

Report of Examination of

National Interstate Insurance Company
Richfield, Ohio

As of December 31, 2010

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Richfield, Ohio
October 18, 2011

Honorable Joseph Torti, III
Deputy Director and Superintendent of Insurance
Chairman, Financial Condition (E) Committee
National Association of Insurance Commissioners
Department of Business Regulation
1511 Pontiac Avenue
Cranston, Rhode Island 02920

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

Dear Madam and Sir:

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

National Interstate Insurance Company

an Ohio domiciled, stock, property and casualty insurance company, hereinafter referred to as the (“Company.”) The examination was conducted at the Company’s home office, located at 3250 Interstate Drive, Richfield, Ohio.

Scope of Examination

The Department last examined the Company as of December 31, 2005. The current examination covers the period of January 1, 2006 through December 31, 2010.

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.

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

For examination years 2006 through 2010, the certified public accounting firm of Ernst & Young, LLP (“E&Y”) provided an unqualified opinion based on statutory accounting principles. Relevant work performed by E&Y during its annual audit of the Company was reviewed during the examination and incorporated into the examination work papers.

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>
Alan Robert Spachman	Chairman, National Interstate Corporation
David Warner Michelson	President and Chief Executive Officer, National Interstate Corporation
Terry Eugene Phillips	Senior Vice President, National Interstate Corporation
Julie Ann McGraw	Vice President and Chief Financial Officer, National Interstate Corporation
Gary Norman Monda	Vice President and Chief Investment Officer, National Interstate Corporation
Michelle Ann Silvestro	Assistant Vice President, National Interstate
Ronald George Steiger, Jr.	Assistant Vice President, National Interstate
Edward Jeffrey Masch	Assistant Vice President, National Interstate
James Allen Parks	Vice President, National Interstate

Anthony Joseph Mercurio	Vice President and Chief Executive Officer, Vanliner Insurance Company
Terri Kaye Johnson	Vice President, National Interstate
Bradford Lee Scofield	Vice President, National Interstate
John Lloyd Woods	Vice President and General Manager - Hawaii Operations, National Interstate
Pamela Lee McDermid	Assistant Vice President, National Interstate
Robert Adrian Bernatchez	Vice President, National Interstate
Arthur Jeffrey Gonzales	Vice President, General Counsel and Secretary, National Interstate Corporation

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>
David Warner Michelson	President
Julie Ann McGraw	Vice President, Chief Financial Officer and Treasurer
Arthur Jeffrey Gonzales	Vice President, General Counsel and Secretary
Terry Eugene Phillips	Senior Vice President
Gary Norman Monda	Vice President, Chief Investment Officer and Assistant Treasurer

Insurance Holding Company System

The Company is a member of a holding company system as defined in Section 3901.32 of the ORC. Great American Insurance Company owns 52.5% of the voting stock of National Interstate Corporation, a publicly traded insurance holding company. The following displays the chain of ownership of the insurance companies as of December 31, 2010:

- Great American Insurance Company
 - Agricultural Services, LLC
 - El Aguila Compania de Seguros, S.A. de C.V.
 - FCIA Management Company, Inc.
 - GAI Warranty Company
 - GAI Warranty Company of Florida
 - Great American Alliance Insurance Company
 - Great American Assurance Company
 - Great American Casualty Insurance Company
 - Great American Contemporary Insurance Company
 - Great American E & S Insurance Company
 - Great American Fidelity Insurance Company
 - Great American Insurance Agency, Inc.
 - Great American Insurance Company of New York
 - Great American Lloyd's Insurance Company
 - Great American Protection Insurance Company
 - Great American Security Insurance Company
 - Great American Spirit Insurance Company
 - National Interstate Corporation (52.5%)
 - Hudson Indemnity, Ltd.
 - National Interstate Insurance Company
 - National Interstate Insurance Company of Hawaii, Inc.
 - Triumpe Casualty Company
 - Vanliner Group, Inc.
 - Vanliner Insurance Company
 - Vanliner Reinsurance Limited

Territory and Plan of Operations

The Company is licensed to transact business in the District of Columbia and all fifty states.

The following schedule illustrates the Company's premium written in 2010 by line of business:

	Direct	Assumed	Ceded	Net	Percent
Commercial auto liability	194,412,107	8,492,546	80,342,758	122,561,895	53.2%
Auto physical damage	64,023,546	13,410,168	14,404,734	63,028,980	27.4%
Workers' compensation	63,014,561	2,594,913	39,745,824	25,863,650	11.2%
Other liability – occurrence	17,932,798	574,748	11,014,990	7,492,556	3.3%
Private passenger auto liability	5,593,256	1,946,499	815,109	6,724,646	2.9%
Inland marine	4,837,395	(7,500)	1,787,185	3,042,710	1.3%
All other	<u>5,111,285</u>	<u>145,517</u>	<u>3,644,376</u>	<u>1,612,426</u>	<u>0.7%</u>
Totals	<u>\$ 354,924,948</u>	<u>\$ 27,156,891</u>	<u>\$ 151,754,976</u>	<u>\$ 230,326,863</u>	<u>100.0%</u>

Significant Operating Results

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

	2010	2009	2008	2007	2006
Premiums earned	<u>\$ 218,102</u>	<u>\$ 208,263</u>	<u>\$ 215,268</u>	<u>\$ 194,612</u>	<u>\$ 173,882</u>
Losses incurred	109,797	91,983	104,443	83,904	80,493
Loss adjustment expense incurred	22,445	18,545	23,310	14,796	16,995
Underwriting expense incurred	<u>72,659</u>	<u>64,744</u>	<u>61,283</u>	<u>52,480</u>	<u>49,477</u>
Total underwriting deductions	<u>204,901</u>	<u>175,272</u>	<u>189,036</u>	<u>151,180</u>	<u>146,965</u>
Net underwriting gain	\$ 13,201	\$ 32,990	\$ 26,232	\$ 43,433	\$ 26,917
Pure loss ratio	50.3%	44.2%	48.5%	43.1%	46.3%
Loss adjustment expense ratio	<u>10.3%</u>	<u>8.9%</u>	<u>10.8%</u>	<u>7.6%</u>	<u>9.8%</u>
Loss ratio	60.6%	53.1%	59.3%	50.7%	56.1%
Underwriting expense ratio	<u>31.5%</u>	<u>31.5%</u>	<u>28.1%</u>	<u>25.8%</u>	<u>26.7%</u>
Combined ratio	<u>92.1%</u>	<u>84.6%</u>	<u>87.4%</u>	<u>76.5%</u>	<u>82.8%</u>

Reinsurance

Effective January 1, 2008, the Company initiated an intercompany reinsurance pooling agreement with its insurance subsidiaries (“the Group”). The effect is to transfer all net retained insurance liabilities of the subsidiaries to the Company and to cede specified percentages of the net underwriting results of the Group to the participating companies as follows:

<u>The Group</u>	<u>% Participation</u>
National Interstate Insurance Company (Lead)	96%
National Interstate Insurance Company of Hawaii, Inc	2%
Triumphe Casualty Company	2%

The passenger transportation book of business is protected by excess of loss reinsurance up to \$5 million on liability or workers’ compensation. An automatic facultative agreement is in place for those policies greater than \$5 million. The Group retains up to 100% of the liability on the first \$1 million and the first \$12 million of losses in the \$4 million excess of the \$1 million, referred to as the annual aggregate deductible (“AAD”). Losses above the AAD are 100% reinsured up to an annual aggregate limit of \$20 million. The Group retains up to 100% of the first \$1 million in auto physical damage losses within this program.

The commercial truck business is reinsured under an excess of loss program with limits up to \$1 million with an automatic facultative agreement in place for those policies greater than \$1 million. The Group retains 100% of the first \$500,000 of liability exposure and 50% of the \$500,000, excess of \$500,000 layer. The Group also retains up to 100% of \$1 million in auto physical damage for this book.

The recreational vehicle program has an excess of loss agreement covering losses up to \$2 million of those exceeding the Group’s retention level of \$400,000 for liability. The Group obtains reinsurance protection for physical damage losses exceeding the Group’s \$350,000 retention up to a \$2 million cover.

Mainland catastrophe protection is in place primarily covering the Group’s auto physical damage in excess of \$750,000 up to \$5 million per occurrence. Likewise, catastrophe excess of loss reinsurance for workers’ compensation is in place for losses greater than \$1 million.

For the Hawaii business, the Group utilizes multiple reinsurance contracts, including excess of loss and quota share programs. Excess of loss protection with limits of \$750,000 excess of \$250,000 is purchased for the general commercial and auto liability business. Workers’ compensation coverage is reinsured with a quota share contract with the Group retaining 40% of the losses up to a limit of \$250,000. Excess protection is in place for losses above that amount. The Group cedes 95% of Hawaii property losses up to a limit of \$3.25 million per risk. A catastrophe cover reinsures auto physical damage and property losses exceeding \$500,000 up to \$5 million.

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, 2010**

Admitted assets

Bonds	\$ 410,583,469
Preferred stocks	7,652,732
Common stocks	172,059,591
Properties occupied by the company	15,887,822
Cash	7,353,082
Other invested assets	<u>13,832,721</u>
Total cash and invested assets	627,369,417
Investment income due and accrued	3,495,588
Uncollected premiums and agents' balances in the course of collection	13,354,505
Deferred premiums, agents' balances and installments booked but deferred and not yet due	88,454,948
Amounts recoverable for reinsurers	5,031,367
Funds held by or deposited with reinsured companies	1,162,596
Current federal and foreign income tax recoverable and interest thereon	4,653,731
Net deferred tax asset	19,105,446
Electronic data processing equipment and software	851,149
Receivables from parent, subsidiaries and affiliates	17,011,664
Aggregate write-ins for other than invested assets:	
Receivable from insureds for deductible payments	824,812
Miscellaneous receivable	523,007
Commission receivable	1,045,377
Amounts refundable on purchase price of Vanliner	14,255,969
Receivable for balance sheet guarantee	<u>2,423,635</u>
Total admitted assets	<u>\$ 799,563,212</u>

**Statement of Liabilities, Capital and Surplus
December 31, 2010**

Liabilities

Losses	\$ 148,644,616
Loss adjustment expenses	46,600,049
Commissions payable, contingent commissions and other similar charges	7,953,789
Other expenses	10,820,252
Taxes, licenses and fees	4,698,593
Unearned premiums	106,142,942
Advanced premiums	959,753
Ceded reinsurance premiums payable	9,479,588
Funds held by company under reinsurance treaties	166,330,288
Amounts withheld or retained by company for account of others	14,059,123
Remittances and items not allocated	1,784,183
Provision for reinsurance	1,322,257
Payable to parent, subsidiaries and affiliates	7,038,476
Aggregate write-ins for liabilities:	
Unearned rental income	<u>82,444</u>
Total liabilities	525,916,352

Capital and Surplus

Aggregate write-ins for special surplus funds:	
Implementation of SSAP 10R	622,241
Common capital stock	3,000,000
Gross paid in and contributed surplus	32,108,779
Unassigned funds	<u>237,915,840</u>
Surplus as regards policyholders	<u>273,646,860</u>
Total liabilities, capital and surplus	<u>\$ 799,563,212</u>

**Statement of Income
As of December 31, 2010**

Premium earned	<u>\$ 218,101,579</u>
Losses incurred	109,797,005
Loss adjustment expenses	22,444,747
Other underwriting expenses incurred	<u>72,658,789</u>
Net underwriting gain	<u>13,201,038</u>
Net investment income earned	17,893,886
Net realized capital losses	<u>1,740,597</u>
Net investment gain	<u>19,634,483</u>
Finance and service charges not included in premiums	507,691
Aggregate write-ins for miscellaneous income:	
Other	1,047,731
Interest from funds held	<u>(3,740,283)</u>
Total other income	<u>(2,184,861)</u>
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	30,650,660
Federal and foreign income taxes incurred	<u>10,793,157</u>
Net income	<u>\$ 19,857,504</u>

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

<u>Capital and Surplus</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Capital & surplus, prior year end	<u>\$ 238,390</u>	<u>\$ 190,134</u>	<u>\$ 182,302</u>	<u>\$ 148,266</u>	<u>\$ 122,825</u>
Net income	19,858	33,158	7,611	37,745	26,579
Change in net unrealized capital gains or (losses) less capital gains tax	12,372	8,483	(633)	(1,009)	1,519
Change in net deferred income tax	2,163	(526)	1,498	1,377	1,108
Change in non-admitted assets	2,952	5,071	(134)	68	(779)
Change in provision for reinsurance	(1,192)	552	(511)	(145)	13
Dividend to stockholders	-	-	-	(4,000)	(3,000)
Aggregate write-ins for gains and losses in surplus					
Implementation of SSAP 10R	<u>(896)</u>	<u>1,518</u>	=	=	=
Net change in capital and surplus	<u>35,257</u>	<u>48,256</u>	<u>7,832</u>	<u>34,036</u>	<u>25,441</u>
Capital and surplus, current year end	<u>\$ 273,647</u>	<u>\$ 238,390</u>	<u>\$ 190,134</u>	<u>\$ 182,302</u>	<u>\$ 148,266</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 appointed John L. Doellman, FCAS, MAAA, an actuary employed with Great American Insurance Company, to certify the total reserves for all years under examination.

Thomas Botsko, Chief Property and Casualty Actuary of the Department, reviewed the actuarial studies performed and determined the loss and loss adjustment expense ("LAE") reserves presented in the Company's 2010 annual statement appear to make a reasonable provision for the Company's loss and LAE reserves.

Subsequent Events

Effective July 1, 2010, the Company acquired Vanliner Insurance Company and on January 1, 2011, the Company entered into an amended pooling agreement with its insurance subsidiaries. The following summarizes the participation percentages:

<u>The Group</u>	<u>% Participation</u>
National Interstate Insurance Company (Lead)	70%
Vanliner Insurance Company	26%
National Interstate Insurance Company of Hawaii, Inc	2%
Triumph Casualty Company	2%

Conclusion

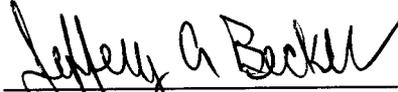
The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2010, and is summarized as follows:

Total Admitted Assets	<u>\$ 799,563,212</u>
Liabilities	\$ 525,916,352
Surplus as Regards Policyholders	<u>273,646,860</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$ 799,563,212</u>

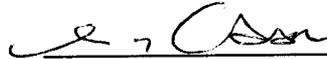
Acknowledgement

In addition to the undersigned, the following representatives of the Department participated in this examination: Kim Somogyi, CPA; Edward Nagorny, CFE, CPA; Louis Radecky, CFE, CPA; Trish Mesler, CPA; William Harrington, CFE, CPA; Thomas Botsko, ACAS, MAAA; Bradley Schroer; Vicky Hugo, AES, CFE and Larry Rice, AES, CISA.

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, 2010.

Jeffery A. Becker 10/18/2011 [Signature] 10/18/2011
Examiner-In-Charge Date Assistant Chief Examiner 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/her knowledge and belief.

Subscribed and sworn to before me this 18 day of October, 2011.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
~~MY COMMISSION EXPIRES MAY 22, 2012~~
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/her knowledge and belief.

Subscribed and sworn to before me this 18 day of October, 2011.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
~~MY COMMISSION EXPIRES MAY 22, 2012~~
My Commission Expires