Report

of the

Examination of

Capitol Specialty Insurance Corporation

Middleton, Wisconsin

As of December 31, 2014

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, *Governor*
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May 19, 2016

Honorable Theodore K. Nickel
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53703

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

CAPITOL SPECIALTY INSURANCE CORPORATION
Middleton, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Capitol Specialty Insurance Corporation (the company or CSIC) was conducted in 2010 and 2011 as of December 31, 2009. The current examination covered the intervening period ending December 31, 2014, and included a review of such 2015 and 2016 transactions as deemed necessary to complete the examination.

The examination of the company was conducted concurrently with the examinations of Capitol Indemnity Company (CIC), a Wisconsin-domiciled insurer, and Platte River Insurance Corporation (PRIC), a Nebraska-domiciled insurer. Wisconsin acted in the capacity as the exam facilitator for the three coordinated examinations. Representatives of the Nebraska Insurance Department participated in the examination, and their work was reviewed and relied on where deemed appropriate.

The examination was conducted using a risk-focused approach in accordance with the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. This approach sets forth guidance for planning and performing the examination of an insurance company to evaluate the financial condition, assess corporate governance, identify current and prospective risks (including those that might materially affect financial condition, either currently or prospectively), and evaluate system controls and procedures used to mitigate those risks.

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, annual statement instructions, and Wisconsin laws and regulations. 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 at the end of the "Financial Data" section in the area captioned "Reconciliation of Surplus per Examination."

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

An independent actuarial firm was engaged under a contract with the Office of the Commissioner of Insurance. The actuary reviewed the adequacy of the company's loss and loss adjustment expense reserves. The actuary's results were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

Capitol Specialty Insurance Corporation was organized in 1961 as All-Star Title Insurance, Inc. The company's name was changed to Capitol Land Title Insurance, Inc., in 1966 when its then ultimate parent, Capitol Transamerica Corporation, purchased the company. Capitol Transamerica Corporation changed its name to CapSpecialty, Inc. (CapSpecialty) in 2014. The company adopted its current name effective November 30, 1993.

Effective January 4, 2002, Alleghany Corporation (Alleghany), a publicly traded company on the New York Stock Exchange, purchased CapSpecialty for approximately $182 million in cash. This transaction made Alleghany the ultimate parent company of CSIC. Prior to the purchase, CapSpecialty was a publicly traded company whose common stock was traded through the National Association of Securities Dealers.

Effective March 31, 2002, CSIC was contributed to its then sister affiliate CIC. This transaction made CSIC a wholly owned subsidiary of CIC. For additional information related to affiliates see the section of this report titled "Affiliated Companies."

Effective January 3, 2002, Alleghany purchased 100% of the common stock of Platte River Insurance Company (PRIC), formerly known as Underwriters Insurance Company. In this way, PRIC became an affiliate of CIC and CSIC; the three insurance companies are collectively known as the CapSpecialty Group within the Alleghany Group. Subsequent to this transaction, CIC and PRIC entered into an affiliated pooling arrangement that was effective January 1, 2002, and amended effective January 1, 2007, to include CSIC as a party to it. The affiliated pooling agreement is outlined in detail in section V of this report titled "Reinsurance."

Effective January 1, 2014, Alleghany Corporation effectuated a reorganization and recapitalization of CapSpecialty. The purpose of the reorganization was to better align the companies within the CapSpecialty Group and the Alleghany organization. The reorganization consisted of a series of separate transactions, all of which were consummated in early 2014.

Initially, the common stock of CapSpecialty was converted to Cumulative Convertible Preferred Stock carrying a 7% preference (the Preferred Stock).

Next, CapSpecialty underwent a tax-free reorganization in which it merged with Teton24, Inc. (Teton24) with CapSpecialty being the surviving entity. Teton24 was a holding company for Professional Risk Management Services, Inc. (PRMS). PRMS is an agency that specializes in medical malpractice for the psychiatric industry. CIC has a retrocession agreement with Transatlantic Reinsurance Company (TRC) in effect in which it assumes business produced by PRMS and reinsured by TRC. Prior to the merger, Teton24 was owned 80% by Transatlantic Holdings, Inc. (THI) and 20% by Stephen Sills, who is the current CEO of CapSpecialty. Consideration given by CapSpecialty to THI included 800 shares of the Preferred Stock and 200 shares of Preferred Stock to Stephen Sills. The Preferred Stock issued to THI and Stephen Sills had a total fair value of $3,000,000, which equaled the fair value of PRMS. Immediately after the merger, THI contributed the 800 shares to its wholly owned subsidiary, TRC.

Next, CapSpecialty's immediate parent, Alleghany Insurance Holdings, Inc. (AIHL) contributed 100% of PRIC's outstanding stock to CapSpecialty, which in turn contributed the stock to CIC, making PRIC a wholly owned subsidiary of CIC. Previously, PRIC was a sister company of CapSpecialty. This transaction increased CIC's surplus by $41,302,243.

The last step of the reorganization consisted of CapSpecialty reserving 24,750 shares of Class B Common Stock for management as part of an incentive plan. AIHL subsequently sold 24,000 shares, or 24%, of the Preferred Stock to TRC, bringing TRC's total ownership to 24.8%. Following the reorganization and prior to taking into account any shares reserved for management, CapSpecialty is owned 75% by AIHL, 24.8% by TRC, and 0.2% by Stephen Sills. On a fully diluted basis, after taking into account the shares reserved for issuance to management, CapSpecialty will be owned approximately 60.1% by AIHL, 19.9% by TRC and 20% by management.

As of December 31, 2014, the company is licensed to write business in the state of Wisconsin and is approved to write business on a nonadmitted basis in the remaining 49 states and in the District of Columbia.

In 2014, the company wrote direct premium in the following states:

California	$11,940,633	14.2%
Florida	10,981,614	13.0
Texas	6,709,039	8.0
New York	6,560,883	7.8
Washington	3,508,690	4.2
Illinois	3,333,012	4.0
Michigan	3,331,738	4.0
Pennsylvania	2,854,354	3.4
New Jersey	2,570,653	3.1
Ohio	2,178,509	2.6
All others	30,231,791	35.9
Total	$84,200,916	100.0%

In Wisconsin, the company is licensed to transact the following lines of business as defined by s. Ins 6.75 (2), Wis. Adm. Code:

(a) Fire, Inland Marine, and Other Property
(d) Liability and Incidental Medical Expense
(e) Automobile
(f) Fidelity
(g) Surety
(n) Miscellaneous

The major products marketed by the CapSpecialty Group (the group) can be divided into three segments which include property and casualty, surety, and professional liability.

The property and casualty segment accounted for 58% of group premium in 2014, of which approximately 45% was written on a nonadmitted basis on CSIC paper. Within the segment, significant lines of business included general liability, property, and package coverages. The group focuses on several types of risks including, but not limited to, restaurants, taverns, hotels and motels, barber and beauty parlors, and daycare centers.

The surety segment accounted for 26% of the group's premium in 2014. The segment focuses on small- to mid-sized standard and nonstandard commercial surety risks. The group recently exited the large construction contract surety market, due to unfavorable results.

The professional liability segment accounted for 16% of the group's premium in 2014, of which approximately 60% was written on a nonadmitted basis on CSIC paper. Professional liability includes, but is not limited to, Miscellaneous and Professional E&O, Environmental, and Miscellaneous Health Care Risks. Following the group's reorganization, the CapSpecialty Group is actively expanding its professional liability segment.

As of December 31, 2014, business for the CapSpecialty Group was written through a sales force consisting of 146 independent agents and 73 general agents licensed to write property and casualty and surety insurance, 112 agents specializing in professional liability coverage and 311 independent agents licensed only to write surety insurance. Some commission rates are on a sliding scale that declines with the volume of premium or risk related to a specific policy. Some commission rates differ by product line dependent on the producer (general agent, independent agent, broker, etc.).

Product Line	Commission Rates
Commercial Surety	6.5% to 40.0%
Non-Standard Surety	20.0% to 42.5%
Fidelity and Crime	6.5% to 40.0%
Property and Casualty	15.0% to 27.5%
Accident and Health	15.0% to 27.5%
Professional Liability	15.0% to 20.0%

Producers are also eligible to earn contingent commissions based on written premium growth performance and loss performance during a calendar year.

The following table is a summary of the net insurance premiums written by the company in 2014. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	$ 855,560	$ 188,598	$ 855,560	$ 188,598
Allied lines	647,669	164,423	647,669	164,423
Commercial multiple peril	27,857,938	10,469,270	27,857,938	10,469,270
Inland marine	524,743	186,656	524,743	186,656
Medical professional liability – occurrence	2,051,580	250,267	2,051,580	250,267
Medical professional liability – claims made	4,139,537	1,271,592	4,139,537	1,271,592
Group accident and health		53,987		53,987
Other accident and health		208		208
Worker's compensation		121,552		121,552
Other liability – occurrence	31,142,622	6,305,037	31,142,623	6,305,036
Other liability – claims made	14,557,346	1,309,906	14,557,345	1,309,907
Products liability – occurrence	2,412,030	469,779	2,412,030	469,779
Commercial auto liability		147,587		147,587
Auto physical damage		41,895		41,895
Fidelity		124,029		124,029
Surety		7,755,421		7,755,421
Burglary and theft	11,891	3,467	11,890	3,468
Total All Lines	$84,200,916	$28,863,674	$84,200,915	$28,863,675

III. MANAGEMENT AND CONTROL

Board of Directors

At the end of 2014 the company's board of directors consisted of four members. On February 26, 2016, the company reduced the number of directors to three. As of the date of this report, the company's board consists of three members, two of which are company officers and the third is an officer at Alleghany. The directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting and are to hold those positions until the earlier of their resignation or removal by the board of directors. Members of the company's board of directors may also be members of other boards of directors in the holding company group. As inside directors, they receive no additional compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Stephen J. Sills New York, New York	Chief Executive Officer of the CapSpecialty Group	2016
John L. Sennott Simsbury, Connecticut	Senior VP and CFO – Alleghany Corporation	2016
Daniel M. McGinnis New Hope, Pennsylvania	President – P&C and Professional Lines Division of the CapSpecialty Group	2016
John E. Rzepinski* Verona, Wisconsin	Vice President, Treasurer, and CFO of the CapSpecialty Group	2016

*Mr. Rzepinski resigned as a director effective February 26, 2016; he retained his position as CFO. As of the date of this report, the company has three directors.

Officers of the Company

Key officers serving as of December 31, 2014, as well as key officers serving as of the date of this report are as follows:

Name	Office	2014 Compensation♦
Stephen J. Sills	CEO, President	$0
John E. Rzepinski	VP, Treasurer, CFO	0
Antonio Celii^	General Counsel, VP, Secretary	0
Alan S. Ogilvie*	Former President - P&C Operations	0
Daniel M. McGinnis	President - P&C and Professional Lines	0
Julianne Splain^	Chief Claim Officer	0
Lawrence J. Seymour~	VP, Head of Actuarial Department	0
Todd Burrick~	Former Head of Business Solutions	0

♦ Compensation is paid to these individuals by the company's parent and is not directly allocated to CSIC. However, these costs may be indirectly allocated to the company through compensation under various affiliated agreements.
^ Hired during 2014.
* Left the company during 2014.
~ Mr. Seymour left the company in 2015. As of the date of this report, Mr. Burrick is head of the Actuarial Department.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committee at the time of the examination is listed below:

Investments Committee
John L. Sennott, Jr., Chair
Stephen J. Sills

CapSpecialty's board of directors has established a number of committees that oversees the operations of CIC, CSIC, and PRIC. Members of CapSpecialty's board at the end of 2014 included Stephen J. Sills, Richard W. Allen, III, Phillip N. Ben-Zvi, Joseph P. Branden, Kenneth W. Brandt, Weston M. Hicks, Daniel M. McGinnis, John E. Rzepinski, Michael C. Sapnar, and John L. Sennott, Jr. As of the date of this report, there are nine directors, as Mr. Allen retired in 2015. At the time of the examination CapSpecialty's board-appointed committees were as follows:

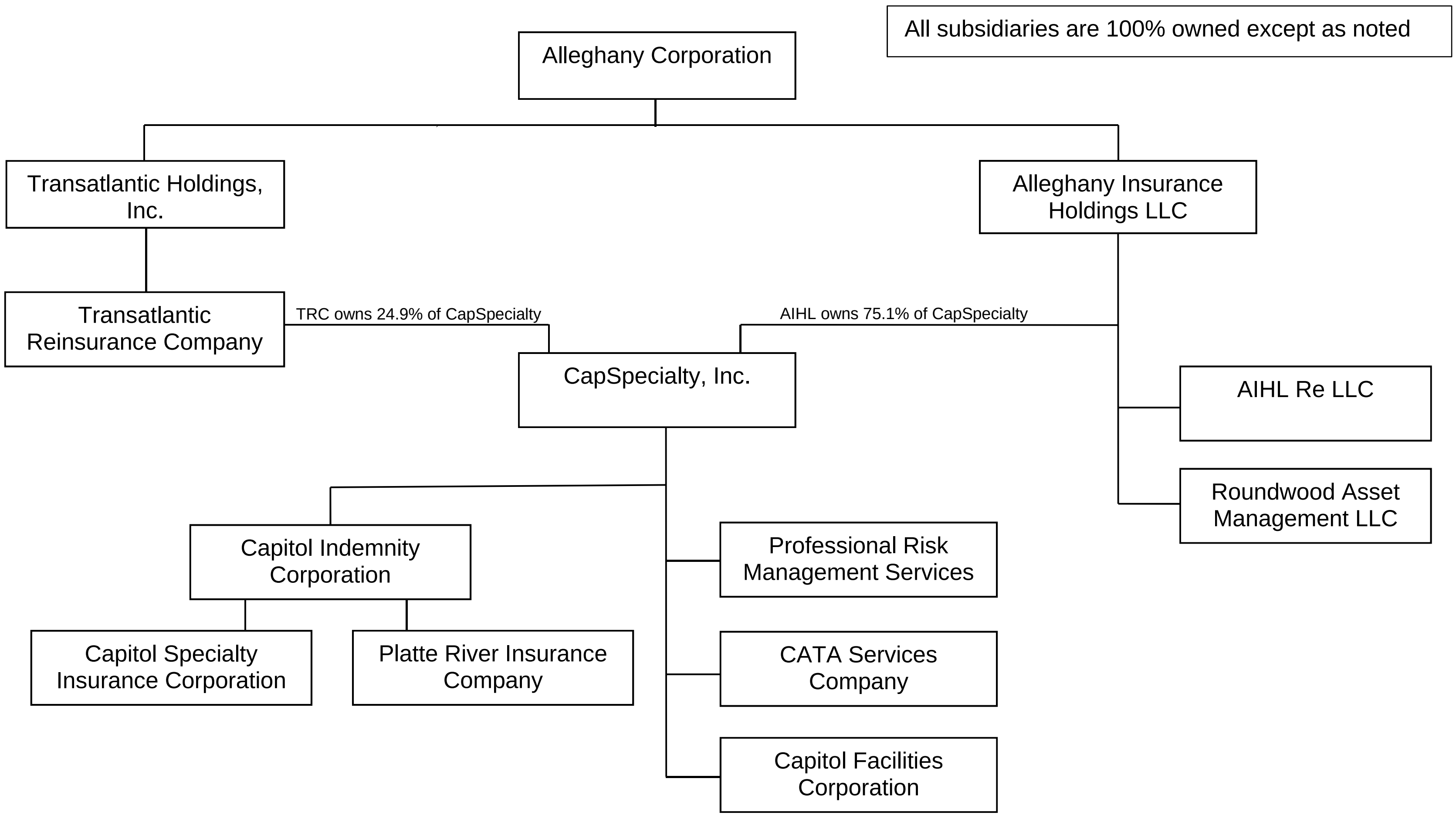
Compensation Committee
Weston M. Hicks, Chair
Joseph P. Brandon

Audit Committee
John L. Sennott, Chair
Phillip N. Ben-Zvi
Joseph P. Brandon

IV. AFFILIATED COMPANIES

Capitol Specialty Insurance Corporation is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates follows the organizational chart

Organizational Chart
As of December 31, 2014



Note that the above organizational chart is a simplified version of the complete organizational chart due to the size and complexity of the holding company system. The chart includes only affiliates that are part of the immediate holding company structure and ones that directly affect the operations of the Capitol Companies.

Alleghany Corporation

Alleghany, a Delaware holding company, was incorporated as a business corporation in 1986 under the laws of the state of Delaware and succeeded the original Alleghany Corporation, of Maryland, which was incorporated in 1929. Alleghany's stock is traded on the New York Stock Exchange under the symbol "Y." Alleghany has two primary reportable segments consisting of reinsurance and insurance. The reinsurance segment operates through THI, and the insurance operations operate through AIHL. AIHL consists of CapSpecialty, RSUI Group, Inc., Pacific Compensation Corporation, AIHL Re LLC (AIHL Re), a Vermont-domiciled captive, and Roundwood Asset Management LLC (Roundwood). Alleghany also owns Alleghany Properties LLC, which owns and manages properties in Sacramento, California. Alleghany holds significant stakes in ORX Exploration, Inc., a regional oil and gas exploration and production company, and Stranded Oil Resources Corporation, an exploration and production company focused on enhanced oil recovery.

As of December 31, 2014, Alleghany's audited consolidated financial statement reported assets of $23,489,436,000, liabilities of $16,007,392,000 and stockholder equity of $7,482,044,000. Consolidated operations for 2014 produced net earnings of $680,132,000.

Alleghany Insurance Holdings LLC

AIHL is a wholly owned subsidiary of Alleghany. AIHL was formed in 2000 in Delaware. AIHL is intended to function as the holding company for the property and casualty insurance segment for Alleghany.

As of December 31, 2014, AIHL's consolidated audited financial statement reported assets of $6,371,258,000, liabilities of $3,576,460,000, and stockholders' equity of $2,794,798,000. Consolidated operations for 2014 produced net income of $208,264,000.

CapSpecialty, Inc.

CapSpecialty is a wholly owned subsidiary of AIHL. CapSpecialty was organized in 1965 for the purpose of acquiring the outstanding stock of CIC and CSIC. Prior to its purchase by Alleghany, CapSpecialty was a publicly traded company through the National Association of Securities Dealers under the symbol "CATA." CapSpecialty was responsible for its legal and other corporate expenses prior to its acquisition by Alleghany. Its sources of revenue are investment income and dividend income from subsidiaries.

As of December 31, 2014, CapSpecialty's unaudited financial statement reported assets of $260,212,967, liabilities of $(308,601), and stockholders' equity of $260,521,568. Operations for 2014 produced net income of $553,689.

Capitol Indemnity Corporation

CIC is a Wisconsin stock insurance company writing property and casualty business. The major products marketed by CIC include commercial multiple peril, surety, other liability, worker's compensation, fidelity, inland marine, fire, other accident and health, products liability, and allied lines. Effective in the first quarter of 2002, CapSpecialty contributed ownership of CSIC to CIC. This transaction made CSIC a wholly owned subsidiary of CIC. Effective January 1, 2007, CIC has a 70% net retention in the affiliated pooling agreement with CSIC and PRIC whereby all business written or assumed on a going-forward basis is combined and reapportioned. For additional information related to the affiliated pooling agreement see the section of this report titled "Reinsurance." CIC is the subject of a contemporaneous examination report.

As of December 31, 2014, CIC's statutory annual statement reported assets of $462,393,090, liabilities of $240,517,610, and surplus of $221,875,480. Operations for 2014 produced a net loss of $(938,016).

Platte River Insurance Company

PRIC, formerly known as Underwriters Insurance Company, was incorporated on January 6, 1972, and commenced business on January 14, 1972. It is domiciled in Nebraska. Effective January 3, 2002, PRIC became an affiliate of CIC when it was purchased by Alleghany for approximately $40 million and subsequently changed its name to that currently used. Effective January 1, 2014, AIHL contributed PRIC's stock to CapSpecialty, who in turn contributed the stock to CIC, thereby making PRIC a wholly owned subsidiary of CIC.

PRIC writes miscellaneous surety bond coverages and license and permit bond coverages, and provides pricing flexibility where CIC and CSIC are also licensed. PRIC has a

15% net retention in the affiliated pooling agreement with CIC and CSIC whereby all business written or assumed on a going-forward basis is combined and reapportioned. For additional information related to the affiliated pooling agreement see the section of this report titled “Reinsurance.”

As of December 31, 2014, PRIC's statutory annual statement reported assets of $124,541,152, liabilities of $83,001,429, and surplus of $41,539,724. Operations for 2014 produced net income of $258,283.

Transatlantic Reinsurance Company

TRC, a New York-domiciled reinsurance company, was incorporated on October 29, 1952, and commenced business on January 1, 1953. On March 6, 2012, TRC’s direct parent, THI, merged with and into a wholly owned subsidiary of Alleghany that was created to facilitate the merger. After the merger was completed, the surviving subsidiary was renamed Transatlantic Holdings, Inc., and TRC became a downstream affiliate of Alleghany. On January 1, 2014, as part of CapSpecialty’s reorganization, TRC acquired 24.8% of CapSpecialty’s Series A Convertible Preferred Stock, resulting in TRC owning 19.9% of CapSpecialty, on a fully diluted basis. TRC is a global reinsurer and offers reinsurance capacity for a full range of property and casualty products on both a treaty and facultative basis.

As of December 31, 2014, TRC’s statutory annual statement reported assets of $14,574,640,306, liabilities of $9,804,140,889, and surplus of $4,770,499,417. Operations for 2014 produced net income of $562,117,158.

AIHL Re LLC

AIHL Re was organized and incorporated under the laws of the state of Vermont on May 25, 2006, and commenced business on June 28, 2006. AIHL Re is a captive reinsurance company which provides reinsurance to Alleghany’s insurance operating subsidiaries and affiliates. Effective July 1, 2015, AIHL Re and the Capitol Companies (CIC, CSIC, and PRIC) entered into an adverse development reinsurance agreement. For additional information related to the adverse development agreement see the section of this report titled “Subsequent Event.”

As of December 31, 2014, the audited GAAP financial statements of AIHL Re reported assets of $23,157,688, liabilities of $12,907,403, and stockholders' equity of $10,250,285. Operations for 2014 produced a net loss of $1,639,835.

Professional Risk Management Services, Inc.

PRMS is an agency that specializes in medical malpractice for the psychiatric industry. The agency generates approximately $35 million of premium per year. All business generated by PRMS is written on Fair American Insurance and Reinsurance Company's (FAIRCO) paper and is reinsured by TRC, which in turn then retrocedes a portion of the business produced by PRMS to CIC.

As of December 31, 2014, PRMS's unaudited GAAP financial statement reported assets of $18,845,236, liabilities of $15,132,907, and stockholders' equity of $3,712,329. Operations for 2014 produced net income of $1,794,095.

CATA Services Company

CATA Services Company (CSVC) is a wholly owned subsidiary of CapSpecialty. CSVC was incorporated in 2013 to provide management, legal, accounting and other support services to a risk purchasing group (North American Kiosk RPG) created by members to provide insurance liability coverage for Kiosk operators throughout the United States.

As of December 31, 2014, CSVC's unaudited GAAP financial statement reported assets of $64,975, liabilities of $2,932, and stockholders' equity of $62,043. Operations for 2014 produced net income of $5,446.

Roundwood Asset Management LLC

Roundwood is a wholly owned subsidiary of AIHL. Roundwood, a Delaware corporation, was organized in 2008 under the name Alleghany Capital Partners LLC. On January 10, 2014, Alleghany Capital Partners LLC changed its name to Roundwood Asset Management LLC. Roundwood manages the equity portfolios of CIC and other affiliates within the Alleghany holding company structure, subject to the direction of their respective boards of directors.

As of December 31, 2014, Roundwood's unaudited GAAP financial statement reported assets of $7,213,691, liabilities of $4,220,812, and stockholders' equity of $2,992,879. Operations for 2014 produced a net income of $3,631,353.

Capitol Facilities Corporation

Capitol Facilities Corporation (CFC) is a wholly owned subsidiary of CapSpecialty. CFC historically facilitated premium financing opportunities for its affiliated insurance entities. With the implementation of a direct billing program by its insurance affiliates in 1998-1999, such arrangements were generally no longer necessary. Therefore, operational activity for CFC is currently limited. CFC is licensed as an insurance agency in all 50 states. These licenses are being maintained should there be a business need to utilize CFC in the future.

As of December 31, 2014, CFC's unaudited GAAP financial statement reported assets of $22,878, liabilities of $(1,872), and stockholders' equity of $24,750. Operations for 2014 produced net loss of $3,477.

Agreements with Affiliates

In addition to common staffing and management control, CSIC's relationship to its affiliates is affected by various written agreements and undertakings. Reinsurance agreements are described in section V of the report titled "Reinsurance." A brief summary of the other agreements and undertakings follows, arranged by counterparty and effective date.

CapSpecialty, Inc.

Tax-Sharing Agreement

Effective January 1, 2002, CIC entered into a Tax-Sharing Agreement with CapSpecialty and certain affiliates of the Alleghany Group. CIC is also responsible to CapSpecialty for the income taxes attributable to its subsidiaries, including CSIC and PRIC. Under this agreement, Alleghany Corporation files a consolidated U.S. federal income tax return that includes CIC and other affiliates of the holding company group.

The agreement sets forth the rights and obligations of the parties to the agreement with respect to the determination and settlement of federal income tax liabilities as well as the allocation of Alleghany Group's consolidated U.S. federal income tax liability in accordance with a rational, systematic formula. The agreement provides for computation of tax, settlement of balances between affiliates, tax-sharing, filing the return, audits and other adjustments, dispute resolution and other administrative requirements. The agreement calls for the prompt settlement of estimated federal tax payments and final year-end calculated adjusted payments on the notified due dates.

Capitol Indemnity Corporation

Administrative Service Agreement

CSIC and CIC entered into an Administrative Services Agreement effective January 1, 2004, and later amended, effective January 7, 2007. Under this agreement, CIC is to provide services essential to the day-to-day operation of CSIC, which include: sales and underwriting services; claims management services; reinsurance recovery services; ancillary insurance and reinsurance services; accounting, tax and auditing services; litigation services; corporate services; management information systems services; actuarial services; agent- and broker-related services; regulatory communications services; treasury services; management reporting services; accounts receivable services; external communications services; internal communication services; legal services; general business services; and additional services which are not otherwise contemplated under this agreement. The companies are also parties to an affiliated pooling agreement described in section V of this report titled “Reinsurance.” In consideration of the services provided to CSIC under this agreement, CSIC shall pay a fee determined by CIC based on the total costs incurred by it in each calendar quarter in connection with the conduct of the pooled business, and CSIC will be responsible for 15% of such total costs (based on its pool participation percentage). CIC shall provide CSIC within 60 days after the end of each quarter the accounting of such total costs. Payments are to be made by CSIC within 20 days after the completion of the aforementioned accounting.

This agreement may be terminated by mutual consent or by either party by giving 90-day written notice, 45-day written notice if the other party becomes insolvent or if the other party has materially breached the terms and conditions of the agreement and such breach has not been cured. Additionally, CIC may terminate the agreement by written notice if CSIC fails to make payment of fees and such failure has not been cured within 30 days.

Office Space and Equipment Use Agreement

Effective January 1, 2004, CSIC entered into an Office Space and Equipment Use Agreement with CapSpecialty. Effective January 1, 2007, CapSpecialty contributed all owned, leased or controlled business equipment and office space to CIC, which caused CSIC to amend this agreement reassigning the rights, duties and obligations from CapSpecialty to CIC. Under this agreement, CIC agrees to provide all equipment reasonably necessary for the continuing operation of CSIC's insurance business, and CIC or one of its affiliates shall be responsible for all repairs and maintenance. CIC shall provide equipment of reasonable quality and quantity. At the direction of CSIC, CIC shall also provide office space reasonably necessary for the continuing operation of CSIC's insurance business, and CIC or one of its affiliates shall be responsible for all janitorial services, maintenance, repairs and utilities with regard to the office space. The office space is only to be used for business and professional offices.

The companies are also parties to an affiliated pooling agreement described in section V of this report titled "Reinsurance." In consideration of the services provided to CSIC under this agreement, CSIC shall pay a fee determined by CIC based on the total costs incurred by it in each calendar quarter in connection with the conduct of the pooled business, and CSIC will be responsible for 15% of such total costs (based on its pool participation percentage). CIC shall provide CSIC within 60 days after the end of each quarter the accounting of such total costs. Payments are to be made by CSIC within 20 days after the completion of the aforementioned accounting.

This agreement may be terminated by mutual consent or it may be terminated by either party by providing 120 days' written notice, 90 days if the other party is insolvent or if the other party materially breaches the contract and the breach has not been cured within the 90 days of the written notice. Additionally CapSpecialty can cancel with 45 days' written notice if CSIC fails to pay for the services or if CSIC is no longer affiliated with CIC.

Unconditional Financial Guaranty Agreement

CSIC and CIC entered into an Unconditional Financial Guaranty Agreement effective February 25, 2004. This agreement was entered into by the two parties to satisfy statutory requirements of the state of Maine in order for CSIC to obtain approval to transact business in that state. The state of Maine requires CIC to guarantee that CSIC's surplus would always meet a $500,000 minimum surplus requirement and exceed the Regulatory Action Risk Based Capital level. Under this agreement CIC is to automatically invest additional capital so that CSIC would continue to meet those levels.

Roundwood Asset Management LLC

Investment Management Agreement

CSIC and Roundwood (previously known as Alleghany Capital Partners LLC) entered into an investment management agreement effective January 1, 2008. The agreement was later amended effective September 9, 2014, to reflect the name change of Alleghany Capital Partners LLC to Roundwood Asset Management LLC. Pursuant to the investment management agreement, CSIC appointed Roundwood to act as CSIC's investment portfolio manager. Roundwood is to make investment decisions and is responsible for investment and reinvestment of CSIC's equity portfolio, in accordance with CSIC's investment guidelines/restrictions.

In consideration of the services provided to CSIC under this agreement, CIC agrees to pay to Roundwood, on behalf of CSIC, a fee equal to the percentage of the market value of all assets managed by Roundwood as of the last trading day of each calendar month. CIC shall pay quarterly fees on behalf of the Capitol Companies based on the following:

> For each month in a quarter one twelfth (1/12) of an amount equal to the sum of (a), (b), and (c)
>
> (a) 1.00% on the first $200,000,000 of the market value of the Capitol Companies' assets managed under the agreement;
>
> (b) 0.50% on the next $200,000,000 of the market value of the Capitol Companies' assets managed under the agreement; and
>
> (c) 0.25% on the market value of the Capitol Companies' remaining assets managed under the agreement.

Settlements are to be made within 30 days after receiving notification by Roundwood. The company is also party to an affiliated pooling agreement with CIC and PRIC described in section V of this report titled “Reinsurance.” Each member of the pool shall be allocated a percentage of the total costs related to their investment management agreements based on each member’s pool participation percentage. For CSIC it is 15%.

The contract may be terminated by either party with 30 days’ written notice. This agreement may also be terminated at any time by CSIC by written notice if Roundwood has defaulted under the terms and conditions of the agreement and such default has not been cured within 5 business days of receipt of written notice.

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions. All contracts, except contract #2 in the Affiliated Contract Section and contract #6 in the Nonaffiliated Contract Section, were in effect as of the examination date.

Affiliated Pooling Agreement

CIC participates in a pooling arrangement with CSIC and PRIC, both of which are affiliated insurance companies. The pool participants cede 100% of their net premiums written, losses, loss adjustment expenses, underwriting expenses and related balance sheet categories (after nonaffiliated external reinsurance) to CIC, excluding business written on behalf of Darwin National Assurance Company or RSUI Indemnity Company. CIC, as the lead company and pool manager, administers all aspects of the pooled business. CIC distributes the net pooled business according to each pool participant's participation percentage outlined in the contract (70% for CIC and 15% each for CSIC and PRIC).

Scope:	All risks written by the company excluding business written on behalf of Darwin National Assurance Company (hereinafter also DNA) and RSUI Indemnity Corporation
Items included:	Premiums written and earned, losses, loss adjustment expenses, underwriting expenses, commissions, contingent commissions, salvage and subrogation recoveries, assessments, taxes, and policyholder dividends
Effective:	January 1, 2002, as amended effective January 1, 2005, December 31, 2006, January 1, 2007, and December 31, 2012
Termination:	The agreement is continuous. It may be terminated at any time by any party on any December 31 with at least 12 months' prior written notice.

Reinsurance Allocation Agreement

As a result of a prior examination recommendation, CSIC entered into a Reinsurance Allocation Agreement with CIC and PRIC, effective January 1, 2012. The agreement provides terms and conditions for the allocation of reinsurance premiums and loss recoveries under reinsurance contacts to which CSIC and one or more of its affiliates are parties. According to the terms of this agreement, when multiple occurrences covered under a contract occur, each company's retention and the reinsurer's limit of liability for the occurrences shall be proportionate to the losses incurred by each company. Reinsurance premium is calculated so that each company affiliate shall only be responsible for its proportionate share of the reinsurance premium.

The agreement is continuous and may only be terminated by mutual agreement of the parties.

Affiliated Ceding Contracts

1.	Type:	Property Quota Share Reinsurance Contract – Tier 1 and 2
	Reinsurer:	Transatlantic Reinsurance Company
	Intermediary:	Willis Re
	Scope:	All business and policies underwritten and classified by the company as property business, subject to terms, conditions and limitations. Business written that exceeds the Tier 1 Sublimit for any state shall not be covered unless specially accepted by the reinsurer. Policies that exclude either wind or hail shall not be covered. Tier 1 counties are more at risk of hurricane loss than Tier 2 counties.
	Retention:	The company shall retain 20% of the net liability in each policy ceded
	Coverage:	80% of the company's net liability and LAE, subject to a maximum location limit that can be ceded by the company of $10,000,000 all coverages
	Premium:	Pro rata of net written premium
	Commissions:	Provisional ceding commission of 32% on all premiums ceded to the reinsurer, which will be adjusted based on the loss ratio. The ceding commission of 32% will be payable at a loss ratio of 44%. If the loss ratio is greater than 44%, the 32% commission will be reduced by 1% for every 0.8% increase in the loss ratio, subject to a minimum ceding commission of 22% at a loss ratio of 52% or greater.
	Effective date:	December 1, 2014
	Termination:	January 1, 2016
	Additional comment:	Coverage under the company's Property Occurrence Excess of Loss treaty inures to the benefit of this contract. For example, if there is a $7 million loss, the Property Occurrence XOL contract will cover $5.5 million (above the company's retention of $1.5 million) and property quota share contract will cover 80% of the remaining $1.5 million. See contract #2 under Nonaffiliated Ceding Contracts.

2.	Type:	Property Quota Share Reinsurance Contract – Tier 3
	Reinsurer:	Transatlantic Reinsurance Company
	Intermediary:	Willis Re
	Scope:	All business and policies underwritten and classified by the company as property business, subject to terms, conditions and limitations. Business written that exceeds the Tier 3 Sublimit for any state shall not be covered unless specially accepted by the reinsurer. Policies that exclude either wind or hail shall not be covered. (Tier 3 counties in coastal states are general less exposed to hurricane risk than Tier 1 and Tier 2 counties.)
	Retention:	The company shall retain 20% of the net liability in each policy ceded
	Coverage:	80% of the company's net liability and LAE, subject to a maximum location limit that can be ceded by the company of $10,000,000 all coverages
	Premium:	Pro rata of net earned premium
	Commissions:	Provisional ceding commission of 32% on all premiums ceded to the reinsurer, which will be adjusted based on the loss ratio. The ceding commission of 32% will be payable at a loss ratio of 50%. If the loss ratio is greater than 50%, the 32% commission will be reduced by 1% for every 1% increase in the loss ratio, subject to a minimum ceding commission of 20% at a loss ratio of 62% or greater.
	Effective date:	April 1, 2014
	Termination:	December 1, 2014
	Additional comment:	This contract was not renewed after its termination
		Coverage under the company's Property Occurrence Excess of Loss treaty inures to the benefit of this contract
3.	Type:	Large Account Commercial Surety Quota Share Contract
	Reinsurer:	Transatlantic Reinsurance Company
	Scope:	Purpose of the contract is to indemnify the company in respect of liability that may accrue to the company as a result of loss(es) under Bonds for Commercial Surety Principals with Outstanding Aggregate Bond Penalties greater than $20,000,000 that are written or renewed on or after the effective date of this contract, and Extra Contractual Obligations. Single bond limit written by the company shall not exceed $10,000,000.
	Retention and coverage:	Quota share participation of all subject bonds in accordance with the following:

a) When Outstanding Aggregate Bond Penalties for any one Principal is greater than $15,000,000 but less than or equal to $25,000,000, retention is 30% per bond, not to exceed $3,000,000 per bond. Reinsurer accepts 70% per bond, not to exceed $7,000,000 per bond or

b) When Outstanding Aggregate Bond Penalties for any one Principal is greater than $25,000,000 but less than or equal to $45,000,000, retention is 10% per bond, not to exceed $1,000,000 per bond. Reinsurer accepts 90% per bond, not to exceed $9,000,000 per bond

Premium: The company shall cede to the reinsurer its exact proportion of the gross net written premium income collected by the company with respect to subject bonds

Commissions: Provisional commission rate of 45% at a loss ratio of 25% to increase by 1% for every 1% decrease in loss ratio to a maximum of 52% at a loss ratio of 18% or lower, or decrease by 1% for every 1% increase in loss ratio to a maximum of 38% at a loss ratio of 32% or greater

Effective date: August 1, 2014

Termination: August 1, 2015

Nonaffiliated Ceding Contracts

1. Type: Casualty Excess of Loss

Reinsurer: Participation in this contract is as follows:

Reinsurers	Percentage
Arch Reinsurance Company	25.00%
Swiss Reinsurance America Corporation	25.00
Endurance Reinsurance Corporation of America	17.50
Hannover Ruck SE	5.00
Alterra Reinsurance USA Inc.	5.00
Lloyd’s Syndicate #4472	4.50
Lloyd’s Syndicate #1458	4.50
Lloyd’s Syndicate #33	10.00
Lloyd’s Syndicate #2014	3.50
Total	100.00%

Intermediary: Willis Re

Scope: All business classified by the company as casualty business including, but not limited to, primary casualty and excess casualty, general liability, umbrella, employers liability, professional liability, health care professional liability, environmental liability, commercial automobile and miscellaneous errors and omissions with stated exclusions

Retention:	Net loss retention of $1,000,000 in respect to any one risk, any one loss occurrence
Coverage:	The reinsurer shall be liable in respect of each and every risk in each and every loss occurrence, including LAE, for the ultimate net loss over and above an initial ultimate net loss retention of $1,000,000 any one risk, any one loss occurrence, subject to a limit of liability to the reinsurer of $10,000,000 any one risk, any one loss occurrence
Premium:	The company shall pay the reinsurer a deposit premium of $8,907,904 in four equal installments. Within 45 days following expiration of the contract, the company shall calculate premium at a rate of 5.71% multiplied by the company's gross net written premium Income. Should the premium so calculated exceed the deposit premium, the company shall immediately pay the reinsurer the difference. Should the premium be less than the deposit premium, the reinsurer shall pay the company the difference subject to a minimum premium of $6,235,533.
Reinstatement:	Up to five free reinstatements; however, the aggregate liability of the reinsurer should never exceed $50,000,000
Commissions:	None
Effective date:	December 1, 2014
Termination:	December 31, 2015

2. Type: Property Occurrence Excess of Loss

Reinsurer: Participants in the contract include:

Reinsurers	**Percentage**
Allied World Insurance Company	22.50%
Arch Reinsurance Company	17.50
Odyssey Reinsurance Company	15.00
Everest Reinsurance Company	10.00
Hannover Ruck SE	15.00
Hiscox Insurance Company (Bermuda) Limited	5.00
Beazley Furlonge Ltd (#0623)	0.45
Beazley Furlonge Ltd (#2623)	2.05
Asta Managing Agency Ltd (#1729)	2.50
Novae Syndicates Ltd (#2007)	5.00
Pembroke Managing Agency Ltd (#4000)	5.00
Total	100.00%

Intermediary:	Willis Re
Scope:	All business classified by the company as property business, including, but not limited to, BOP and CMP property, commercial auto property, automobile physical damage, crime, fire and allied lines, inland marine and glass, and burglary and theft with stated exclusions

Retention:	Net Loss retention of $1,500,000 in respect to any one risk, any one loss occurrence
Coverage:	The reinsurer shall be liable in respect of each and every loss occurrence for the ultimate net loss over and above an initial ultimate net loss retention of $1,500,000 for each and every loss occurrence, subject to a limit of liability to the reinsurer of $8,500,000 for each and every loss occurrence
Premium:	The company shall pay the reinsurer a deposit premium of $1,200,000 in four equal installments of $300,000. Within 45 days following expiration of the contract, the company shall calculate premium at a rate of 2.857% multiplied by the company's net earned premium income. Should the premium calculated exceed the deposit premium, the company shall immediately pay the reinsurer the difference. Should the premium be less than the deposit premium, the reinsurer shall pay the company the difference subject to a minimum premium which is 70% of the deposit premium.
Reinstatement:	The company shall pay no additional premium for the first $8,500,000. For the second reinstatement, the company will pay an additional premium equal to a) the percentage of the $8,500,000 limit reinstated times b) the reinsurer's premium for the term of the contract. The reinsurer's liability shall never exceed $8,500,000 for any one loss occurrence and limited to a total aggregate of $25,500,000.
Commissions:	None
Effective date:	December 1, 2014
Termination:	January 1, 2016

3. Type: Four Layer Surety and Fidelity Excess of Loss

Reinsurer: Participants in the contract include:

Reinsurers	**Percentage**
Munich Reinsurance America, Inc.	27.50%
Odyssey Reinsurance Company	20.00
R+V Versicherung A.G.	22.50
Endurance Reinsurance Corp of America	20.00
Lloyds Syndicate #566	5.00
Axis Reinsurance Co	5.00
Total	100.00%

Intermediary:	Willis Re
Scope:	All bond business classified by the company as contract surety, commercial surety and fidelity under the Manual of Rules, Procedures and Classifications for Fidelity, Forgery and Surety

	Bonds of The Surety & Fidelity Association of America with exclusions
Retention:	
First layer	Surety – $1,500,000 in respect to each loss discovered, each principal Fidelity – $1,500,000 in respect to each loss discovered, each event
Second layer	Surety – $5,000,000 in respect to each loss discovered, each principal Fidelity – $5,000,000 in respect to each loss discovered, each event
Third layer	Surety – $10,000,000 in respect to each loss discovered, each principal Fidelity – $10,000,000 in respect to each loss discovered, each event
Fourth layer	Surety – $15,000,000 in respect to each loss discovered, each principal Fidelity – $15,000,000 in respect to each loss discovered, each event
Coverage:	
First layer	Surety – $3,500,000 excess of $1,500,000 in respect to each loss discovered, each principal and $10,500,000 in aggregate for the contract year Fidelity – $3,500,000 excess of $1,500,000 in respect to each loss discovered, each event and $10,500,000 in aggregate for the contract year
Second layer	Surety – $5,000,000 excess of $5,000,000 in respect to each loss discovered, each principal and $10,000,000 in aggregate for the contract year Fidelity – $5,000,000 excess of $5,000,000 in respect to each loss discovered, each event and $10,000,000 in aggregate for the contract year
Third layer	Surety – $5,000,000 excess of $10,000,000 in respect to each loss discovered, each principal and $10,000,000 in aggregate for the contract year Fidelity – $5,000,000 excess of $10,000,000 in respect to each loss discovered, each event and $10,000,000 in aggregate for the contract year
Fourth layer	Surety – $5,000,000 excess of $15,000,000 in respect to each loss discovered, each principal and $10,000,000 in aggregate for the contract year Fidelity – $5,000,000 excess of $15,000,000 in respect to each loss discovered, each event and $10,000,000 in aggregate for the contract year

Premium:

First layer	Annual deposit premium of $1,081,729 paid in quarterly installments; annual minimum premium of $973,556, subject to adjustment at the rate of 2.11% of gross net earned premium
Second layer	Annual deposit premium of $338,361 paid in quarterly installments; annual minimum premium of $304,525, subject to adjustment at the rate of 0.66% of gross net earned premium
Third layer	Annual deposit premium of $164,054 paid in quarterly installments; annual minimum premium of $147,648, subject to adjustment at the rate of 0.32% of gross net earned premium
Fourth layer	Annual deposit premium of $102,534 paid in quarterly installments; annual minimum premium of $92,280, subject to adjustment at the rate of 0.20% of gross net earned premium

Reinstatement:

First layer	The company may reinstate coverage two full times in the event that coverage under this layer is exhausted. The company shall pay an additional premium for the first full reinstatement based upon 75% of the pro rata amount of the reinstatement. The premium payment for the second reinstatement shall be based upon 100% of the pro rata amount of the reinstatement.
Second layer	The company may reinstate coverage once in the event that coverage under this layer is exhausted. The company shall pay an additional premium based upon 125% of the pro rata amount of the reinstatement.
Third layer	The company may reinstate coverage once in the event that coverage under this layer is exhausted. The company shall pay an additional premium based upon 100% of the pro rata amount of the reinstatement.
Fourth layer	The company may reinstate coverage once in the event that coverage under this layer is exhausted. The company shall pay an additional premium based upon 150% of the pro rata amount of the reinstatement.

	Commissions:	None
	Effective date:	December 1, 2014
	Termination:	November 30, 2015
4.	Type:	Employment Practices Liability Reinsurance Agreement
	Reinsurer:	Hartford Steam Boiler Inspection and Insurance Company
	Scope:	Covers all of the company’s liability for loss under an EPL coverage form attached to new and renewal policies on or after the effective date of agreement, with stated exclusions.

	Coverage:	100% of losses, including defense costs, limited to $250,000 each wrongful employment act, subject to annual aggregate limit in the policy not to exceed $250,000
	Premium:	Pro rata share of net earned premium
	Commission:	40%
	Effective date:	February 1, 2014
	Termination:	This agreement is continuous and can be terminated by either party by giving at least 120 days' prior notice in writing
5.	Type:	Equipment Breakdown Reinsurance Agreement
	Reinsurer:	Hartford Steam Boiler Inspection and Insurance Company
	Scope:	All equipment breakdown liability business, with stated exclusions
	Coverage:	100% of losses limited to $25,000,000 for any one accident and any one policy/risk
	Premium:	2.82% of the company's net written premiums relating to business owners', property or package policies covered
	Effective date:	March 1, 2010
	Termination:	This agreement is continuous and can be terminated by either party by giving at least 180 days' prior notice in writing
	Additional comments:	Profit-sharing plan developed to provide additional incentives for the production of profitable equipment breakdown insurance. The profit commission is based on business written over a 12-month period beginning each January 1st and is calculated as follows: Total plan losses (calculated as 57% of earned premiums); less total incurred losses (which includes LAE calculated as 4% of earned premium); less any loss carry forward (from prior periods); and multiplied by 40% through May 31, 2010, and 50% effective June 1, 2010. Accounting periods beginning January 1, 2011, and thereafter shall be 50% of the positive balance. Any negative balance calculated prior to applying the percentage will be carried forward to the subsequent period.
6.	Type:	Professional Liability Quota Share
	Reinsurer:	Old United Casualty Company
	Scope:	All miscellaneous professional liability business entered into or assumed by CIC from MPP Company, Inc. (hereinafter also MPP) through an Asset Purchase Agreement between the two parties dated June 29, 2009. This includes business written by MPP on behalf of the company pursuant to a program administrator agreement between the two parties effective September 17, 2009, where the effective date of anniversary

		date of the policies written falls within the term of this agreement (November 3, 2009, to November 3, 2010, later amended to include dates through January 1, 2015).
	Retention:	50% of policy limits for each policy ceded under this contract
	Coverage:	50% of policy limits for each policy ceded under this contract
	Premium:	50% of written premium relating to risks covered under this contract
	Commissions:	34.1% of premium ceded under this agreement
	Effective date:	November 3, 2009, amended each year thereafter
	Termination:	This agreement shall terminate: a) upon termination of all claims incurred relating to covered policies; b) mutual written agreement by both parties; or c) the reinsurer incurs a 20% loss of its surplus, its A.M. Best Rating is lowered to less than an A- or there is a commencement of a rehabilitation, liquidation, conservation or other delinquency proceeding against it
	Additional comment:	The contract expired on January 1, 2015, and was not renewed
7.	Type:	Property Facultative
	Reinsurers:	General Reinsurance Corporation
	Scope:	All business classified by the company as fire, allied lines, inland marine, or commercial multiple peril (property coverages) with certain named exclusions. Subject business is further defined in this agreement as covering hotels, motels, offices, condominiums, apartments, community-based residential facilities, restaurants, bowling alleys, strip shopping centers, casinos, retail/mercantile occupancies, recreational centers, religious facilities, social centers, surgical/health centers or health care facilities with occupancies as residential and offices.
	Retention:	$10,000,000 per risk
	Coverage:	Up to $15,000,000 in excess of the company's retention of $10,000,000 per risk
	Premium:	Rates range from 0.02 to 0.16 and are applied to each $100 of accepted coverage above $10,000,000 with a minimum premium of $250 per risk. Rates are based on the size of the risk and the type of commercial business structure of the property risk.
	Commissions:	None
	Effective date:	December 1, 2014
	Termination:	January 1, 2016

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2014, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination." Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation.

Capitol Specialty Insurance Corporation
Assets
As of December 31, 2014

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 70,326,978	$	$ 70,326,978
Common Stocks	13,825,132		13,825,132
Cash, cash equivalents, and short-term investments	2,116,734		2,116,734
Investment income due and accrued	497,995		497,995
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	5,794,722	1,131,171	4,663,551
Deferred premiums, agents' balances, and installments booked but deferred and not yet due	7,400,737	128,930	7,271,807
Reinsurance:			
Amounts recoverable from reinsurers	13,006,371		13,006,371
Current federal and foreign income tax recoverable and interest thereon	420,656		420,656
Net deferred tax asset	1,480,654		1,480,654
Total Assets	$114,869,979	$1,260,101	$113,609,878

Capitol Specialty Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2014

Losses		$ 23,579,128
Loss adjustment expenses		4,110,942
Commissions payable, contingent commissions, and other similar charges		1,377,976
Taxes, licenses, and fees (excluding federal and foreign income taxes)		830
Unearned premiums		14,251,244
Ceded reinsurance premiums payable (net of ceding commissions)		12,399,391
Payable to parent, subsidiaries, and affiliates		4,404,293
Write-ins for liabilities:		
Funds held – unclaimed property		1,039
Total liabilities		60,124,843
Common capital stock	$ 6,500,000	
Gross paid in and contributed surplus	34,475,652	
Unassigned funds (surplus)	12,509,383	
Surplus as regards policyholders		53,485,035
Total Liabilities and Surplus		$113,609,878

Capitol Specialty Insurance Corporation
Summary of Operations
For the Year 2014

Underwriting Income		
Premiums earned		$27,653,316
Deductions:		
Losses incurred	$11,340,816	
Loss adjustment expenses incurred	4,125,696	
Other underwriting expenses incurred	14,739,589	
Total underwriting deductions		30,206,101
Net underwriting gain (loss)		(2,552,785)
Investment Income		
Net investment income earned	1,761,130	
Net realized capital gains (losses)	333,297	
Net investment gain (loss)		2,094,427
Other Income		
Net gain (loss) from agents' or premium balances charged off	(60,981)	
Finance and service charges not included in premiums	17,791	
Miscellaneous (expense) income	(304)	
Total other income		(43,494)
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		(501,852)
Dividends to policyholders		4,417
Net income (loss) after dividends to policyholders but before federal and foreign income taxes		(506,269)
Federal and foreign income taxes incurred		(607,902)
Net Income		$ 101,633

Capitol Specialty Insurance Corporation
Cash Flow
For the Year 2014

Premiums collected net of reinsurance			$29,744,507
Net investment income			2,278,370
Miscellaneous income			(43,494)
Total			31,979,383
Benefit- and loss-related payments		$14,157,911	
Commissions, expenses paid, and aggregate write-ins for deductions		17,896,213	
Dividends paid to policyholders		4,417	
Federal and foreign income taxes paid (recovered)		(1,577,820)	
Total deductions			30,480,721
Net cash from operations			1,498,662
Proceeds from investments sold, matured, or repaid:			
Bonds	$7,262,873		
Stocks	5,232,218		
Miscellaneous proceeds	30,645		
Total investment proceeds		12,525,736	
Cost of investments acquired (long-term only):			
Bonds	7,441,259		
Stocks	5,676,369		
Miscellaneous applications	185,096		
Total investments acquired		13,302,724	
Net cash from investments			(776,988)
Cash from financing and miscellaneous sources:			
Other cash provided (applied)		(1,372,834)	
Net cash from financing and miscellaneous sources			(1,372,834)
Reconciliation:			
Net change in cash, cash equivalents, and short-term investments			(651,160)
Cash, cash equivalents, and short-term investments:			
Beginning of year			2,767,894
End of Year			$ 2,116,734

Capitol Specialty Insurance Corporation
Compulsory and Security Surplus Calculation
December 31, 2014

Assets			$113,609,878
Less security surplus of insurance subsidiaries			
Less liabilities			60,124,843
Adjusted surplus			53,485,035
Annual premium:			
Individual accident and health	$ 208		
Factor	15%		
Total		$ 31	
Group accident and health	53,987		
Factor	10%		
Total		5,397	
Lines other than accident and health	28,806,772		
Factor	20%		
Total		5,761,354	
Compulsory surplus (subject to a minimum of $2 million)			5,766,782
Compulsory Surplus Excess (or Deficit)			$47,718,251
Adjusted surplus (from above)			$53,485,035
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)			8,073,496
Security Surplus Excess (or Deficit)			$45,411,539

Capitol Specialty Insurance Corporation
Analysis of Surplus
For the Five-Year Period Ending December 31, 2014

The following schedule details items affecting surplus during the period under examination as reported by the company in its filed annual statements:

	2014	**2013**	**2012**	**2011**	**2010**
Surplus, beginning of year	$52,946,295	$52,185,031	$37,709,587	$36,046,838	$32,144,484
Net income	101,633	(1,837,715)	1,229,168	2,284,846	3,887,502
Change in net unrealized capital gains/losses	(127,887)	1,871,908	(692,707)	(473,105)	116,622
Change in net deferred income tax	222,396	122,977	(1,004,328)	480,634	(1,555,292)
Change in non-admitted assets	342,598	604,094	2,535,647	(3,229,626)	1,453,522
Cumulative effect of changes in accounting principles			407,664		
Contribution from CIC			12,000,000	4,000,000	
Dividends to stockholders				(1,400,000)	
Surplus, End of Year	$53,485,035	$52,946,295	$52,185,031	$37,709,587	$36,046,838

Capitol Specialty Insurance Corporation
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2014

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Unusual IRIS results are denoted with asterisks and discussed below the table.

	Ratio	**2014**	**2013**	**2012**	**2011**	**2010**
#1	Gross Premium to Surplus	211%	160%	132%	179%	251%
#2	Net Premium to Surplus	54	49	43	56	66
#3	Change in Net Premiums Written	12	15	5	-11	-4
#4	Surplus Aid to Surplus	2	1	1	1	2
#5	Two-Year Overall Operating Ratio	105*	108*	100*	96	93
#6	Investment Yield	2.0*	2.2*	2.4*	2.8*	3.1
#7	Gross Change in Surplus	1	1	38	5	12
#8	Change in Adjusted Surplus	1	1	7	-6	12
#9	Liabilities to Liquid Assets	61	60	52	62	73
#10	Agents' Balances to Surplus	9	10	5	3	12
#11	One-Year Reserve Development to Surplus	0	8	5	2	0
#12	Two-Year Reserve Development to Surplus	7	16	9	-4	-5
#13	Estimated Current Reserve Deficiency to Surplus	14	11	3	-7	-8

Ratio No. 5 measures the company's profitability over the previous two-year period. The exceptional results in 2012-2014 were, in part, due to a combination of poor results from a discontinued book of business and subsequent adverse loss development which occurred in 2012-2014.

Ratio No.6 measures the amount of the company's net investment income as a percentage of the average amount of cash and invested assets. The company reported an exceptional ratio each year under examination, with the exception of 2010. The exceptional ratios are primarily due to the low interest rate environment. The company's investment yield was not remarkable, as the industry average during the period under examination was approximately 2.8%.

Growth of Capitol Specialty Insurance Corporation

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2014	$113,609,878	$60,124,843	$53,485,035	$ 101,633
2013	110,181,276	57,234,981	52,946,295	(1,837,715)
2012	99,451,912	47,266,881	52,185,031	1,229,168
2011	83,553,826	45,844,239	37,709,587	2,284,846
2010	89,993,476	53,946,638	36,046,838	3,887,502
2009	83,425,610	51,281,126	32,144,484	2,977,007

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2014	$113,064,590	$28,863,675	$27,653,316	55.9%	51.2%	107.1%
2013	84,698,892	25,706,719	23,640,486	67.8	51.8	119.6
2012	69,100,344	22,367,779	21,688,127	58.8	51.3	110.1
2011	67,556,743	21,237,458	22,404,005	56.4	49.2	105.6
2010	90,354,332	23,855,846	24,644,661	57.3	45.6	102.9
2009	91,353,343	24,797,394	25,002,272	50.3	47.5	97.8

Due to the pooling agreement between the Capitol Companies, gross premium written also includes premium written by CIC and PRIC. The decrease in gross premium written in 2011 can be attributed to soft market conditions as well as a decrease in business written by CSIC, which terminated a producer's block of business due to unfavorable development for accident years 2010 and prior. Gross premium written began to increase in 2013 and 2014; the growth is primarily from the expansion of the group's professional liability segment and medical professional business written by CSIC as well as the business produced by PRMS.

The company reported an underwriting loss each year during the exam period; the combined ratio increased every year with the exception of 2014. The combined ratio peaked at 119.6% in 2013 as the company experienced significant underwriting losses and an increase in expenses. In 2013, the company experienced significant adverse development from a book of business which was discontinued in 2011; the adverse development continued into 2014. The expense ratio ranged from 45.6% to 51.8% during the exam period and is fairly high for a property and casualty insurer. A large reason for the elevated expense ratio is the fact that more than 25% of the pooled business is surety business which has a higher commission (and lower loss ratio) than traditional property and casualty business. Other contributors to the company's elevated expense ratio include the group's investment in its professional lines segment and technology upgrades, which the company expects will help it become more efficient. Despite the company's high expense ratio, it reported a net income every year of the exam period, with the exception of 2013. The net income was mostly a result of earned investment income and realized capital gains and to a lesser extent, federal and foreign income tax benefits incurred.

The company's surplus increased each year during the period under examination. In 2011 and 2012, the company received a surplus contribution from CIC in the amount of $4 million and $12 million, respectively. The surplus contributions were required by the state of New York in order to meet the state's minimum surplus requirements for surplus lines insurers. In 2013, surplus increased 1.5% despite reporting a net loss of $1,837,715, as the company was able to offset underwriting losses through unrealized capital gains resulting from a strong stock market.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination. The amount of surplus reported by the company as of December 31, 2014, is accepted.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were two specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Reinsurance—It is recommended that the company report reinsurance transactions in accordance NAIC Annual Statement Instructions - Property and Casualty.

   Action—Compliance

2. Reinsurance—it is recommended that the company comply with NAIC Accounting Practices and Procedures Manual, SSAP No. 62R, paragraph 9. It is further recommended that the company comply with s. Ins 52.06 (2), Wis. Adm. Code.

   Action—Compliance

Summary of Current Examination Results

This section contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

Investments

Custodial agreements of Wisconsin-domiciled companies must comply with guidelines contained in the NAIC's Financial Condition Examiners Handbook. The review of the custodial agreement with Bank of New York revealed that the agreement does not include all of the suggested clauses as contained in the NAIC's Financial Condition Examiners Handbook to ensure proper controls and safeguards. The following items were missing from the agreement:

1. If the custodian agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer's domiciliary commissioner.

2. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting schedules, the custodian agrees to maintain records sufficient to determine and verify such information.

3. The custodian shall secure and maintain insurance protection in an adequate amount.

It is recommended that the company revise its custodial agreement to include the guideline provisions contained in the NAIC's Financial Condition Examiners Handbook.

VIII. CONCLUSION

As of December 31, 2014, the company reported admitted assets of $113,609,878, liabilities of $60,124,843 and surplus of $53,485,035. During the period under examination, assets increased 36%, gross premium written increased 24%, and surplus increased 66%. The substantial increase in surplus was primarily from $16 million in capital contributions from CIC, which CSIC needed to meet New York requirements. The company reported a net underwriting loss in each year during the examination period; underwriting losses were mostly due to adverse development from a discontinued book of business. Despite underwriting losses, the company reported a net income in four of the past five years, as earned investment income and realized capital gains were able to offset a large portion of the underwriting losses.

The examination resulted in one recommendation and there were no reclassifications of account balances or adjustments to surplus as reported by the company in its year-end 2014 financial statutory financial statements. The examination verified the financial condition of the company as reported in its annual statement as of December 31, 2014.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 40 - Investments—It is recommended that the company revise its custodial agreement to include the guideline provisions contained in the NAIC's Financial Condition Examiners Handbook.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
James Vanden Branden	Insurance Financial Examiner
Nick Hartwig	Insurance Financial Examiner
David Jensen	IT Specialist
Jerry DeArmond	Reserve Specialist

Respectfully submitted,

Levi Olson
Examiner-in-Charge

XI. SUBSEQUENT EVENT

Effective July 1, 2015, CIC, CSIC, and PRIC entered into an Adverse Development Agreement with AIHL Re. The agreement applies only in the event CIC, CSIC, and/or PRIC suffer adverse loss development. It applies to (1) all claims with a date of loss prior to January 1, 2015, on policies, contracts and binders of insurance or reinsurance underwritten, renewed or assumed by CIC, CSIC, or PRIC, and (2) all claims classified as Large Construction Contract Surety, regardless of date of loss. The agreement calls for the AIHL Re to indemnify the group for 100% of the amount by which the group's ultimate net losses exceed the sum of (1) the group's carried reserves as of June 30, 2015, on all business covered, and (2) 32% of the group's net earned premium earned after the effective date on large construction surety business, up to AIHL Re’s aggregate limit of liability of $50 million.

The premium paid by the group under the agreement is 0.1% of the sum of the group’s carried reserves and the group’s net earned premium earned after the effective date on business classified as large construction contract surety.

The agreement is supported by a Keep Well Agreement between AIHL Re and Alleghany, whereby Alleghany agrees to maintain surplus of $10 million in AIHL Re at all times.

As of December 31, 2015, the group ceded approximately $3.5 million in losses to the AIHL Re, of which approximately $519,000 related to CSIC.

Relating to the Adverse Development Reinsurance Agreement above, a Reinsurance Trust Agreement was entered between CIC, CSIC, Platte River, AIHL Re and U.S. Bank National Association, which establishes a trust account allowing CIC and CSIC to take credit on its statutory financial statements the full amount of reinsurance provided by the Adverse Development Reinsurance Agreement. The effective date of the Reinsurance Trust Agreement is December 31, 2015.