PROCEEDINGS BEFORE JANE L. CLINE
INSURANCE COMMISSIONER
STATE OF WEST VIRGINIA

IN RE: FIRST SURETY CORPORATION

Administrative Proceeding No.: 11-AP-FINCON-02000

AGREED ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION AND DIRECTING ACTION

COMES NOW Jane L. Cline, Insurance Commissioner of the State of West Virginia, and issues this Order which adopts the REPORT OF FINANCIAL EXAMINATION as of December 31, 2009, of FIRST SURETY CORPORATION (hereinafter referred to as "Company") and directs action based upon the following findings, to wit:

JURISDICTION

1. Jane L. Cline is the Insurance Commissioner of the State of West Virginia (hereinafter the "Insurance Commissioner" and/or "WVOIC") and is charged with the duty of administering and enforcing the provisions of Chapter 33 of the West Virginia Code of 1931, as amended.

2. The Company was incorporated on November 19, 1979 and authorized by the Insurance Commissioner to transact business in the State of West Virginia as permitted and authorized under Chapter 33, Article 5 of the West Virginia Code.

FINDINGS OF FACT

1. An examination of the financial condition and operational affairs of the Company for the (5) year period beginning December 31, 2005 and ending December 31, 2009, was conducted in accordance with West Virginia Code §33-2-9(c) by the Insurance Commissioner.

2. On April 27, 2011, the examiner filed a REPORT OF FINANCIAL EXAMINATION with the Insurance Commissioner pursuant to W.Va. Code § 33-2-9(j) (2). A copy of the REPORT OF FINANCIAL EXAMINATION is attached hereto as Exhibit A and incorporated herein as if set forth in full.

3. On or about April 27, 2011, a true and accurate copy of the REPORT OF FINANCIAL EXAMINATION was forwarded to the Company by certified mail, return receipt requested. On May 4, 2011, the Company received a copy of the REPORT OF FINANCIAL EXAMINATION.

4. Pursuant to W.Va. Code § 33-2-9(j)(2), the Company was notified and afforded a period of thirty (30) days after receipt of the REPORT OF FINANCIAL EXAMINATION within which to make a submission, rebuttal, or objection concerning any matter contained in the REPORT OF FINANCIAL EXAMINATION.

5. By letter dated June 15, 2011, amending its letter dated June 6, 2011, management of the Company indicated that they had reviewed the REPORT OF FINANCIAL EXAMINATION and objected to the following:

(A). The Company disagrees with the finding on accounting for the reinsurance treaty.

(B). The Company disagrees with the finding on payments under the Tax Sharing Agreement.

(C). The Company disagrees with the determination in paragraph nine that the reinsurance treaty "failed to meet the transfer of risk test." The Company further disagrees with the subsequent conclusions based on this determination, and the effect stated in paragraph eleven and the recommendation in the Reinsurance section as responded to under Significant Findings.

(D). The Company disagrees with the remainder of the section dealing with the Tax Sharing Agreement (TSA) after sections one through five in the Report of Examination.

(E). **The Company does not believe adjustments made to the Company's 12/31/09 financial statements are appropriate.**

6. The Company, with the exception of those items mentioned in paragraph number 5 of this Order, concurred with the findings of the examination. A copy of the Company's response letter of June 15, 2011, is attached hereto as Exhibit B.

7. Subsequent to the reporting period covered by the financial examination, the Company has amended the reinsurance agreement in question and made the amendments retroactive to the beginning of the agreement. Therefore, the West Virginia Offices of the Insurance Commissioner ("WVOIC") does not require that

financial statements for prior years be restated.

8. Subsequent to the reporting period covered by the financial examination, a Tax Sharing Agreement has been filed with and approved by the WVOIC (subject to the parameters of the WVOIC approval letter dated June 29, 2011), in accordance with the Report of Examination findings to the Company . Accordingly the WVOIC agrees to not require refunds from the Company's parent based on payments made for prior tax years as a result of the Company's proposed solution to the examination finding.

9. By the letter dated June 15, 2011 and other discussions with the WVOIC, as set forth in paragraphs 7 and 8 above, the Company acknowledges that all issues so disputed with WVOIC concerning this REPORT of FINANCIAL EXAMINATION have and are being addressed despite the disagreement amongst the parties.

10. Further, the Company has informed the Insurance Commissioner that despite its objections to the REPORT OF FINANCIAL EXAMINATION, it wishes to move forward with resolution of this Examination and will not further contest or object to the Commissioner moving forward with Adoption of this AGREED ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION AND DIRECTING ACTION.

CONCLUSIONS OF LAW

W.Va. Code § 33-2-9(j)(3)(A) provides that following a review of the REPORT OF FINANCIAL EXAMINATION, the examination work papers, and any written submission, rebuttal, or objection, the Insurance Commissioner shall enter an ORDER adopting the REPORT OF FINANCIAL EXAMINATION as filed or with modifications or corrections.

ORDER

It is therefore AGREED by the Parties and ORDERED the following:

1. It is **ORDERED** that the REPORT OF FINANCIAL EXAMINATION of FIRST SURETY CORPORATION, attached hereto as Exhibit A, is hereby ADOPTED and APPROVED by the Insurance Commissioner.

2. It is further **ORDERED** that a copy of this AGREED ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION AND DIRECTING ACTION and the adopted REPORT OF FINANCIAL EXAMINATION shall be mailed to FIRST SURETY CORPORATION by certified mail, return receipt requested upon entry of this Order by the Insurance Commissioner.

3. It is **ORDERED** that FIRST SURETY CORPORATION shall file with the Insurance Commissioner, within thirty (30) days of the issuance of this ORDER, affidavits executed by each of its directors stating under oath that they have received a copy of the adopted REPORT OF FINANCIAL EXAMINATION and a copy of this AGREED ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION and DIRECTING ACTION, in accordance with W.Va. Code § 33-2-9(j) (4).

4. It is **ORDERED** that FIRST SURETY CORPORATION take whatever actions are required to comply with the recommendations set forth in the REPORT OF FINANCIAL EXAMINATION and shall demonstrate compliance to the satisfaction of the Insurance Commissioner, provided further that First Surety based on its actions and the approval by the Commissioner, all referred

to in paragraphs 7 and 8 above, has satisfied and is in compliance with the recommendations set forth in the REPORT OF FINANCIAL EXAMINATION regarding reinsurance accounting and calculation of tax under the Tax Sharing Agreement and no further action is required by First Surety Corporation for those recommendations.

5. That FIRST SURETY CORPORATION waives any right to any notice, administrative hearing or appeal there from for the actions taken by the Insurance Commissioner herein this Agreed Order Adopting Report of Financial Examination and Directing Action. FIRST SURETY CORPORATION reserves herein its rights to notice, administrative hearing or appeal for any future enforcement actions taken by the Commissioner that might result from this Agreed Order, if any.

6. It is finally **ORDERED** that this administrative matter be hereby dismissed from the administrative docket of the Insurance Commissioner.

Entered this 30th day of June, 2011.

Jane L. Cline
Insurance
Commissioner
State of West Virginia

THE PARTIES DO SO AGREE:

OFFICES OF THE INSURANCE COMMISSIONER

STATE OF WEST VIRGINIA

By: ______________________

Andrew R. Pauley, Associate Counsel
Attorney Supervisor, APIR

6/29/11
Date

FIRST SURETY CORPORATION

BY: Robert J. Kenney ______________
[Print Name]

Signed: ______________________

Its: ___President______________________

Dated: June 29, 2011

REPORT OF FINANCIAL EXAMINATION

OF

FIRST SURETY CORPORATION

AS OF

DECEMBER 31, 2009

EXHIBIT

A

<u>**TABLE OF CONTENTS**</u>

March 1, 2011

Honorable Jane L. Cline
West Virginia Insurance Commissioner
1124 Smith Street, 4th Floor
Charleston, West Virginia 25301

Honorable Scott H. Richardson,
Chair of the Southeastern Zone
1201 Main Street Suite 1000
Columbia, SC 29201

Dear Commissioner:

Pursuant to the authority vested in the West Virginia Offices of the Insurance Commissioner, an examination has been made of the affairs and financial condition of:

FIRST SURETY CORPORATION
300 Summers Street East, Suite 970
Charleston, West Virginia 25301

First Surety Corporation, hereinafter referred to as "the Company or FSC", is a West Virginia domiciled stock insurance company. The financial examination was conducted in Charleston, West Virginia at the Company's home office.

The Report of Financial Examination, reflecting the status of the Company as of December 31, 2009, is hereby submitted.

Respectfully,

Norman Koefoed, CFE

SCOPE OF FINANCIAL EXAMINATION

The Company is a West Virginia domiciled stock insurance company incorporated November 19, 1979, that received a license to conduct the business of insurance on November 19, 1979, from the West Virginia Offices of the Insurance Commissioner ("WVOIC"). The WVOIC completed a limited scope organizational examination as of March 31, 2009. This is the first full scope financial examination performed since the Company was acquired as a shell from its former parent, Celina, by Jacobs Financial Group, Inc. ("JFG") on December 31, 2005.

A single-state examination was conducted by a representative of the WVOIC and covered the period from January 1, 2005, through December 31, 2009, and included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

The examination was conducted pursuant to the instruction, procedures and guidelines prescribed by the WVOIC and in accordance with the National Association of Insurance Commissioners' Financial Examiners Handbook ("Handbook"). The Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the company by obtaining information about the company including corporate governance, identifying and assessing inherent risks within the company and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to and required by West Virginia Code.

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

SUMMARY OF SIGNIFICANT FINDINGS

The Company failed to properly account for the reinsurance treaty in that they used reinsurance accounting rather than deposit accounting as required by SSAP 62R and SSAP 75. See the reinsurance section of this report for additional information. This is a significant compliance and reporting finding.

The Company improperly made payments to the parent, Jacobs Financial Group, Inc. pursuant to the Tax Sharing Agreement that was filed with and approved by the WVOIC. See the holding company system and affiliated party transactions section of this report for additional information. This is a significant compliance finding in that it involves inappropriate related party transactions.

In some cases, the Company is failing to collect premium on a timely basis in accordance with the Coal Reclamation Bond Agreement. The Company is effectively assuming credit risk beyond what is contemplated in their plan of operations and is effectively making interest free loans to the bonded principals.

Since this was the first full scope financial examination performed since the Company resumed business after the sale to JFG by Celina there are no updates on other significant regulatory information disclosed in a previous examination. The examiner notes that in depth examination procedural steps reviewing market conduct compliance matters were not performed during the financial examination.

SUBSEQUENT EVENTS

There are no known material subsequent events.

COMPANY HISTORY

The Company was incorporated as West Virginia Fire and Casualty Company and was a part of the Celina Group. On December 31, 2005, all of the stock of West Virginia Fire and Casualty Company was acquired by JFG from the Celina Mutual Insurance Company. The acquisition was approved by the WVOIC pursuant to a Consent Order dated December 23, 2005. The acquisition consisted of the purchase of marketable investments and did not include any existing policy related assets or liabilities. On January 29, 2006, the name of the Company was changed from West Virginia Fire and Casualty Company to First Surety Corporation.

The Company began insurance operations on November 19, 1979. On December 31, 2005, the Company and Celina entered into a bulk reinsurance treaty. Under the bulk reinsurance treaty, Celina assumed the liabilities of the Company of approximately $9.6 million and received assets of an equal amount. No statutory gain or loss was recognized by the Company as a result of this transaction.

On January 1, 2006, the Company commenced operations writing surety bonds in the State of West Virginia.

CORPORATE RECORDS

The Articles of Incorporation, Bylaws, and recorded minutes of annual policyholder member meetings and meetings of the Board of Directors and its Committees were examined for statutory compliance and support. The Company appears to comply with all reviewed statutory requirements and adhere with the provisions of its Articles of Incorporation and Bylaws.

MANAGEMENT AND CONTROL

The Company is governed by a Board of Directors composed of five (5) individuals elected by the shareholder. All of the members of the Board are outside directors with the exception of John Jacobs. Daily operations are directed by the President, Mr. Robert Kenney. There has been no turnover in management team since the Company was acquired by JFG.

The members of the Board of Directors and their principal business affiliations as of December 31, 2009 were as set forth in the table below.

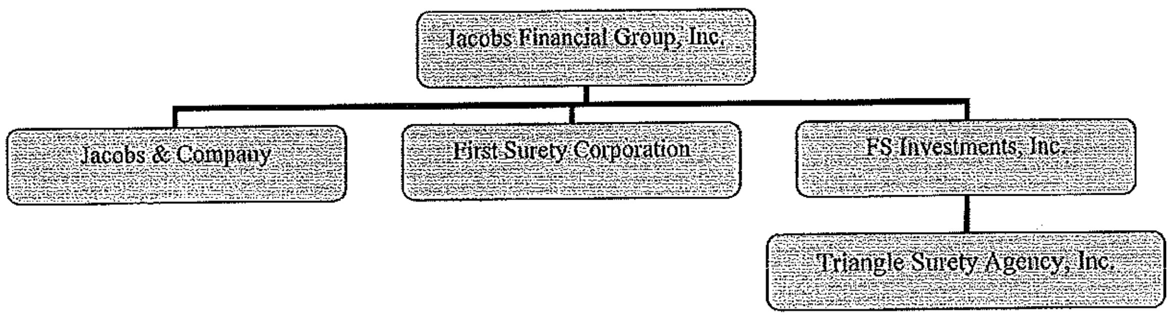
Member	Principal Business Affiliation
John Michael Jacobs, Chairman	Jacobs Financial Group, Inc.
Linda Jane Aguilar	Retired Banker
Charles David Thomas	George H. Friedlander & Company
Frederick Earnest Ferguson	Deceased (2010)
Timothy Allen Maddox	Silverstein & Maddox Insurance, Inc.

There are no committees of the Board.
The Officers serving as of December 31, 2009 were as set forth in the table below.

Officer	Office
Robert Joseph Kenney	President
Timothy Allen Maddox	Secretary
Robert Joseph Kenney	Treasurer

HOLDING COMPANY SYSTEM AND AFFILIATED PARTY TRANSACTIONS

The Company is a member of a holding company system. An organization chart of the principal members of the holding company system follows.



During the period under examination, the Company has been a party to several inter-company agreements.

The Company is a party to an Agency Agreement between the Company, Triangle and John Jacobs effective June 1, 2007 and amended effective June 1, 2010. This agreement and amendment appoints Triangle as an agent of the Company without binding authority and sets the commission for business produced for the Company at 30% of premium for new business and 15% of premium for renewal business.

The Company has an Investment Management Agreement between the Company and Jacobs & Company. This agreement was amended in June, 2010.

The Company has an Expense Sharing Agreement between the Company, Jacobs Financial Group, Inc., Jacobs & Company, FS Investments, Inc., and Triangle. This agreement had an effective date of June 1, 2007. The agreement was amended on January 1, 2010 and again on July 12, 2010.

There is a Tax Sharing Agreement that became effective January 1, 2006. This agreement was filed with and approved by the Office of the Insurance Commissioner. Parties to this agreement are the Company, Jacobs Financial Group, Inc. Jacobs & Company, FS Investments, Inc., Triangle, and Crystal Mountain Water, Inc. Under this agreement each of the subsidiary entities computes its stand alone tax liability and pays to the parent the computed tax amounts. The Tax Sharing Agreement reads in part "...A Subsidiary's Stand-Alone Tax Liability shall be determined as if the Subsidiary filed separate federal income tax returns...). Another section reads in part "...A Subsidiary's Stand-Alone Tax Liability **shall be determined using the Group's overall effective federal corporate rate for the year in question...**" (emphasis added).

For purposes of this examination, the examiner has accepted the following definition of "effective tax rate". Effective tax rate is the actual tax paid divided by the net taxable income before taxes, expressed as a percentage.

Pursuant to the Tax Sharing Agreement, the Company has improperly reported that they have incurred $95,301 in federal income tax in 2009 and had a liability in the amount of $7,644 for federal income tax at December 31, 2009.

During 2008, 2009 and 2010, the Company improperly paid or offset against other receivables $60,500, $142,698, and $103,776 respectively.

The examiner has determined that the payments and establishment of a liability are improper in that they were calculated using a tax rate other than the rate set forth in the filed and approved Tax Sharing Agreement.

Additionally it should be noted that the Company is making payments more frequently than is called for in the agreement.

An examination adjustment was made to remove the liability for federal income tax as it is not in accordance with the terms of the filed and approved Tax Sharing Agreement. No asset has been established for the recovery of the improper payments made in 2010 as it would be a non admitted asset due to the current financial condition of the parent. A non admitted asset is included in the financial statements in the amount of $203,198 for the amounts improperly paid in 2008 and 2009.

> **It is recommended that the Company not make payments for federal income tax to the parent that are not in accordance with the Tax Sharing Agreement filed with and approved by the West Virginia Office of the Insurance Commissioner.**

FIDELITY BOND AND OTHER INSURANCE

The examination determined that the Company's business insurance policy provides $185,000 of insurance coverage for acts of employee dishonesty. The amount is in compliance with the minimum standard of $100,000 calculated using guidelines delineated in the NAIC Financial Condition Examiners Handbook.

The Company appears to have adequate insurance coverage in force covering other risks and/or hazards to which it may be exposed.

EMPLOYEE WELFARE

The Company has no employees as all of the staff of the Company are employees of an affiliated company and provide services to the Company under an expense sharing agreement.

TERRITORY AND PLAN OF OPERATION

The Company writes surety business in the States of West Virginia and Ohio. The majority of the surety bonds issued by the Company are coal land reclamation bonds. The Company markets itself as an insurer providing a "different approach" and offers both fully collateralized and partially collateralized bonds primarily to the coal mining industry. In some cases, the Company is failing to collect premium on a timely basis in accordance with the Coal Reclamation Bond Agreement. The Company is effectively assuming credit risk beyond what is contemplated in their plan of operations and is effectively making interest free loans to the bonded principals.

It is recommended that the Company collect all premiums due in a timely manner.

GROWTH OF COMPANY

The following exhibit depicts the growth of the Company throughout the exam period as reported by the company.

Year	Net Admitted Assets	Policyholder Surplus	Net Premium Written	Net Income
2005	$ 2,752,946	$ 2,752,946	$ 4,842,154	$ 1,634,282
2006	$ 3,862,544	$ 3,569,979	$ 343,361	$ (100,851)
2007	$ 4,952,419	$ 4,400,362	$ 568,936	$ 54,173
2008	$ 6,159,345	$ 5,313,919	$ 676,310	$ 177,018
2009	$ 6,680,982	$ 5,844,169	$ 512,389	$ 279,135

REINSURANCE

The examination determined that the following reinsurance coverage was in place as of December 31, 2009.

Primary Excess of Loss Reinsurance Contract

Effective Date: April 1, 2009 to April 1, 2010, extended to July 1, 2010

Retention & Limit: The reinsured shall retain the first $300,000 of Ultimate Net Loss as respects any one loss discovered, any one bond, in excess of the collateral held on that bond by the reinsured, and the reinsurer shall indemnify the reinsured against such loss in excess thereof, subject to the reinsurance limit of $1,200,000 as respects any one loss discovered, any one bond. Reinsurers will benefit from the combined collateral obligation as set out in the reinsured's coal reclamation bond agreement. The maximum recovery hereon in respect of each principal shall be $4,800,000 or 345% of the premium hereon (after adjustments and including reinstatement premiums) whichever the lesser for each agreement year.

Collateral Warranty: It is hereby expressly warranted that the reinsured shall maintain irrevocable letters of credit or cash collateral across all bonds covered hereunder to the value of a minimum of 20% of the outstanding individual bond amounts.

Reinstatement: Each loss hereon reduces the amount of indemnity provided hereunder, but the amount so exhausted shall be reinstated from the time of payment of the loss, and for each amount so reinstated, the reinsured agrees to pay to the reinsurer an additional premium calculated as follows:

(a) For the first $1,200,000 reinstated, an additional premium calculated at 70% of the premium hereon times the amount reinstated as a proportion of $1,200,000
(b) For the second $1,200,000 reinstated, NIL additional premium
(c) For the third $1,200,000 reinstated, an additional premium calculated at 35% of the premium hereon times the amount reinstated as a proportion of $1,200,000

Nevertheless, the reinsurer's liability hereunder shall never exceed $1,200,000 for any one bond, any one loss discovered and $4,800,000 for all losses discovered during any one agreement year.

Reinsurance Premium: As premium for the reinsurance provided hereunder, the reinsured shall pay 35% of its gross net written premium for the first agreement year of this contract, subject to a minimum premium of $490,000. The reinsured shall pay the reinsurer a deposit premium of $600,000 payable quarterly in arrears, $150,000 on July 1, 2009, $150,000 on October 1, 2009, $150,000 on January 1, 2010, and $150,000 on April 1, 2010.

Ultimate Net Loss: The term ultimate net loss means the actual loss, including allocated loss adjustment expense pro-rata and in addition to reinsurer's limit of liability, paid or to be paid by the Company on its net retained liability after making deductions for all recoveries, salvages, subrogations and all claims of inuring reinsurance, whether collectible or not; provided, however, that in the event of the insolvency of the Company, payment by the reinsurer shall be made in accordance with the provisions of the insolvency article. Nothing herein shall be construed to mean that losses under this contract are not recoverable until the Company's ultimate net loss has been ascertained.

The examination determined that the above treaty failed to meet the transfer of risk test as set out in SSAP 62R and that the Company failed to properly account for this reinsurance treaty in that they utilized reinsurance accounting rather than deposit accounting as required by SSAP 62R and SSAP 75.

The effect of this examination change in accounting method reduces surplus by $368,635 and has been included in the financial statements included in this Report.

It is recommended that the Company do appropriate and timely analysis of reinsurance treaties as required by SSAP 62R and utilize the proper accounting as set out is SSAP 62R and SSAP 75.

ACCOUNTS AND RECORDS

The Company maintains its books and records at its home office in Charleston, West Virginia. In general, the Company's accounting and corporate records were maintained in a manner in which the financial condition was readily verifiable.

The Company's accounting procedures, practices, and account records were reviewed and tested to the extent necessary. The trial balance prepared from the Company's general ledger and work papers for the year ended December 31, 2008, was agreed to the Annual Statement.

STATUTORY DEPOSIT

During the period under examination, the Company was licensed only in the States of West Virginia, Indiana, and Ohio. During the period under examination, the Company did business only in the States of West Virginia and Ohio. The statutory deposit as of December 31, 2009, consisted of cash and securities held in a Citibank, N.A. account, with cost of $1,070,650 and a market value of $1,088,359. This statutory deposit is held in a trust account established at a financial institution contracted with the West Virginia State Treasurer's Office.

FINANCIAL STATEMENTS

The following pages contain financial statements showing the Company's financial position as of December 31, 2009, as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

FIRST SURETY CORPORATION INSURANCE COMPANY

ASSETS
December 31, 2009

Assets	Per Annual Statement	Examination Adjustments	Nonadmitted Assets	Per Examination	Notes
Bonds	$ 5,708,735	$ -	$ -	$ 5,708,735	
Cash and Short-term investments	898,495	-	-	898,495	
Subtotals, Cash and Invested Assets	6,607,231	-	-	6,607,231	
Investment income due and accrued	28,379	-	-	28,379	
Uncollected premiums and agents' balances	26,981	-	-	26,981	
Net deferred tax asset	12,209	-	-	12,209	
Due from parent	-	203,198	203,198	-	3
Electronic data processing equipment and software	6,181	-	-	6,181	
Totals	$ 6,680,982	$ 203,198	$ 203,198	$ 6,680,982	

FIRST SURETY CORPORATION INSURANCE COMPANY

LIABILITIES, SURPLUS AND OTHER FUNDS
December 31, 2009

	Per Annual Statement	Examination Adjustments	Per Examination	Notes
Liabilities				
Losses	$ 547,030	$ -	$ 547,030	
Loss adjustment expenses	-	-	-	
Commissions payable	-	-	-	
Other expenses	66,353	-	66,353	
Taxes; licenses and fees	10,867	-	10,867	
Current federal and foreign income taxes	7,644	(7,644)	-	1
Unearned premiums	156,573	368,634	525,207	2
Advance premium	7,880	-	7,880	
Ceded reinsurance premiums payable	40,000	-	40,000	
Payable to Parent, Subsidiaries & Afilliates	467	-	467	
Total Liabilities	$ 836,813	$ 360,990	$ 1,197,803	
Surplus as Regards Policyholders				
Common Stock	1,000,000	-	1,000,000	
Gross paid in and contributed surplus	4,436,946	-	4,436,946	
Unassigned Surplus	$ 407,223	$ (360,990)	$ 46,233	1, 2
Total Surplus as Regards Policyholders	$ 5,844,169	$ (360,990)	$ 5,483,179	
Total Liabilities, Surplus and Other Funds	$ 6,680,982	$ -	$ 6,680,982	

FIRST SURETY CORPORATION INSURANCE COMPANY

SUMMARY OF OPERATIONS
December 31, 2009

	Per Annual Statement	Examination Adjustments	Per Examination	Notes
Underwriting Income				
Premiums Earned	$ 757,380	$ 121,366	$ 878,746	2
Losses Incurred	191,076	-	191,076	
Loss Expenses Incurred	-	-	-	
Other Underwriting Expenses Incurred	447,144	-	447,144	
Total Underwriting Deductions	638,220	-	638,220	
Net Underwriting Gain	119,160	121,366	240,526	
Investment Income				
Net Investment Income Earned	218,658	-	218,658	
Net Realized Capital Gains	36,618	-	36,618	
Net Investment Gain	255,276	-	255,276	
Other Expense				
Reinsurance deposit in the amount of $490,000 written off to -0- as there are no expected future cash flows	-	490,000	490,000	2
Total Other Income	-	-	-	
Net Income Before Dividends to Policholders and Federal Income Taxes	$ 374,436	$ (368,634)	$ 5,802	
Federal Income Taxes Incurred	95,301	-	95,301	1
Net Income	$ 279,136	$ (368,634)	$ (89,499)	

FIRST SURETY CORPORATION INSURANCE COMPANY

COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS
December 31, 2009

The following is a reconciliation of surplus between the amount reported by the Company and as determined by examination:

Item:	Adjustments to Surplus Increase	Adjustments to Surplus Decrease	
Surplus as Regards Policyholders per December 31, 2009 Annual Statement			$5,844,169
Current federal income tax	7,644		
Increase in unearned premium		368,634	
Totals	7,644	368,634	
Net Adjustments to Surplus as Regards Policyholders			(360,990)
Surplus as Regards Policyholders per Examination			$5,483,179

NOTES TO FINANCIAL STATEMENTS

1 To remove the liability for federal income tax payable under the Tax Sharing Agreement. There is no asset or increase to surplus as regards policyholders from the reversal of the expense, as any amounts due from Jacobs Financial Group, Inc. would be non-admitted assets.

2 To reverse the effect of the Company accounting for the reinsurance treaty utilizing reinsurance accounting and to adjust the financial statements to reflect the use of deposit accounting as required by SSAP 62R and SSAP 75.

3 To book an asset for the amounts recoverable as of December 31, 2009 for payments improperly made to the parent under the tax sharing agreement. This asset has been nonadmitted as the parent is insolvent and does not appear to have the ability to make immediate repayment to the Company.

SUMMARY OF RECOMMENDATIONS

It is recommended that the Company not make payments for federal income tax to the parent that are not in accordance with the Tax Sharing Agreement filed with and approved by the West Virginia Office of the Insurance Commissioner.

It is recommended that the Company do appropriate required analysis of reinsurance treaties as required by SSAP 62R and utilize the proper accounting as set out is SSAP 62R and SSAP 75.

It is recommended that the Company collect all premiums due in a timely manner.

EXAMINERS ACKNOWLEDGMENT AND SIGNATURE

The cooperation and assistance extended by the President and staff of the Company during the course of the financial examination is hereby acknowledged.

In addition to the undersigned, Walter Anderson, Examiner, West Virginia Offices of the Insurance Commissioner, Jeffrey S. Passis, reinsurance specialist of JPassis and Associates, and Robert Bear, FCAS, CPCU, MAAA, FCA, consulting actuary of RAB Actuarial Solutions, LLC participated in this examination.

EXAMINERS AFFIDAVIT AS TO STANDARDS AND PROCEDURES USED IN AN EXAMINATION

State of Illinois
County of Sangamon

Norman C. Koefoed, being duly sworn, states as follows:

1. I have authority to represent the West Virginia Offices of the Insurance Commissioner in the examination of First Surety Corporation.
2. The West Virginia Offices of the Insurance Commissioner are accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report, and the examination of First Surety Corporation was performed per instruction of the Chief Examiner and in a manner consistent with the standards and procedures required by the West Virginia Offices of the Insurance Commissioner.

The affiant says nothing further

Norman C. Koefoed

Norman C. Koefoed, CFE

Subscribed and sworn before me by Norman C. Koefoed on this 1 day of March 2011.

Christine R. Brian

Notary Public

OFFICIAL SEAL
NOTARY PUBLIC
STATE OF ILLINOIS
CHRISTINE R BRIAN
MY COMMISSION EXPIRES
MARCH 15, 2014

My Commission expires 3-15-2014 (Date)

FIRST SURETY CORPORATION
300 Summers Street, Suite 970
Charleston, WV 25301
Telephone (304) 720-1985 (800) 551-4989
Facsimile (304) 342-9726

June 15, 2011

HAND-DELIVERY

Honorable Jane L. Cline
WV Insurance Commissioner
1124 Smith Street
Charleston, WV 25301

RE: Report of Examination as of December 31, 2009
NAIC #38504 WV File #D026

Dear Commissioner Cline:

First Surety Corporation (FSC) received on May 4, 2011, your letter dated April 27, 2011, providing the referenced Report of Examination. We provided a response on June 6, 2011 and, due to additional evidence being received, are now providing the following amended response, addressing each topic of the Report.

Scope of Financial Examination

We have no comment.

Significant Findings

- **We disagree with the finding on accounting for the reinsurance treaty**. Our basis for this disagreement is the analysis and opinion of a qualified actuary, concurred with by FSC's independent actuary, in which he concluded that the reinsurance treaty meets the conditions stated in SSAP 62R. Support for this position is provided below in Item 1: Reinsurance Accounting. **Nevertheless, FSC, with your concurrence , has amended its reinsurance agreement effective 4-1-09 and initiated a new reinsurance agreement effective 7-1-11, each of which address the issues raised in the examination and therefore making FSC's use of reinsurance accounting appropriate .**

- **We disagree with the finding on payments under the Tax Sharing Agreement**. Our basis for this disagreement is that notwithstanding any inconsistencies in the TSA, taxes were calculated and paid in accordance with the parties' intent. (Support for this position is described below in Item 2: Tax Sharing Agreement). **Nevertheless, FSC will amend the TSA to address any inconsistencies. In addition** the amended TSA will **reflect that FSC will be entitled to any loss carry backs or carry forwards for losses it incurs and entitled to reimbursement from JFG, and to the extent JFG does not timely reimburse**

EXHIBIT
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FSC the applicable tax refund provided for in the TSA, FSC may offset from payments due from FSC to JFG and affiliates the amount of such tax refund/s.

- **We acknowledge that in some instances FSC has failed to collect renewal premium when due.** We have amended our procedures, which are described below in Item 3: Premium Receivables.

- **We accept the finding regarding the first full scope financial examination.**

Other Findings

We have no objections or comments to these sections:

- Subsequent Events
- Company History
- Corporate Records
- Management and Control
- Fidelity Bond and Other Insurance
- Employee Welfare
- Growth of Company
- Accounts and Records
- Statutory Deposits

Item 1: Reinsurance Accounting

- Reinsurance
    - We have no comment regarding paragraphs one through eight which accurately restate the terms and conditions of the reinsurance agreement.
    - **We disagree with the determination in paragraph nine that the treaty "failed to meet the transfer of risk test."**
    - **We disagree with the subsequent conclusions based on this determination, and the effect stated in paragraph eleven and the recommendation in the Reinsurance section as responded to under Significant Findings. Our position is based upon the following:**

        - In accordance with SSAP 62R, the Company's reinsurance treaty was reviewed at the time of agreement by Martin K. Kelly, A.C.A.S., M.A.A.A., who determined it met the reasonably self-evident threshold in SSAP 62R and therefore to qualify for reinsurance accounting.
        - In addition, FSC's independent actuary, Brett Miller, FCAS, MAAA, FCA, ARM of Merlinos & Associates, Inc., Actuaries And Consultants provided their review and opinion that FSC's reinsurance contract passed risk transfer

from the exemption granted by SSAP 62R Sec. 16 and should not be reclassified from a reinsurance contract to a deposit treaty contract.

We believe it bears noting that on June 30, 2010, FSC submitted its application for a Certificate of Authority, T listing, with the United States Department of the Treasury, Financial Management Service (FMS). A requirement of T listing is reinsurance. The FMS has reviewed FSC's application and has not advised FSC that there are any deficiencies with its reinsurance or FSC's quarterly and annual statements utilizing reinsurance accounting.

Nevertheless, FSC, with your concurrence , has amended its reinsurance agreement effective 4-1-09 (copy of Addendum 3 attached) and initiated a new reinsurance agreement effective 7-1-11 (copy of agreement attached), each of which address the issues raised in the examination and therefore making FSC's use of reinsurance accounting appropriate .

Item 2: Tax Sharing Agreement. (TSA)

- Holding Company System and Affiliated Party Transactions
  - We have no comment regarding paragraphs one through five of this section of the Report of Examination.
  - **We disagree with the remainder of this section.** Payments to Jacobs Financial Group, (JFG) for taxes have been in accordance with the TSA based on the intentions of the parties thereto.

Prior to JFG's purchase of the Company from Celina, management understood that the new subsidiary would be included in the consolidated tax return of the parent and that it would pay tax to the parent based on its Stand-Alone Basis. Legal counsel drafted the original Tax Sharing Agreement (TSA) for the parent and affiliates, including a definition for Stand-Alone Tax Liability. Subsection (b) of this section reads as follows:

> *A Subsidiary's Stand-Alone Tax Liability shall be determined using the highest effective federal corporate rate for the year in question. The computation of a Subsidiary's Stand-Alone Tax Liability shall not be affected by the alternative minimum tax, as defined in Code Section 55, unless the Stand-Alone Tax Liability of the Subsidiary would be higher under the alternative minimum tax determined on a Stand-Alone Basis, in which case the Stand-Alone Tax Liability computed using the alternative minimum tax will be used.*

Staff for the Office of the Insurance Commissioner correctly pointed out that with "highest. . . .rate" the subsidiary may be caused to pay more tax than the tax calculated on its Stand-Alone Basis and that such a result would not be acceptable. The Company agreed with staff, as it did not intend to pay tax in any amount greater than tax calculated on its Stand-Alone Basis, and the accounting staff edited the TSA by striking "highest" and inserting "Group's overall" without benefit of counsel, attempting to address the issue raised by OIC for the applicable tiered rate. The intent of the parties remained constant but the revised language inserted for a specific circumstance obviously became inconsistent with the intent demonstrated throughout the remainder of the agreement. The Company has at all times paid tax calculated based on its Stand-Alone Basis and nothing more, and reported such payments in its quarterly and annual statements as stated in Exhibits F, G, H, I, J, K, L and M (attached).

In the limited target examination referred to above, the Examiner reviewed the TSA and concluded: "Based on the approvals by the Department and my review of the agreement for the period under examination, no significant adjustments or adverse findings were identified for the Tax Sharing Agreement." This is contrary to the position taken by the Examiner in the subject examination.

FSC has paid its taxes under the TSA earlier than required and will in the future ensure that it pays in accordance with the schedule specified in the TSA.

The TSA and this section of the Report of Examination are further addressed by our legal counsel, Dechert, LLP in the attached Exhibit N and by our auditors, Malin, Bergquist and Company, LLP, FSC's independent auditor who audited the annual statements included in the above listed Exhibits, in the attached Exhibit O.

Conclusion – FSC has paid its taxes in accordance with the TSA.

Nevertheless, FSC will amend the TSA to address any inconsistencies contained therein. In addition, FSC will amend the TSA to reflect that FSC will be entitled to any loss carry backs or carry forwards for losses it incurs and entitled to reimbursement from JFG for such carry backs or carry forwards. To the extent JFG does not timely reimburse FSC the applicable tax refund for such losses, FSC may offset from payments due from FSC to JFG and affiliates the amount of such tax refund amount/s.

Item 3: Premium Receivables.

- Territory and Plan of Operation
  - FSC acknowledges that some renewal premiums have not been collected when due. However –
    - At the time of initial underwriting it was evident that the principals had the intention and ability to pay all premiums due.
    - In all cases, past due premiums are followed up with: 1) written demand for payment; 2) verbal demand for payment; 3) face-to-face meetings to demand payment.
    - We will consider accessing applicable collateral to effect payment of past due premiums.
    - We will file for a rate change to provide FSC with the flexibility to apply a service charge when any premium is past due.

Financial Statements

- We do not believe that the adjustments made to the FSC 12/31/09 financials are appropriate.
    - In accordance with SSAP 62R, FSC's reinsurance agreement at the time it was entered into was determined to meet the exemption in SSAP 62 and therefore qualify for reinsurance accounting.
    - FSC's independent actuary provided their review and opinion that FSC's reinsurance contract passed risk transfer from the exemption granted by SSAP 62R Sec. 16 and should not be reclassified from a reinsurance contract to a deposit treaty contract
    - FSC, with your concurrence, has amended its reinsurance agreement and initiated a new reinsurance agreement addressing the issues raised in the examination.
        - As a result, no adjustments are necessary. We concur with the WVOIC's separate determination that no restatement of prior year financials are necessary.
    - Though we disagree with the ROE's TSA findings, we believe that the amendments to the reinsurance agreement and TSA render adjustments for federal income taxes unnecessary.
    - Though we disagree with the financial statement adjustments made in the ROE, we believe that if the adjustments were in fact appropriate that the resulting federal income tax incurred for 2009 would not have remained at $95,301 but would have been reduced to an amount less than the adjusted net income before taxes of $5,802.

Summary of Recommendations

Subject to the rebuttal by FSC above, FSC accepts the recommendations in this section.

The following summarizes FSC's actions to-date based on the ROE. FSC requests acknowledgement in the findings in Report of Examination as of December 31, 2009, for the following:

- FSC has made payments to JFG in accordance with the TSA as intended by the parties and will seek amendments to the TSA consistent with these intentions.
- FSC has obtained appropriate required analysis of reinsurance treaties as required by SSAP 62R. FSC's reinsurance agreement as amended meets the requirements of SSAP 62R according to the WVOIC..
- FSC has amended its premium collection procedures and will continue to do all it can to collect premium when due and take additional actions as outlined.

The examination and efforts of Mr. Norman Koefoed and Ms. Leah Cooper are appreciated for our mutual goal that FSC's operations continually seek improvement and efficiency. We believe this examination will improve understanding for the benefit of FSC and your department going forward.

Sincerely,

Robert J. Kenney
President

c: T. Randolph Cox
Les Hatley
Martin K. Kelly
Peter Kern
Brett E. Miller
James H. Nix
First Surety Corporation Board of Directors
Jacobs Financial Group, Inc.

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