

Report  
of the  
Examination of  
Old Republic Surety Company  
Brookfield, Wisconsin  
As of December 31, 2012

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

**Scott Walker**, Governor  
**Theodore K. Nickel**, Commissioner

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December 20, 2013

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Honorable Theodore K. Nickel  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
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Commissioner:

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

OLD REPUBLIC SURETY COMPANY  
Brookfield, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of Old Republic Surety Company (ORSC or the company) was conducted in 2008 as of December 31, 2007. The current examination covered the intervening period ending December 31, 2012, and included a review of such 2013 transactions as deemed necessary to complete the examination.

The examination was conducted using a risk-focused approach in accordance with the NAIC Financial Condition Examiners Handbook, which sets forth guidance for planning and performing an examination to evaluate the financial condition and identify prospective risks of an insurer. This approach includes the obtaining of information about the company including corporate governance, the identification and assessment of inherent risks within the company, and the evaluation of system controls and procedures used by the company to mitigate those risks. The examination also included an assessment of the principles used and significant estimates made by management, as well as an evaluation of the overall financial statement

presentation and management's compliance with statutory accounting principles, annual statement instructions, and Wisconsin laws and regulations.

The examination of the company was conducted concurrently with the examination of the Old Republic General Insurance Group. Representatives of the Pennsylvania Insurance Department (PID) acted in the capacity as the lead state for the coordinated exams. Work performed by the PID was reviewed and relied on where deemed appropriate.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

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

The company was incorporated on December 28, 1981, under the title Northwestern National Surety Company, and commenced business on the same date. The company was organized as a subsidiary of Northwestern National Insurance Company of Milwaukee, Wisconsin, (NNIC) to specialize in underwriting surety and fidelity risks.

NNIC is currently a subsidiary of AK Steel Holding Corporation. NNIC is a multi-line property and casualty insurer and reinsurer, which is currently running off its existing business. Prior to the organization of the company, NNIC had acquired Lawyers Surety Corporation (LSC) and State Surety Company (SSC) and assumed their business. In 1982 the company began to assume the surety and fidelity risks of NNIC. In 1983, NNIC contributed the stock of LSC and SSC to the company.

During NNIC's ownership, the company acted as a reinsurer as well as a direct writer. NNIC assumed 100% of the direct business of LSC and SSC and ceded its direct fidelity and surety risks, together with the business assumed from LSC and SSC, to the company. Agents of LSC and SSC wrote business where these insurers were licensed, while NNIC's agents wrote for the company in the other states. LSC and SSC functioned as the company's marketing vehicles and branch offices.

On May 30, 1986, Northwestern National Insurance Company of Milwaukee, Wisconsin, sold the company and its subsidiaries to the Old Republic International Corporation (ORI). ORI contributed the shares to Old Republic General Insurance Group, Inc. (ORGIG), which, in turn, contributed the shares to Old Republic Surety Group, Inc. (ORS Group). In this manner, the company became a third-tier subsidiary of ORI and a direct, wholly owned subsidiary of the ORS Group. Effective with the acquisition, the company name was changed to that presently used.

Effective November 15, 1991, ORSC entered into transfer and assumption contracts with LSC and SSC, rendering these companies inactive except with respect to bonds of definite expiry for which premiums had already been collected. The licenses and charters of Lawyers

Surety Corporation and State Surety Company were sold to nonaffiliated organizations on June 2, 1994, and February 1, 1995, respectively.

The company is staffed by its own officers and employees and pays most of its expenses on its own behalf. However, as a member of a holding company system, ORSC engages in the exchange of risks and services with affiliates under various written agreements. Accordingly, intercompany balances are created in the ordinary course of business with settlements made on either a monthly or quarterly basis, depending on the terms of the applicable written agreement. Expenses other than taxes are allocated on the basis of specific identification or resource utilization estimates. The company files its federal income taxes on a consolidated basis with Old Republic International Corporation and other affiliates that are regarded as being members of ORI's General Insurance Group.

The company leases all office facilities necessary to its operations. ORSC's operations are coordinated from its home office in Brookfield, Wisconsin. A nonaffiliated vendor is contracted for the storage of home office records. Support services are provided through a network of satellite offices in the following 15 cities:

Atlanta, Georgia	Denver, Colorado	Phoenix, Arizona
Birmingham, Alabama	Des Moines, Iowa	Pittsburgh, Pennsylvania
Charlotte, North Carolina	Irvine, CA	Portland, Oregon
Dallas, Texas	Kansas City, Kansas	Salt Lake City, Utah
Decatur, Illinois	Orlando, Florida	South Bend, Indiana

In 2012, the company wrote direct premium in the following states:

California	\$ 3,196,627	10.0%
Illinois	2,960,181	9.3
Florida	2,543,547	8.0
South Carolina	2,338,134	7.3
Minnesota	1,864,307	5.8
All others	<u>19,018,730</u>	<u>59.6</u>
Total	<u>\$31,921,526</u>	<u>100.0%</u>

The company is licensed in the District of Columbia and all states except Alaska, Connecticut, Delaware, Hawaii, Kentucky, Louisiana, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Rhode Island, and Vermont.

Old Republic Surety Company specializes in underwriting contractors' performance and payment bonds, fidelity and surety bonds, and notary public bonds.

All direct business is written through approximately 4,500 independent agents. The company uses standard contract forms and commission schedule for its agents. Agents are compensated according to the following commission schedule, unless a special rate is negotiated:

<b>Product Type</b>	<b>Commission Rate</b>
Blanket fidelity bonds, including public employees' blanket bonds and forgery coverage	20.0%
Contract bonds	
First \$2,500,000 of contract price	30.0
Next \$2,500,000 of contract price	17.5
Over \$5,000,000 of contract price	12.5
Any bonds involving abnormal acquisition costs or other expense or unusual hazards or exposure	Negotiated
All other product types	30.0

In addition, agents who meet a defined minimum premium volume are eligible to receive a contingent commission which ranges between 1% and 6% of the premiums earned by the company from that agent's production. The sliding scale for contingent commission is based on the agent's composite ratio which the company defines as the sum of (a) the ratio of incurred losses to earned premiums and (b) the ratio of commission to written premium. The lower an agent's composite ratio, the higher the agent's contingent commission rate. No contingent commission is paid if the agent's composite ratio is 55% or higher. Exceptionally favorable or unfavorable experience is carried forward but only to the first succeeding year.

In addition to its direct business, the company reinsures the surety and fidelity risks of affiliates, Old Republic Insurance Company, Old Republic General Insurance Corporation, and Bituminous Casualty Corporation. The company underwrites and coordinates the marketing of surety and fidelity bonds on behalf of these affiliates which write such risks mainly in jurisdictions in which ORSC is not licensed.

The following table is a summary of the net insurance premiums written by the company in 2012. The growth of the company is discussed in the "Financial Data" section of this report.

<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Other Liability - Occurrence	\$ 54,624	\$ 12,698	\$ 0	\$ 67,322
Fidelity	3,065,417	381,454	126,973	3,319,898
Surety	<u>28,801,485</u>	<u>5,349,364</u>	<u>1,592,754</u>	<u>32,558,095</u>
Total All Lines	<u>\$31,921,526</u>	<u>\$5,743,516</u>	<u>\$1,719,727</u>	<u>\$35,945,315</u>

The following table is a summary of the direct and assumed insurance premiums written by specific product lines offered by the company in 2012.

<b>Line of Business</b>	<b>Gross Premium</b>	<b>Percent of Product Mix</b>
Other Liability:		
Notary Errors and Omissions	\$ 67,322	0.2%
Fidelity:		
Business Services	1,419,565	3.8
ERISA/Pension	911,855	2.4
Other	<u>1,115,451</u>	<u>3.0</u>
Total Fidelity	3,446,871	9.2
Surety:		
Contract	16,155,892	42.9
Other Judicial Bonds	298,709	0.8
Fuel Tax	202,650	0.5
Motor Vehicle Dealers	374,867	1.0
Contractors License	7,051,916	18.7
All Other License and Permit	6,171,149	16.4
Miscellaneous Indemnity	1,782,364	4.7
Public Official	909,047	2.4
Probate	680,617	1.8
Notary	<u>523,638</u>	<u>1.4</u>
Total Surety	<u>34,150,849</u>	<u>90.7</u>
Total All Lines	<u>\$37,665,042</u>	<u>100.0%</u>

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of six members. Directors are elected annually to serve a one-year term. Officers are elected at the board's annual organizational meeting. The directors receive no compensation for serving on the board. Members of the company's board of directors may also serve as members of other boards of directors in the holding company system.

Currently the board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
James A. Kellogg Hartland, Wisconsin	President and Chief Operating Officer Old Republic International Corporation	2013
Gerald C. Leach New Berlin, Wisconsin	President and Chief Executive Officer Old Republic Surety Company	2013
Spencer LeRoy III La Grange, Illinois	Senior Vice President / General Counsel and Secretary Old Republic International Corporation	2013
Karl W. Mueller Naperville, Illinois	Senior Vice President and Chief Financial Officer Old Republic International Corporation	2013
R. Scott Rager Oak Brook, Illinois	Senior Vice President Old Republic International Corporation	2013
Aldo C. Zucaro Barrington, Illinois	Chairman of the Board and Chief Executive Officer Old Republic International Corporation	2013

## Officers of the Company

The officers serving at the time of this examination are as follows:

<b>Name</b>	<b>Office</b>	<b>2012 Compensation</b>
Aldo C. Zucaro	Chairman of the Board and Treasurer	\$ 0*
Spencer LeRoy III	Secretary	0
Gerald C. Leach	President and Chief Executive Officer	316,887
Rick A. Johnson	Senior Vice President, Assistant Treasurer, Assistant Secretary, Chief Financial Officer	187,838
Alan P. Pavlic	Senior Vice President, General Counsel	178,469

\* This amount does not include compensation paid to Mr. Zucaro by other companies within the holding company system. The Old Republic International Corporation's definitive proxy statement for the 2012 annual meeting of shareholders held on May 24, 2013, indicated that the salary, bonus and other compensation paid to Mr. Zucaro in 2012 amounted to \$1,293,392.

## Committees of the Board

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

### **Executive Committee**

Gerald C. Leach, Chair  
James A. Kellogg  
R. Scott Rager  
Aldo C. Zucaro

### **Finance Committee**

James A. Kellogg, Chair  
Karl W. Mueller  
R. Scott Rager

### **Compensation Committee**

James A. Kellogg, Chair  
R. Scott Rager  
Aldo C. Zucaro

#### **IV. AFFILIATED COMPANIES**

Old Republic Surety Company is a member of a holding company system led by Old Republic International Corporation. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates follows the organizational chart.

Old Republic International Corporation is one of the 50 largest publicly held insurance organizations in the United States, with a substantial interest in a diversified range of insurance and reinsurance services. ORI manages its business through more than 127 corporate entities, of which 27 are insurance subsidiaries covering all 50 states and Canada.

Old Republic companies market, underwrite and provide risk management services through two operational groups consisting of the General Insurance Group and the Title Insurance Group. Operations of the former Mortgage Insurance Group are now effectively in a run-off posture with the flagship operation, Republic Mortgage Insurance Company, under the supervision of the North Carolina Insurance Department. A small life and health insurance business is also conducted in the U.S. and Canada, principally as an adjunct to the General Insurance Group operations. The General Insurance Group provides a wide variety of property and casualty insurance coverages as well as related services to predominantly transportation, commercial construction, forest products, energy, general manufacturing and financial services industries. The Title Insurance Group provides title insurance and related real estate transfer services for individual, business, and government entities. The former Mortgage Insurance Group provided mortgage guaranty insurance for first mortgage loans, primarily on residential properties incorporating one- to four-family dwelling units.

Within these two broad active operating segments, ORI and its subsidiaries operate in a decentralized manner that emphasizes specialization by type of insurance coverage and ensures diversification and dispersion of risks. Growth has been sought through methodical progress within the specific industries and product niches to which the Old Republic holding company system has committed itself.

ORSC may be regarded as a member of a distinct holding company subsystem within the General Insurance Group, consisting of Old Republic Surety Group, Inc., ORSC, Old Republic Surety Consulting, Inc., and Capital Services Agency, Inc. These entities serve the small- to mid-sized surety market segment.

### **Organizational Chart**

**As of December 31, 2012**

Old Republic International Corporation (DE)	ORI
Old Republic General Insurance Group, Inc. (DE)	ORGIG
Bitco Corporation (DE)	BC
Bituminous Casualty Corporation (IL)	BCC
Old Republic General Insurance Corporation (IL)	ORGIC
Old Republic Insurance Company (PA)	ORIC
Old Republic Surety Group, Inc. (DE)	ORS Group
Old Republic Surety Company (WI)	ORSC
Capital Service Agency, Inc. (IA)	CSA
Old Republic Surety Consulting, Inc. (DE)*	
Old Republic National Services Group, Inc. (IL)	ORNSG
Old Republic Asset Management Corporation (IL)	ORAM
Old Republic General Services, Inc. (IL)	ORGS
Old Republic Capital Corporation (DE)	ORCC

\* Old Republic Surety Consulting, Inc., merged with and into Old Republic Surety Group, Inc., effective April 15, 2013. Old Republic Surety Group, Inc., is the surviving entity; it will continue to use the name Old Republic Surety Group, Inc.

Note that the above organizational chart shows only a segment of the group's structure. Only the affiliates that directly affect the operations of Old Republic Surety Company are included.

### **Present Succession of Control**

#### **Old Republic International Corporation**

Old Republic International Corporation is a Chicago-based multiple lines insurance holding company incorporated under the laws of Delaware on March 10, 1969. ORI's common shares are publicly traded on the New York Stock Exchange. On a consolidated basis for the fiscal year ending December 31, 2012, ORI reported total assets of \$16.22 billion, liabilities of \$12.63 billion, and total common shareholders' equity of \$3.59 billion. Operations for 2012 produced a net loss of \$68.6 million.

### **Old Republic General Insurance Group, Inc.**

Old Republic General Insurance Group, Inc., was incorporated in Delaware on December 3, 1979. This wholly owned subsidiary of ORI is the leading holding company of ORI's General Insurance Group. The General Insurance Group is the most significant operating division within the holding company system and contains the greatest diversity in terms of the lines of business and scope of ancillary insurance activities. ORGIG's combined statutory financial statements as of December 31, 2012, reported assets of \$7,926,146,671, liabilities of \$5,320,561,072, surplus of \$2,605,585,599, and net income of \$208,021,480.

### **Old Republic Surety Group, Inc.**

Old Republic Surety Group, Inc., organized on March 27, 1986, is a holding company domiciled in Delaware. The corporation was organized as a means to reward executives responsible for the financial results of ORSC and its subsidiaries should their guidance in the initial years of these companies profit ORI. ORGIG provided \$13,400,000 of the corporation's initial capitalization through the purchase of 4,000 common shares at \$100 per share, 9,500 shares of redeemable voting preferred shares at \$1,000 per share, and \$3,500,000 in ten-year debenture. Seven executives subscribed to a total of 1,000 common shares at \$100 per share. Pursuant to a stock subscription and purchase agreement dated effective May 30, 1986, participating executives were able to exchange their common shares for cash or common shares of ORI between July 1, 1996, and July 1, 2001. All the executives exchanged their common shares resulting in ORGIG owning 100% of the ORS Group. On a consolidated basis, for the fiscal year ending December 31, 2012, ORS Group reported assets of \$122,279,504, liabilities of \$59,576,909, shareholders' equity of \$62,702,595, and net income of \$2,478,918.

### **Significant Affiliates**

This section addresses affiliated entities that are not in the "succession of control" section above but with which the company has some business relationship.

### **Old Republic Asset Management Corporation**

Old Republic Asset Management Corporation (ORAM), organized as an Illinois corporation on January 28, 1966, provides investment management services to the members of the

Old Republic holding company system, including ORSC, pursuant to written agreements. The corporation was initially known as Trinity Insurance Agency, Inc. In March 1980 the corporate title was changed to that presently used as a reflection of the change in its purposes and scope of activities. The corporation has no employees, rather it utilizes those of Old Republic General Services, Inc. Functionally, it serves as a cost allocation center for accounting control purposes. As of December 31, 2012, the corporation reported (unaudited) assets of \$4,950,999, liabilities of \$482,417, and shareholders' equity of \$4,468,582. Operations for 2012 produced net income of \$541,155.

#### **Old Republic General Services, Inc.**

Old Republic General Services, Inc., organized as an Illinois corporation on July 20, 1960, provides various general and administrative services for members of the Old Republic holding company system, including ORSC. Services include, but are not limited to, accounting, records management, tax preparation, legal activity, and data processing. Services of this type are provided pursuant to written service agreements. Functionally, it serves the same purpose as ORAM, except for different categories of expense. The corporation was formerly known as R.E. Flannery and Associates, Inc. In 1978, the corporate title was changed to that presently used as a reflection of the change in its purpose and scope of activities. As of December 31, 2012, the corporation reported assets of \$4,266,806, liabilities of \$7,057,585, common shareholders' equity of \$(2,790,779), and net loss of \$549,522.

#### **Old Republic Insurance Company**

Old Republic Insurance Company was incorporated under the laws of the Commonwealth of Pennsylvania on April 11, 1935, and commenced business on April 21, 1935. Interests identified with various coal companies and allied industrial concerns organized the corporation under the title Coal Operators Casualty Company. On April 18, 1955, the Old Republic holding company system acquired control of the corporation from its original sponsors and on June 7 of the same year changed the name to that presently used.

ORIC is the lead carrier and primary employer in ORI's General Insurance Group. ORIC's marketing efforts are concentrated on large commercial accounts with specialized

insurance requirements. It is licensed in all 50 U.S. states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. As of December 31, 2012, the audited statutory basis financial statements of ORIC reported assets of \$2,439,819,609, liabilities of \$1,564,899,190, and capital and surplus of \$874,920,419. Operations for 2012 produced net income of \$84,387,601.

#### **Bituminous Casualty Corporation**

Bituminous Casualty Corporation is a property and liability insurance company domiciled in the state of Illinois. The company specializes in providing insurance coverage for businesses in the forest products, gas and oil, and building and construction industries in the midwestern, southwestern, and southeastern part of the United States. As of December 31, 2012, the audited statutory basis financial statements of Bituminous Casualty Corporation reported assets of \$719,804,772, liabilities of \$445,592,515, and capital and surplus of \$274,212,257. Operations for 2012 produced net income of \$24,316,817.

#### **Old Republic Capital Corporation**

Old Republic Capital Corporation is a Delaware corporation formed in 1987 as a subsidiary of Old Republic International Corporation. The company provides short-term financial liquidity for ORI's insurance company subsidiaries. Primarily, ORCC has provided this liquidity through the issuance of short-term commercial paper that has maturities of less than one year. The proceeds of the sale of this commercial paper are used for the general corporate purposes by ORI. The commercial paper issued by ORCC is unconditionally guaranteed by ORI and is exempt from registration under the Security Act of 1933. The commercial paper program is currently inactive. As of December 31, 2012, the corporation reported assets of \$934,660, liabilities of \$97,675, and common shareholders' equity of \$836,985. Operations for 2012 produced net income of \$72,457.

#### **Subsidiary**

##### **Capital Services Agency, Inc.**

Capital Services Agency, Inc. (CSA) was incorporated in Iowa on September 1, 1963. Old Republic Surety Company acquired the corporation in connection with its acquisition of State Surety Corporation on December 31, 1982. CSA is an insurance agency that specializes in the

placement of surety risks with its parent, ORSC, and affiliate, ORIC. As of December 31, 2012, CSA reported assets of \$205,385, liabilities of \$(2,943), retained earnings of \$208,328, and net income of \$3,478.

#### **Old Republic Surety Consulting, Inc.**

Old Republic Surety Consulting, Inc., was incorporated in Delaware on May 27, 1992. This wholly owned subsidiary of ORS Group was organized to provide consulting services on surety issues to nonaffiliated parties from time to time. The corporation has no employees of its own, rather it utilizes employees of ORSC as necessary. Functionally, it serves as a cost allocation center for accounting control purposes. As of December 31, 2012, the corporation reported assets of \$223,231, liabilities of \$(82), equity of \$223,313, and net loss of \$1,159. The corporation was merged with and into Old Republic Surety Group, Inc., effective April 15, 2013. Old Republic Surety Group, Inc., is the surviving entity; it will continue to use the name Old Republic Surety Group, Inc.

#### **Agreements with Affiliates**

The company is staffed by its own officers and employees and pays most of its expenses on its own behalf. However, as a member of a holding company system, ORSC engages in the exchange of risks and services with affiliates under various written agreements. Reinsurance agreements are described in the reinsurance section of this report. A brief summary of the other 10 agreements follows.

#### **Tax-Sharing Agreement**

The company entered into a federal tax-sharing agreement by and between ORI and its four subsidiaries in the Old Republic Surety Group of companies through an addendum to this agreement dated April 28, 2004. This agreement establishes a method for allocating the consolidated tax liability of the affiliated group among ORI and the subsidiaries, for reimbursing ORI for payment of such tax liability, and for compensating any party for use of its losses and/or tax credits. For each tax period each member in the group should calculate its separate federal income tax liability and pay such amount to ORI. If the sum of the amount payable to ORI in this manner exceeds the consolidated tax liability for the year, ORI will allocate the excess in

accordance with each member's share of excess losses and tax credits that were absorbed in the consolidated return. ORI will pay to each member its allocable portion of such excess amount within 45 days after the date of filing of the consolidated return. This agreement may be terminated by mutual agreement of both parties.

#### **Service Agreement with Old Republic Insurance Company**

The company entered into a service agreement dated January 1, 1994, with ORIC, whereby each party agreed to avail itself of certain resources and support to be provided by the other. ORSC agreed to provide ORIC with human resources support, administration of the executive fleet program, and payroll function. Though not specified in the agreement, ORSC's services with respect to this agreement apply only to employees of ORIC's Milwaukee branch. ORIC agreed to furnish ORSC with data processing hardware and related software, lease management for its home office only, and mail room service. Either party may terminate this agreement at any time with 120 days' written notice to the other. In the event of termination, both parties will provide reasonable assistance to the other party in obtaining replacement services.

#### **Expense Reimbursement Agreement with Old Republic Insurance Company**

Effective January 1, 1994, the company entered into an expense reimbursement agreement with ORIC. Under this agreement, the parties agree to furnish one another with monthly statements of expenses incurred with respect to their services agreement effective January 1, 1994, as described in the foregoing paragraph.

ORSC is to furnish a monthly billing reflecting services rendered based on the following:

- A. Human resources charged on the proportionate shares of employees times human resource salaries and associated costs.
- B. Cost of leases for fleet automobiles on actual billings as received by the leasing company.
- C. Health insurance on an actual basis for participation under the health insurance plan in force.

ORIC is to furnish a monthly billing reflecting service rendered based on the following:

- A. The central processing unit ("CPU") utilization factor is to be negotiated annually based on current and expected activities.
- B. Disk space on actual storage in megabytes by the cost of megabyte.
- C. Data processing operation overhead is to be based on the CPU utilization factor.

- D. IBM and other software on the CPU utilization factor.
- E. Occupancy cost is to be apportioned on actual square footage utilized.
- F. Mail room at an hourly rate.

Any costs which are paid by either party to outside concerns which can be directly identified to the other party will be billed directly on a monthly basis and may be included with invoices for services rendered. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. Either party may terminate this agreement at any time with 120 days' written notice to the other.

#### **Service Agreement with Old Republic Insurance Company**

Effective June 1, 1986, the company entered into a service agreement whereby the company is to provide certain services with respect to the fidelity and surety business produced by ORIC including, but not limited to, underwriting, claims management, billing and receipts, rate and form filings, appointment, training, supervision of agents, and accounting services. Any party may terminate this agreement at any time with 120 days' prior written notice. The agreement would terminate automatically upon termination of reinsurance cessions to ORSC.

#### **Expense Reimbursement Agreement with Old Republic Insurance Company**

Effective June 1, 1986, the company entered into an expense reimbursement agreement with ORIC. Under this agreement, the company agrees to furnish ORIC with a quarterly statement of expenses incurred with respect to its service agreement effective June 1, 1986, as described in the foregoing paragraph. Invoiced expenses may include allocation of salaries and other overhead items but shall not in any case exceed on an annual basis 30% of the total premiums covered by the reinsurance agreement effective June 1, 1986. ORIC has the right to inspect relevant books and records of ORSC at any time during normal business hours. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. There is no direct provision for termination, but as a practical matter, cancellation and runoff of the company's assumption reinsurance contract with ORIC would effectively nullify this agreement, as would cancellation of the service agreement described above.

## **Investment Counsel Services Agreement with Old Republic Asset Management Corporation**

Effective July 1, 2012, the company entered into an investment counsel services agreement with ORAM. (This replaced the previous agreement which had been in effect since October 1, 1995.) Under this agreement, ORAM is to act as investment counsel, advising the company on investment policy, executing purchases and sales of investments, monitoring the value of its invested assets, and preparing investment statements for insurance regulatory purposes on a quarterly basis. ORSC is to retain the custody of, responsibility for, and the control of all investments. This agreement may be terminated by either party upon 30 days' advance notice. The fee for services provided by ORAM is a sliding scale percentage that declines as assets under management increase. ORSC is to pay ORAM the following quarterly fee based on assets under management (less a working capital credit in the amount of \$1,000,000) at the date the fee is assessed.

<b>Net Portfolio Assets</b>	<b>Quarterly Fee</b>	<b>Annualized Quarterly Fee</b>
Minimum Fee	\$500	\$2,000
First \$100,000,000	1.25 basis points	5 basis points
Next \$150,000,000	0.75 basis points	3 basis points
Over \$250,000,000	0.50 basis points	2 basis points

In 2012, ORSC incurred \$46,662 in fees for investment counsel and services rendered by ORAM.

## **Service Agreement with Old Republic Surety Consulting, Inc.**

Effective January 1, 1992, the company entered into an agreement with Old Republic Surety Consulting, Inc., whereby the company would make officers and employees available to Old Republic Surety Consulting, Inc., as necessary. Old Republic Surety Consulting, Inc., in turn, agrees to furnish ORSC with evidence of its authority to perform services as required on its behalf and to reimburse ORSC for funds advanced and expenses incurred on its behalf. Either party may terminate this agreement at any time with 120 days' written notice to the other. This agreement was terminated simultaneously with the merger of Old Republic Surety Consulting, Inc., with and into Old Republic Surety Group, Inc., effective April 15, 2013.

**Expense Reimbursement Agreement with Old Republic Surety Consulting, Inc.**

Effective January 1, 1992, the company entered into an expense reimbursement agreement with Old Republic Surety Consulting, Inc. Under this agreement, the company agrees to furnish Old Republic Surety Consulting, Inc., with a quarterly statement of expenses incurred with respect to its service agreement effective January 1, 1992, as described in the foregoing paragraph. Invoiced expenses may include costs incurred in performing accounting and administrative services and may include allocations of salaries and other overhead items. Old Republic Surety Consulting, Inc., has the right to inspect relevant books and records of ORSC at any time during normal business hours. Any dispute that cannot be agreeably resolved between the parties is to be referred to the internal auditors of ORI for resolution. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. Either party may terminate this agreement at any time with 120 days' written notice to the other. This agreement was amended effective January 1, 1994, to clarify wording with respect to services provided by ORSC. This agreement was terminated simultaneously with the merger of Old Republic Surety Consulting, Inc., with and into Old Republic Surety Group, Inc., effective April 15, 2013.

**Expense Reimbursement Agreement with Old Republic Surety Group, Inc.**

Effective January 1, 1997, the company entered into an expense reimbursement agreement with ORS Group. Under this agreement, the company agrees to furnish ORS Group with a statement in September and December of each year of expenses incurred with respect to any accounting and miscellaneous services that the company might perform for ORS Group. Invoiced expenses may include costs incurred in performing accounting and administrative services and may include allocations of salaries and other overhead items. ORS Group has the right to inspect the books and records of ORSC at any time during normal business hours. Any dispute that cannot be agreeably resolved is to be referred to the internal auditors of ORI for resolution. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. There is no formal provision for the termination of services under this agreement.

**Service and Expense Reimbursement Agreement with Capital Service Agency, Inc.**

Effective January 1, 1999, the company entered into a service and expense reimbursement agreement with Capital Service Agency, Inc. Under this agreement, the company agrees to furnish CSA with a statement periodically throughout the year of expenses incurred with respect to any accounting and miscellaneous services that the company might perform for CSA. Invoiced expenses may include costs incurred in performing accounting and administrative services and may include allocations of salaries and other overhead items. CSA has the right to inspect relevant books and records of ORSC at any time during normal business hours. Any dispute that cannot be agreeably resolved between the parties is to be referred to the internal auditors of ORI for resolution. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. There is no formal provision for the termination of services under this agreement.

## 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.

### Nonaffiliated Ceding Contracts

The company has entered a four-layer excess of loss reinsurance agreement, with 50% of the risk being ceded to Munich Reinsurance America, Inc., 40% of the risk ceded to Transatlantic Reinsurance Company, and 10% of the risk ceded to Hannover Reinsurance Company. The agreement has been in place since January 1, 2012. Contract surety, miscellaneous surety and fidelity bonds are covered by the agreement. Certain exclusions apply. The agreement is not continuous and can be terminated with 30 days' notice. The reinsurers shall not be liable for losses discovered after the effective date of termination unless the company exercises an extended discovery option. Extensions are for one-year periods, to a maximum extension of two years. There are no ceding commissions provided. Net loss is defined, in part, as all loss and allocated expense payments made by the company in the investigation, defense, settlement, or mitigation of claims or potential claims on the business reinsured. The coverages provided under this agreement are summarized as follows:

1. Type: First Excess Cover of Loss
- Business reinsured: Surety and Fidelity
- Retention:
  - a. Contract Surety - \$500,000 each principal retention, plus 5% of net loss each principal in excess of \$500,000, up to a per principal limit of \$3,000,000
  - b. Miscellaneous Surety - \$250,000 each principal retention
  - c. Fidelity and Forgery - \$250,000 each loss event retention
- Coverage:
  - a. Contract Surety - 95% of net loss each principal in excess of \$500,000, not to exceed each principal limit of \$3,000,000
  - b. Miscellaneous Surety - 100% of net loss each principal in excess of \$250,000, not to exceed each principal limit of \$3,000,000
  - c. Fidelity and Forgery - 100% of net loss each loss event in excess of \$250,000, not to exceed each loss event limit of \$3,000,000

Total coverage for all principals and loss events shall not exceed an annual aggregate limit of 95% of \$7,500,000 for each calendar year in which the contract remains in effect

Premium:	2.4% of gross fidelity and surety premium is the deposit and minimum premium due each calendar quarter of the agreement. The annual minimum premium is \$895,500.
Reinstatement:	One at 10% and one at 100%
2. Type:	Second Excess Cover of Loss
Business reinsured:	Surety and Fidelity
Retention:	<ul style="list-style-type: none"> <li>a. Contract Surety - 10% of net loss and principal in excess of \$3,000,000 up to a per principal limit of \$5,000,000</li> <li>b. Miscellaneous Surety - 10% of net loss each principal in excess of \$3,000,000 up to a per principal limit of \$5,000,000</li> <li>c. Fidelity and Forgery - 10% of net loss each principal in excess of \$3,000,000 up to a per principal limit of \$5,000,000</li> </ul>
Coverage:	<ul style="list-style-type: none"> <li>a. Contract Surety - 90% of net loss each principal in excess of \$3,000,000 not to exceed each principal limit of \$5,000,000</li> <li>b. Miscellaneous Surety - 90% of net loss each principal in excess of \$3,000,000 up to a per principal limit of \$5,000,000</li> <li>c. Fidelity and Forgery - 90% or net loss each principal in excess of \$3,000,000 up to a per principal limit of \$5,000,000</li> </ul> <p>Total coverage for all principals and loss events shall not exceed an annual aggregate limit of 90% of \$6,000,000 for each calendar year in which the contract remains in effect</p>
Premium:	0.333% of gross surety and fidelity premiums written subject to an annual minimum premium of \$124,200
Reinstatement:	One at 50% and one at 100%
3. Type:	Third Excess Cover of Loss
Business reinsured:	Contract Surety
Retention:	10% of net loss each principal in excess of \$5,000,000, up to a per principal limit of \$10,000,000
Coverage:	<p>90% of net loss each principal in excess of \$5,000,000, not to exceed each principal limit of 90% of \$10,000,000</p> <p>Total coverage for all principals shall not exceed an annual aggregate limit of 90% of \$10,000,000 for each calendar year in which the contract remains in effect</p>
Premium:	0.392% of gross surety and fidelity premiums written, subject to an annual minimum premium of \$146,250
Reinstatement:	One at 100%

4. Type:	Fourth Excess Cover of Loss
Business reinsured:	Contract Surety
Retention:	6.75% of net loss each principal in excess of \$10,000,000, up to a per principal limit of \$20,000,000
Coverage:	93.25% of net loss each principal in excess of \$10,000,000, not to exceed each principal limit of \$20,000,000  Total coverage for all principals shall not exceed an annual aggregate limit of 93.25% of \$10,000,000 for each calendar year in which the contract remains in effect
Premium:	0.477% of gross surety and fidelity premiums written, subject to an annual minimum premium of \$178,020
Reinstatements:	None

#### **Affiliated Assuming Contracts**

1. Type:	100% Quota Share
Reinsured:	Old Republic Insurance Company
Scope:	Covered open claims of the reinsured under binders, policies and reinsurance contracts providing fidelity, surety and notary public errors and omissions insurance or reinsurance
Coverage:	<ul style="list-style-type: none"> <li>a. 100% of the liability in force as of April 1, 1996, assumed by the reinsured from the company under a portfolio reinsurance treaty effective January 1, 1986</li> <li>b. 100% of the liability in force as of April 1, 1996, assumed by the reinsured under its agreements with six named insurers</li> <li>c. 100% of the liability of the reinsured in force as of and written on or after April 1, 1996, under contracts underwritten and managed by the company</li> </ul>
Premium:	<p>With respect to coverage a – c, above:</p> <ul style="list-style-type: none"> <li>a. Reinsured to pay all reserves for (i) unearned premium reserves, (ii) open claims, including IBNR, (iii) LAE, and (iv) policyholders' dividend liability for unexpired bonds, all as of April 1, 1996</li> <li>b. Reinsured to pay (i) unearned premium reserves for liabilities in force and (ii) net written premiums defined as gross written premiums less premiums returned</li> <li>c. Same as b, above</li> </ul>
Commissions:	<p>With respect to coverage a – c, above:</p> <ul style="list-style-type: none"> <li>a. The company is to pay ceding commission rate equal to policy acquisition costs on unearned premium reserves</li> <li>b. The company is to pay (i) ceding commission on reinsurance retroceded equal to policy acquisition costs on unearned premium reserves and (ii) ceding commission on retroceded</li> </ul>

- net written premiums sufficient to reimburse the reinsured for ceding commission paid to its ceding reinsurers
- c. The company is to pay (i) ceding commission equal to policy acquisition costs on unearned premium reserves and (ii) ceding commission on net written premiums equal to the sum of:
- Commissions paid or due on insurance ceded
  - Premium taxes or other fees on insurance ceded
  - Board and bureau fees or assessments and guaranty fund or similar assessments, and
  - Between 2.00% to 0.75% of premium received on reinsurance ceded based on net written premiums
- d. With respect to coverage b and c, the company is to pay an additional ceding commission equal to a prorated amount of the reimbursement made by the reinsured to the company for servicing costs incurred by the company in servicing the issuance of all insurance retroceded

Effective date:	June 1, 1986
Termination:	At any December 31 <sup>st</sup> by either party providing at least 90 days' prior written notice
2. Type:	100% Quota Share
Reinsured:	Bituminous Casualty Corporation
Scope:	All fidelity and surety risks underwritten by Old Republic Surety Company, excluding fidelity on package policies
Coverage:	100% of all fidelity and surety losses, including loss adjustment expenses, incurred by the reinsured or its subsidiaries
Premium:	100% of written premium
Commissions:	100% reimbursement to the reinsured of all costs incurred by the fidelity and surety department
Effective date:	April 1, 1989
Termination:	At any date by either party giving 60 days' advance written notice

## **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, 2012, annual statement. 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. 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."

**Old Republic Surety Company**  
**Assets**  
**As of December 31, 2012**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$72,359,509	\$	\$72,359,509
Stocks:			
Common stocks	12,634,985		12,634,985
Cash, cash equivalents, and short-term investments	6,474,783		6,474,783
Investment income due and accrued	876,947		876,947
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	3,651,884	405,093	3,246,791
Reinsurance:			
Amounts recoverable from reinsurers	75,351		75,351
Current federal and foreign income tax recoverable and interest thereon	59,113		59,113
Net deferred tax asset	2,608,108		2,608,108
Receivable from parent, subsidiaries, and affiliates	595,062		595,062
Write-ins for other than invested assets:			
Miscellaneous assets	31,730	31,530	200
Prepaid expenses	264,244	264,244	
Receivable from leasing company	5,433	5,433	
Leasehold improvements	<u>313,860</u>	<u>313,860</u>	
<b>Total Assets</b>	<u><b>\$99,951,009</b></u>	<u><b>\$1,020,160</b></u>	<u><b>\$98,930,849</b></u>

**Old Republic Surety Company**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2012**

Losses		\$13,101,673
Loss adjustment expenses		8,086,229
Commissions payable, contingent commissions, and other similar charges		1,114,054
Other expenses (excluding taxes, licenses, and fees)		2,518,154
Taxes, licenses, and fees (excluding federal and foreign income taxes)		547,293
Unearned premiums		23,614,222
Advance premium		221,024
Ceded reinsurance premiums payable (net of ceding commissions)		272,248
Amounts withheld or retained by company for account of others		39,212
Drafts outstanding		437,901
Write-ins for liabilities:		
Escheat fund liability		89,232
Miscellaneous liabilities		325
Leasehold improvement tenant allowance		<u>172,353</u>
Total liabilities		50,213,920
Common capital stock	\$ 2,900,000	
Gross paid in and contributed surplus	16,534,036	
Unassigned funds (surplus)	<u>29,282,893</u>	
Surplus as regards policyholders		<u>48,716,929</u>
Total Liabilities and Surplus		<u>\$98,930,849</u>

**Old Republic Surety Company  
Summary of Operations  
For the Year 2012**

<b>Underwriting Income</b>		
Premiums earned		\$37,629,148
Deductions:		
Losses incurred	\$ 6,108,373	
Loss adjustment expenses incurred	2,117,914	
Other underwriting expenses incurred	<u>27,323,668</u>	
Total underwriting deductions		<u>35,549,955</u>
Net underwriting gain (loss)		2,079,193
<b>Investment Income</b>		
Net investment income earned	3,682,405	
Net realized capital gains (losses)	<u>442,315</u>	
Net investment gain (loss)		4,124,720
<b>Other Income</b>		
Net gain (loss) from agents' or premium balances charged off		
Total other income		<u>(13,372)</u>
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		6,190,541
Dividends to policyholders		<u>117,815</u>
Net income (loss) after dividends to policyholders but before federal and foreign income taxes		6,072,726
Federal and foreign income taxes incurred		<u>1,265,326</u>
Net Income		<u>\$ 4,807,400</u>

**Old Republic Surety Company  
Cash Flow  
For the Year 2012**

Premiums collected net of reinsurance		\$36,043,909
Net investment income		4,048,394
Miscellaneous income		<u>(13,372)</u>
Total		40,078,931
Benefit- and loss- related payments	\$ 4,079,914	
Commissions, expenses paid, and aggregate write-ins for deductions	31,153,101	
Dividends paid to policyholders	117,815	
Federal and foreign income taxes paid (recovered)	<u>1,982,240</u>	
Total deductions		<u>37,333,070</u>
Net cash from operations		2,745,861
Proceeds from investments sold, matured, or repaid:		
Bonds	\$9,049,762	
Stocks	<u>2,418,171</u>	
Total investment proceeds		11,467,933
Cost of investments acquired (long-term only):		
Bonds	4,990,842	
Stocks	<u>4,608,107</u>	
Total investments acquired	<u>9,598,949</u>	
Net cash from investments		1,868,984
Cash from financing and miscellaneous sources:		
Dividends to stockholders	4,200,000	
Other cash provided (applied)	<u>(452,475)</u>	
Net cash from financing and miscellaneous sources		<u>(4,652,475)</u>
<b>Reconciliation:</b>		
Net change in cash, cash equivalents, and short-term investments		(37,630)
Cash, cash equivalents, and short-term investments:		
Beginning of year		<u>6,512,413</u>
End of year		<u>\$ 6,474,783</u>

**Old Republic Surety Company  
Compulsory and Security Surplus Calculation  
December 31, 2012**

Assets		\$98,930,849
Less liabilities		<u>50,213,920</u>
Adjusted surplus		48,716,929
Annual premium:		
Lines other than accident and health	\$35,945,315	
Less policyholder dividends	<u>117,815</u>	
Subtotal	35,827,500	
Factor	<u>20%</u>	
Compulsory surplus (subject to a minimum of \$2 million)		<u>7,165,500</u>
Compulsory Surplus Excess (or Deficit)		<u>\$41,551,429</u>
Adjusted surplus (from above)		\$48,716,929
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%)		<u>10,031,700</u>
Security Surplus Excess (or Deficit)		<u>\$38,685,229</u>

**Old Republic Surety Company  
Analysis of Surplus  
For the Five-Year Period Ending December 31, 2012**

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

	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Surplus, beginning of year	\$48,079,493	\$45,762,903	\$43,286,258	\$42,786,110	\$45,684,556
Net income	4,807,400	6,612,390	5,558,937	2,806,813	3,107,402
Change in net unrealized capital gains/losses	168,633	(106,343)	920,943	1,017,937	(1,340,735)
Change in net deferred income tax	(1,291,332)	(641,774)	(53,389)	210,918	440,068
Change in non- admitted assets	584,337	652,317	250,154	664,480	(1,105,181)
Cumulative effect of changes in accounting principles	568,398				
Dividends to stockholders	<u>(4,200,000)</u>	<u>(4,200,000)</u>	<u>(4,200,000)</u>	<u>(4,200,000)</u>	<u>(4,000,000)</u>
Surplus, End of Year	<u>\$48,716,929</u>	<u>\$48,079,493</u>	<u>\$45,762,903</u>	<u>\$43,286,258</u>	<u>\$42,786,110</u>

**Old Republic Surety Company  
Insurance Regulatory Information System  
For the Five-Year Period Ending December 31, 2012**

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. There were no unusual results.

Ratio	2012	2011	2010	2009	2008
#1 Gross Premium to Surplus	77%	86%	96%	103%	96%
#2 Net Premium to Surplus	74	82	93	100	94
#3 Change in Net Premiums Written	-9	-7	-2	9	-2
#4 Surplus Aid to Surplus	0	0	0	0	0
#5 Two-Year Overall Operating Ratio	86	84	85	83	77
#6 Investment Yield	4.0	4.3	4.4	4.6	4.4
#7 Gross Change in Surplus	1	5	6	1	-6
#8 Change in Adjusted Surplus	1	5	6	1	-6
#9 Liabilities to Liquid Assets	54	57	60	61	59
#10 Agents' Balances to Surplus	7	7	7	8	6
#11 One-Year Reserve Development to Surplus	-12	-14	-10	-5	-9
#12 Two-Year Reserve Development to Surplus	-18	-17	-10	-11	-12
#13 Estimated Current Reserve Deficiency to Surplus	-21	-15	-14	-13	-10

**Growth of Old Republic Surety Company**

Year	Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income
2012	\$ 98,930,849	\$50,213,920	\$48,716,929	\$4,807,400
2011	100,986,380	52,906,887	48,079,493	6,612,390
2010	102,399,616	56,636,713	45,762,903	5,558,937
2009	98,629,040	55,342,782	43,286,258	2,806,813
2008	94,103,146	51,317,036	42,786,110	3,107,402
2007	99,113,070	53,428,514	45,684,556	6,940,665

  

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
2012	\$37,665,042	\$35,945,315	\$37,629,148	21.9%	76.1%	98.0%
2011	41,172,225	39,539,112	41,920,406	19.4	74.0	93.4
2010	44,030,061	42,689,334	43,269,867	20.1	72.4	92.5
2009	44,755,805	43,412,826	41,655,230	24.7	72.2	96.9
2008	41,266,977	40,005,735	40,869,060	14.3	73.1	87.4
2007	42,105,354	40,667,096	40,730,769	15.4	70.6	86.0

Since its inception, the company has been consistently profitable. The company has reported a net income of over \$2.8 million each year during the period under examination. In 2012

the company reported net income of \$4.8 million. The company has reported positive underwriting results in all five years under examination and a steady stream of investment income derived from the company's conservative investment portfolio. The combined ratio has been consistently below 100% in the last five years, with the loss and LAE ratio component being on average at 20%. The company's elevated underwriting expenses, as reflected by the underwriting expense ratio of approximately 74%, correspond to current industry practices and business concentration in the surety market. The company's gross and net underwriting leverage ratios have decreased over the period under examination due to a combination of surplus growth and premium decrease. Both gross and net premium written have decreased by 11% and 12%, respectively, in the last five years, reflecting the company's selective underwriting philosophy and the soft insurance market that the industry has experienced in the past few years. Surplus has increased 7% since 2007. Admitted assets have decreased 0.2% to \$99 million, while liabilities have decreased 6% to \$50 million since year-end 2007.

#### **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, 2012, of \$48,716,929 is accepted.

#### **Examination Reclassifications**

There were no reclassifications required by the examination results.

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were five 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. Information Technology—It is recommended the company implement stronger password controls for accounts which have access to their applications and data.

Action—Compliance

2. Disaster Recovery Plan—It is recommended that the company update its disaster recovery plan to incorporate the items mentioned above. In addition, once the plan is completed, the company should file evidence of the plan with this office within 90 days.

Action—Compliance

3. Report of Executive Compensation—It is recommended that the company properly complete the Report on Executive Compensation as required by ss. 601.42 and 611.63 (4), Wis. Stat.

Action—Compliance

4. Financial Reporting—It is recommended that the company report the closing balances in its annual statement filings as of December 31 in accordance with s. Ins 50.20 (1) (b), Wis. Adm. Code.

Action—Compliance; see comments in the “Summary of Current Examination Results” section.

5. Actuarial Report—It is recommended that in actuarial reports supporting future Statement of Actuarial Opinion, the Appointed Actuary include a reconciliation of the earned premium to Schedule P data.

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.

### **Financial Reporting**

The company uses a variety of cutoff dates prior to December 31 with various segments of the company's operations being cutoff at different times. This practice is used by all of the ORI's insurance subsidiaries in order for ORI, a publicly traded corporation, to comply with its financial reporting deadlines. The prior examination concluded that the company's financial statements were not materially misstated due to the early cutoffs. Further, the examination concluded that the company has policies and procedures in place to monitor and adjust its year-end balance for any unusual or significant transactions that take place prior to year-end. However, this accounting practice constitutes a departure from the prescribed NAIC accounting practices and standards. The prior examination report made a recommendation that required the company to report the closing balances in its annual statement filings as of December 31 in accordance with s. Ins 50.20 (1) (b), Wis. Adm. Code. Subsequent to the issuance of the prior examination report, OCI issued a letter on November 19, 2009, to the company granting the company a relief from compliance with this recommendation under the condition that the company continues to monitor and report the effects of any significant transactions that occur prior to December 31 but after the company's closing date on its year-end financial statement. The current examination concluded that the company's financial statements were not materially misstated due to early cutoff. Therefore, the examination concluded that the company is in compliance with the prior examination recommendation, as revised in the letter from OCI dated November 19, 2009.

### **Claims Administration**

The company's claim representatives have the authority to change reserves up to \$1,000; reserves in excess of \$1,000 must be approved by the vice president of claims. The claim representative must provide the vice president with the file and a "Reserve Change Request" form indicating the current reserve and the requested reserve. Once approved, the vice president of

claims signs the form and the change is logged by the claims supervisor in the Manual Claims Supervisor Reserve Change Log. The claims supervisor then returns the file, along with the authorization, to the claim representative for entry on the system and proper recording in the Manual Claims Representative Reserve Change Log. Any reserves posted must be supported by information and documentation contained within the file. In the event of the absence of the vice president of claims, the senior claims representative has the authority to approve reserve changes up to \$25,000. Any reserve increase or decrease in excess of \$25,000 requires prior senior vice president e-mail/fax approval.

During the review of the company's claims procedures and controls it was noted that on multiple occasions reserve change requests had no approval signature by the proper authority. Furthermore, it was found that some of the reserve change requests in excess of \$1,000 were approved by the senior claims representative, even when the vice president of claims was present in the office. It is recommended that the company follow its written claim procedures and controls in its claims administration processes.

The company advised the examiners that it has since updated its claim procedures manual to reflect that senior claim representative has independent authority to approve a reserve of up to \$25,000.

## **VIII. CONCLUSION**

The company has reported a net income in each year since 2007. The company has maintained conservative gross and net underwriting leverage ratios. Admitted assets have decreased 0.2% to \$99 million, while liabilities have decreased 6% to \$50 million since 2007. Policyholders' surplus has increased 7% to \$48.7 million since year-end 2007.

The current examination of Old Republic Surety Company resulted in one recommendation related to the claims administration and no adjustments to surplus.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 36 - Claims Administration—It is recommended that the company follow its written claim procedures and controls in its claims administration processes.

## 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:

<b>Name</b>	<b>Title</b>
Jerry DeArmond	Insurance Financial Examiner Advanced Loss Reserve Specialist
David Jensen	Insurance Financial Examiner Advanced Information Technology Specialist
Stephanie Falck	Insurance Financial Examiner
James Vanden Branden	Insurance Financial Examiner
Scott Bleifuss	Insurance Financial Examiner

Respectfully submitted,

Rauf Mirza  
Examiner-in-Charge