

Report of Examination of

**Colony Specialty Insurance Company**  
Columbus, Ohio

As of December 31, 2011

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Columbus, Ohio  
April 17, 2013

Honorable Mary Taylor  
Lt. Governor/Director  
State of Ohio  
Department of Insurance  
50 West Town Street  
3<sup>rd</sup> 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

**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, 2008. The Department’s current examination covers the period of January 1, 2009 to and including December 31, 2011.

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 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:

<u>Name</u>	<u>Principal Occupation</u>
Samuel C. Anderson	Senior Vice President, Argo Group U.S., Inc.
Michael E. Arledge	President – Commercial Specialty, Argo Group U.S., Inc.
Craig S. Comeaux	Vice President, Secretary and Deputy General Counsel, Argo Group U.S., Inc.
Louis D. Levinson	President – Excess and Surplus Lines, Argo Group U.S., Inc.
Barbara L. Sutherland	Senior Vice President, General Counsel and Chief Claim Officer, Argo Group U.S., Inc.

### Officers

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

<u>Name</u>	<u>Title</u>
Louis D. Levinson	President
Craig S. Comeaux	Secretary
Melinda J. Thompson	Treasurer
Samuel C. Anderson	Senior Vice President
Lynn K. Geurin	Vice President
Gail T. Kimpfler	Senior Vice President
Daniel G. Platt	Vice President
Mary M. Stulting	Vice President
Barbara L. Sutherland	Vice President

## **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 (“National”), 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, on both an admitted and non-admitted basis to supplement Colony’s underwriting business. At year-end 2011, the Company was licensed in 49 states and the District of Columbia and had excess and surplus authority in one state.

## **Reinsurance**

Effective August 1, 1997, the Company entered into 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.

Effective January 1, 2009, the Company entered into a quota share reinsurance agreement with Colony through which it cedes to Colony 100% of its net retained liabilities after inuring reinsurance.

Effective October 1, 2007, the Company entered into a ceded quota share reinsurance agreement with an affiliate, Argo Reinsurance Ltd. Under the agreement, the Company cedes 30% of net earned premium and losses effective October 1, 2007, net of inuring reinsurance, related to business underwritten by the Company. Effective April 1, 2008, the percentage ceded by the Company under this agreement was increased to 50%.

## **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, 2011**

Bonds	\$ 34,022,683
Common stocks	7,285,454
Cash, cash equivalents and short-term investments	<u>21,986,808</u>
Subtotal, cash and invested assets	63,294,945
Investment income due and accrued	284,177
Uncollected premiums and agents' balances in course of collection	1,423,543
Amounts recoverable from reinsurers	343,184
Receivables from parent, subsidiaries, and affiliates	<u>5,708,346</u>
Total admitted assets	<u>\$ 71,054,195</u>
Losses	\$ 0
Losses adjustment expenses	0
Commissions payable, contingent commissions and other charges	30,072
Taxes, licenses and fees	87,518
Current federal income taxes	3,719,272
Net deferred tax liability	77,509
Ceded reinsurance premiums payable	635,543
Funds held by company under reinsurance treaties	40,766,558
Amounts withheld or retained by company for account of others	582
Provision for reinsurance	119,790
Payable to parent, subsidiaries and affiliates	<u>436,556</u>
Total liabilities	45,873,400
Common capital stock	3,500,000
Gross paid in and contributed surplus	8,002,700
Unassigned funds (surplus)	<u>13,678,095</u>
Total surplus and other funds	<u>25,180,795</u>
Total liabilities, surplus and other funds	<u>\$ 71,054,195</u>

**Statement of Income**  
**As of December 31, 2011**

Premiums earned	\$ 0
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	2,403,238
Net realized capital gains	<u>13,402,897</u>
Net investment gain	<u>15,806,135</u>
Net gain from agents' or premium balances charged off	(780)
Intercompany interest expense	<u>(226,129)</u>
Total other income	<u>(226,909)</u>
Net income before federal income taxes	15,579,226
Federal income taxes incurred	<u>546,725</u>
Net income	<u>\$ 15,032,501</u>

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Capital and surplus, December 31 prior year	\$ 78,136	\$ 74,004	\$ 63,244
Net income	15,033	2,552	10,836
Change in net unrealized capital gains or (losses)	(10,012)	1,125	5,353
Change in net deferred income tax	50	(41)	(7,448)
Change in non-admitted assets	(105)	(3)	1,519
Change in provision for reinsurance	(119)	(1)	0
Paid in capital	0	500	500
Dividends to stockholders	<u>(57,802)</u>	<u>0</u>	<u>0</u>
Change in surplus during the year	<u>(52,955)</u>	<u>4,132</u>	<u>10,760</u>
Capital and surplus, December 31 current year	<u>\$ 25,181</u>	<u>\$ 78,136</u>	<u>\$ 74,004</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 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, 2011 Annual Statement.

David M. Shepherd, FCAS, MAAA, of Merlinos & Associates, Inc., was contracted by the Virginia Bureau of Insurance to review the reserves for the Group as of December 31, 2011. Mr. Shepherd found that the Appointed Actuary's analysis and conclusions 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.

Thomas S. Botsko, ACAS, MAAA, Chief Property & Casualty Actuary of the Department, reviewed the work performed by Mr. Shepherd. Based on his review, Mr. Botsko determined that the loss and loss adjustment expense reserves presented in the Company's 2011 Annual Statement are reasonably stated.

## 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 Assets	<u>\$ 71,054,195</u>
Liabilities	45,873,400
Capital and Surplus	<u>25,180,795</u>
Total Liabilities, Capital and Surplus	<u>\$ 71,054,195</u>

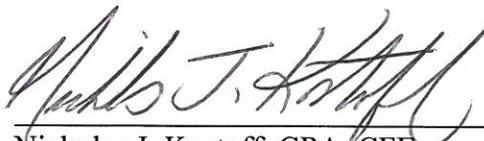
## Subsequent Events

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

## Acknowledgement

In addition to the aforementioned and undersigned, the following representatives of the Department participated in this examination: David T. Finkler, CPA, CFE, CISA, AES; and Bradley J. Schroer, of the Department, participated in this examination.

Respectfully,



Nicholas J. Kostoff, CPA, 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.

*Nicholas J. Kostoff* 5/22/13  
Examiner-In-Charge Date

*Elizabeth Chase* 5/22/13  
Assistant Chief Examiner Date

State of Ohio

County of Franklin

Personally appeared before me the above named Nicholas J. Kostoff 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 22 day of May, 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/her knowledge and belief.

Subscribed and sworn to before me this 22 day of May, 2013.

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