davis	President and Chief Executive Officer Colony Insurance Company Richmond, Virginia
Barbara L. Sutherland	Senior Vice President, General Counsel and Chief Claims Officer Argo Group US, Inc. San Antonio, Texas
Craig S. Comeaux	Vice President, Secretary and Deputy General Counsel Argo Group US, Inc. San Antonio, Texas

Officers

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

Name	Title
Arthur G. Davis	President and Chief Executive Officer
Marlo M. Edwards	Senior Vice President
Becky L Kenyon	Senior Vice President
Kevin J. Rehnberg	Senior Vice President
Laurie E. Banez	Vice President
Donna M. Biondich	Vice President
Craig S. Comeaux	Vice President and Secretary
Arnold J. Cottrell	Vice President
Lynn K. Geurin	Vice President and Assistant Treasurer
Daniel G. Platt	Vice President
Mary M. Stulting	Vice President
Barbara L. Sutherland	Vice President and General Counsel
Melinda J. Thompson	Vice President
Janice W. Zwinggi	Vice President and Treasurer

Insurance Holding Company System

The Company is a member of a holding company system as defined under Section 3901.32 of the ORC. The Company is a wholly owned subsidiary of Colony Insurance Company (“Colony”), a Virginia domiciled insurance company. The Company, along with Colony and Colony National Insurance Company, comprise the Colony Group. The Company’s ultimate parent is Argo Group International Holdings, Ltd., a Bermuda Corporation, which is publicly traded on the NASDAQ stock market.

Territory and Plan of Operations

The Company writes property and casualty insurance. At year-end 2014, the Company was licensed in 49 states and the District of Columbia and had excess and surplus authority in one state.

Reinsurance

The Company had the following reinsurance coverage in force at December 31, 2014:

Ceded to Non-Affiliated Reinsurers:

<u>Type of Agreement</u>	<u>Class of Business</u>	<u>Company Retention</u>	<u>Reinsurer's Limits</u>
Per Risk Excess of Loss	Property	<u>Layer 1</u> \$2,500,000 each loss, each risk	\$2,500,000 each loss, each risk, \$5,000,000 each loss occurrence; \$12,500,000 all loss occurrences
		<u>Layer 2</u> \$5,000,000 each loss	\$5,000,000 each loss, each risk, \$5,000,000 each loss occurrence; \$10,000,000 all loss occurrences
Quota Share	Liability	60% up to \$1,000,000	40% up to \$1,000,000; subject to a maximum annual aggregate limit of liability of \$10,000,000
Excess of Loss	Liability	<u>Layer 1</u> \$2,000,000 each occurrence	\$3,000,000 excess of \$2,000,000 each liability, subject to limit of liability of \$12,000,000 all loss occurrences
		<u>Layer 2</u> \$5,000,000 each occurrence	\$5,000,000 excess of \$5,000,000 each liability, subject to limit of liability of \$15,000,000 all loss occurrences

<u>Type of Agreement</u>	<u>Class of Business</u>	<u>Company Retention</u>	<u>Reinsurer's Limits</u>
Excess of Loss	Liability	\$10,000,000	\$10,000,000 excess of 10,000,000 each liability, subject to limit of liability of \$20,000,000 all loss occurrences
Quota Share (expired 7/15/2014)	Umbrella	<u>Layer 1</u> 37.5% up to \$10,000,000	62.5% up to \$10,000,000
		<u>Layer 2</u> 27% between \$10,000,000 and \$15,000,000	73% between \$10,000,000 and \$15,000,000
Excess of Loss	Combined Casualty	<u>Layer 1</u> \$2,000,000	\$8,000,000 excess of \$2,000,000 per occurrence; annual aggregate limit of \$56,000,000
		<u>Layer 2</u> \$10,000,000	\$5,000,000 excess of \$10,000,000 per occurrence; annual aggregate limit of \$15,000,000
Excess of Loss	Environmental Liability on Washington State UST (underground storage tank) coverage	\$75,000 each claim	\$925,000 each claim in excess of company retention

<u>Type of Agreement</u>	<u>Class of Business</u>	<u>Company Retention</u>	<u>Reinsurer's Limits</u>
Excess of Loss	Property Catastrophe	<u>Layer 1</u> \$25,000,000	\$50,000,000 excess of \$25,000,000 each and every loss occurrence
		<u>Layer 2</u> \$75,000,000	59% of \$150,000,000 excess of \$50,000,000, each and every loss
		<u>Layer 3</u> \$125,000,000	30% of \$200,000,000 excess of \$50,000,000, each and every loss
		<u>Layer 4</u> \$225,000,000	65% of \$100,000,000 excess of \$225,000,000, each and every loss
		<u>Layer 5</u> \$325,000,000	85% of \$100,000,000 excess of \$325,000,000, each and every loss
		<u>Layer 6</u> \$425,000,000	64% of \$50,000,000 excess of \$425,000,000, each and every loss
Excess of Loss	Aggregate Sweeper Cover	\$25,000,000 each and every loss	\$50,000,000

Ceded to Affiliated Reinsurers:

The Company is a participant in an intercompany quota share agreement with Rockwood Casualty Insurance Company (“Rockwood”). Under the terms of this agreement, the Company cedes to Rockwood 100% of its workers’ compensation business, all of which is managed by Rockwood.

The Company is a participant in a quota share reinsurance agreement with Colony through which it cedes to Colony 100% of its net retained liabilities after inuring reinsurance.

The Company is a participant in a quota share reinsurance agreement with an affiliate, Argo Reinsurance Ltd. Under the agreement, the Company cedes 50% of net earned premium and losses, net of inuring reinsurance, related to business underwritten by the Company.

Significant Operating Results

The Company reported no premiums earned, losses incurred, or expenses incurred for any year under examination as a result of the 100% quota share reinsurance agreement with Colony.

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, Surplus and Other Funds

Statement of Income

Statement of Changes in the Capital and Surplus Account

**Statement of Assets, Liabilities, Surplus and Other Funds
December 31, 2014**

Assets

Bonds	\$ 36,618,842
Common stocks	18,265,151
Cash, cash equivalents and short-term investments	<u>3,410,221</u>
Subtotal, cash and invested assets	58,294,214
Investment income due and accrued	256,976
Uncollected premiums in course of collection	2,292,292
Deferred premiums and installments booked but deferred	86,533
Amounts recoverable from reinsurers	2,667,402
Receivables from parent, subsidiaries, and affiliates	<u>1,726,818</u>
Total admitted assets	<u><u>\$ 65,324,235</u></u>

Liabilities

Taxes, licenses and fees	\$ 506,922
Current federal income taxes	196,043
Net deferred tax liability	1,435,530
Dividends declared and unpaid-Stockholders	7,400,000
Ceded reinsurance premiums payable	1,251,727
Funds held by company under reinsurance treaties	33,523,629
Provision for reinsurance	901,876
Payable to parent, subsidiaries and affiliates	<u>119,589</u>
Total liabilities	<u><u>45,335,316</u></u>

Capital and Surplus

Common capital stock	3,500,000
Gross paid in and contributed surplus	8,002,700
Unassigned funds (surplus)	<u>8,486,219</u>
Total surplus and other funds	<u>19,988,919</u>
Total liabilities, surplus and other funds	<u><u>\$ 65,324,235</u></u>

Statement of Income
For the Year Ended December 31, 2014

Premiums earned	\$ <u>0</u>
Losses incurred	0
Loss adjustment expenses incurred	0
Other underwriting expenses incurred	<u>0</u>
Total underwriting deductions	<u>0</u>
Net underwriting gain	<u>0</u>
Net investment income earned	1,159,063
Net realized capital gains	<u>80,100</u>
Net investment gain	<u>1,239,163</u>
Net gain from agents' or premium balances charged off	787
Intercompany interest expense	<u>(300,302)</u>
Total other income	<u>(299,515)</u>
Net income before federal income taxes	939,648
Federal income taxes incurred	<u>182,068</u>
Net income	<u>\$ 757,580</u>

Statement of Changes in the Capital and Surplus Account

	2014	2013	2012
Capital and surplus, prior year end	\$27,257,223	\$25,224,850	\$25,180,797
Net income	757,580	628,438	464,717
Change in net unrealized capital gains	(34,657)	1,472,925	391,832
Change in net deferred income tax	(26,763)	105,577	318,057
Change in non-admitted assets	(245,518)	(37,154)	(35,372)
Change in provisions for reinsurance	(318,946)	(137,413)	(325,728)
Impact of prior year adjustment	0	0	(769,453)
Dividends to stockholders	(7,400,000)	0	0
Net change in capital and surplus	(7,268,304)	2,032,373	44,053
Capital and surplus, current year end	\$19,988,919	\$27,257,223	\$25,224,850

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 Ronald J. Swanstrom, FCAS, MAAA, Senior Vice President and Chief Reserving Actuary, Argo Group U.S., Inc., to render the Company's Statement of Actuarial Opinion ("Opinion"). Mr. Swanstrom prepared an Actuarial Report supporting the Opinion in connection with the preparation of the Company's December 31, 2014 Annual Statement.

David M. Shepherd, FCAS, MAAA, Greg Fanoie, FCAS, MAAA, of Merlinos & Associates, Inc., was contracted by Virginia Bureau of Insurance to review the reserves for the Group as of December 31, 2014. Mr. Shepherd and Mr. Fanoie found that the Appointed Actuary's analysis and conclusion to be reasonable. He concluded that carried net and direct and assumed reserves are not materially different from the Appointed Actuary's point estimate and are supported by an adequate level of analysis. As such, he did not consider an adjustment of reserves to be merited.

Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2014, and is summarized as follows:

Total Admitted Assets	<u>\$ 65,324,235</u>
Liabilities	45,335,316
Capital and Surplus	<u>19,988,919</u>
Total Liabilities, Capital and Surplus	<u>\$ 65,324,235</u>

Subsequent Events

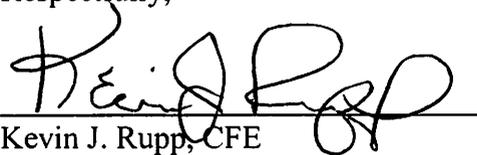
There have been no events subsequent to the examination date which would have a material effect on the financial condition of the Company.

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 undersigned, the following representative of the Department participated in this examination: Stephen W. Bishel, CPA.

Respectfully,



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



Rick A. Rhoades, CPA
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, 2014.

Kevin J. Rupp 5/26/16 Rick Rhoades 5/26/16
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 26 day of May, 2016.

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, Rick A. Rhoades, 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 26 day of May, 2016.

Elizabeth Chase
(Notary Public)

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