PROCEEDINGS BEFORE MICHAEL D. RILEY
INSURANCE COMMISSIONER
OF THE STATE OF WEST VIRGINIA

IN RE: FIRST SURETY CORPORATION

Administrative Proceeding No.: 16-AP-FINCON-02001

ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION

COMES NOW Michael D. Riley, Insurance Commissioner of the State of West Virginia, and issues this Order Adopting Report of Financial Examination as of December 31, 2014, of First Surety Corporation (hereinafter sometimes referred to as the "Company") based upon the following findings, to wit:

JURISDICTION

1. Michael D. Riley is the Insurance Commissioner of the State of West Virginia (hereinafter the "Insurance Commissioner") and is charged with the duty of administering and enforcing the provisions of Chapter 33 of the West Virginia Code.

2. The Company was incorporated and began business on November 19, 1979 as West Virginia Fire and Casualty Company, owned by its parent Celina Mutual Insurance Company. On December 31, 2005, Jacobs Financial Group, Inc. acquired all of the stock of West Virginia Fire and Casualty Company. The acquisition was approved by the Insurance Commissioner through a Consent Order dated December 23, 2005. Following the acquisition, the name of the Company was changed to First Surety Corporation.

3. The Company is licensed in the states of West Virginia, Ohio and Indiana. In West Virginia, the Company is licensed as a property & casualty company and authorized by the Insurance Commissioner to transact the business in the lines of casualty, marine, surety and fire. The Company operates as a surety targeting the energy industries in the eastern United States.

FINDINGS OF FACT

1. A full scope, five-year examination of the financial condition and operational affairs of the Company, for period beginning January 1, 2010 and ending December 31, 2014, was undertaken by examiners for the Insurance Commissioner and conducted in accordance with the terms and provisions of West Virginia Code §33-2-9.

2. On January 7, 2016, the examiners 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. The January 7, 2016 Report of Financial Examination was forwarded to the Company on or about January 12, 2016. Pursuant to W.Va. Code § 33-2-9(j)(2), the Company was afforded a period of thirty (30) days after receipt of the Report of Financial Examination within which to make a written submission or rebuttal with respect to any matters contained in the examination report.

4. By letter dated February 12, 2016, the Company indicated it had reviewed the Report of Financial Examination and offered a written submission and rebuttal thereto, pursuant to W.Va. Code § 33-2-9(j)(3), noting its objections to the examination report.

5. As required, the Insurance Commissioner has now fully considered and reviewed the Report of Financial Examination, together with any written submissions or rebuttals of the Company, including the Company's specific objections, and all relevant portions of the examiner's work papers and is prepared to enter this Order in accordance with W.Va. Code § 33-2-9(j)(3).

CONCLUSIONS OF LAW

Pursuant to W.Va. Code § 33-2-9(j)(3), following a review of the Report of Financial Examination, the examination work papers and any written submission or rebuttal, the Insurance Commissioner shall enter an Order adopting the Report of Financial Examination as filed or with

modifications or corrections, or enter an Order rejecting the examination report with directions to the examiners to reopen the examination for purposes of obtaining additional data, documentation or information and refiling, or call for an investigatory hearing with no less than twenty days' notice to the Company for purposes of obtaining additional documentation data, information and testimony.

ORDER

Accordingly, it is therefore ORDERED as follows:

1. That the January 7, 2016 Report of Financial Examination of the Company, attached hereto as Exhibit A, is ADOPTED and APPROVED by the Insurance Commissioner without modifications or corrections pursuant to W.Va. Code § 33-2-9(j)(3)(A).

2. That a copy of this Order Adopting Report of Financial Examination, including Exhibit A, shall be mailed to the Company, via certified mail, return receipt, upon entry by the Insurance Commissioner pursuant to W.Va. Code § 33-2-9(j)(4).

3. That, pursuant to W.Va. Code § 33-2-9(j)(4), the Company shall file with the Insurance Commissioner, within thirty (30) days of the issuance of this Order Adopting Report of Financial Examination, affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related orders.

4. That, pursuant to W.Va. Code §33-2-9(j)(3)(A), if the Report of Examination revealed that the Company is operating in violation of any law, rule or prior Order of the Insurance Commissioner, the Insurance Commissioner may order the Company to take any action the Insurance Commissioner considers necessary and appropriate to cure the violation(s), if not already undertaken by the Company. Pursuant to W.Va. Code § 33-2-9(l)(3), in the event the Insurance Commissioner determines that regulatory action is appropriate as a result of the examination, analysis or review, he may initiate any proceedings or actions as provided by law.

5. That, pursuant to W.Va. Code § 33-2-9(j)(4), any Order entered pursuant to W.Va. Code § 33-2-9(j)(3) shall be considered a final administrative decision and may be appealed to the Circuit Court of Kanawha County, West Virginia pursuant to W.Va. Code §§ 33-2-14 and 33-2-9(j)(4).

WHEREFORE, for the foregoing reasons stated herein, the January 7, 2016 Report of Financial Examination of the Company is ADOPTED and APPROVED by the Insurance Commissioner. The objections and exceptions of any party aggrieved hereto are noted herein and preserved.

Entered this 14th day of March, 2016.

Michael D. Riley, Insurance Commissioner
State of West Virginia

REPORT OF EXAMINATION

OF

FIRST SURETY CORPORATION

CHARLESTON, WV

NAIC #38504

AS OF DECEMBER 31, 2014

EXHIBIT

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SALUTATION

January 7, 2016
Charleston, West Virginia

The Honorable Michael D. Riley
West Virginia Insurance Commissioner
1124 Smith Street
Charleston, West Virginia 25301

Pursuant to the authority vested in the West Virginia Offices of the Insurance Commissioner ("WVOIC"), as well as rules, regulations and procedures promulgated by the National Association of Insurance Commissioners ("NAIC"), an examination has been made of the administrative affairs, books, records, and financial condition of:

First Surety Corporation
300 Summers Street, #970
Charleston, West Virginia 25301

hereinafter referred to as the "Company" or "FSC". The following Report of Examination is respectfully submitted.

SCOPE OF EXAMINATION

The Company was last examined as of December 31, 2009. This examination commenced on March 16, 2015 and is a multi-state, full scope, five-year examination pursuant to WV Code §33-2-9(a), as amended, covering the period from January 1, 2010 through December 31, 2014, including any material transactions or events occurring subsequent to the examination date and noted during the course of the examination.

The purpose of this examination is to assess the financial condition of the Company and set forth findings of fact (together with citations of pertinent laws, regulations and rules) with regard to any material adverse findings disclosed by the examination.

The general procedures of the examination followed rules and standards as set forth in the NAIC Financial Condition Examiners Handbook ("Handbook") and West Virginia Laws, Regulations, and Directives of the West Virginia Insurance Commissioner. The examination was conducted 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 risk within the Company and evaluating system controls and procedures used to mitigate those risks. In addition, 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 were assessed.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. Accordingly, planning materiality and tolerable error thresholds were based on professional judgment after considering the nature of the business written by the Company, operating results, and the Company's financial position as of December 31, 2014.

The report is presented on an exception basis. It is designed to set forth the facts with regard to any material adverse findings disclosed during the examination. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were discussed with responsible Company officials during the course of the examination.

SUMMARY OF SIGNIFICANT FINDINGS

As a result of the current examination period and review of the subsequent events, the following findings were noted:

1) Based on examiners review of the CPA workpapers, we noted instances where the Company did not maintain adequate documentation to support updates to premium calculations as a result of changes to the bond amounts. Examiners concur with this finding.

2) Based on the Company's response to inquiry on establishment of adequate collateral, examiners concluded that determination of adequacy of collateral followed by collection

of additional collateral appears to be at management's discretion. There are no formally document procedures that would indicate if/when additional collateral must be obtained.

3) Upon examiner request for the recent financial statements of FSC's parent company, Jacobs Financial Group, Inc. (JFGI or parent), the Company responded that audited financial statements as of 5/31/2013 were the most recent financials available for review.

4) Based on review, examiners noted that the Company made aggressive dividend payments in 2012, 2013 and 2014. The amounts of these dividend payments, on two occasions, exceeded the ordinary dividend threshold contained in the WV statutes, and the Company did not obtain prior approval of the WV OIC before issuing these dividends. Additionally, in February 2015, the Company prematurely declared and partially paid a dividend to its parent, prior to filing of the 2014 Annual Statement. The 2015 dividend was paid despite the objection raised by the Company President and Treasurer. These decisions again reflected the Company's willingness to aggressively pay dividends and deliberate disregard for adherence to WV law. The aggressive and premature payment of these dividends is arguably detrimental to the mid to long term financial health of the Company.

5) Based on 2015 Board minute review, the Board approved and paid estimated taxes, purportedly under the JFGI Tax Sharing Agreement, prior to their due date to the parent at the request of the Board Chairman. Based on review of the executed Tax Sharing Agreement, there is no provision for early payments made by FSC to JFGI. The only related provision in the agreement appears to address the event of a delay in payment from FSC to JFGI. As a result, this transaction is considered by the WV OIC as an unapproved short term loan. It appears that these transactions were occurring on an approximately monthly basis rather than estimated taxes being settled quarterly in compliance with the provisions of the TSA. See the Subsequent Event section for further details.

6) Based on aging of premium receivable balances reported as of YE-2014, Q1-2015 and Q2-2015, it appears that collections of non-admitted premium receivable balances are not producing results with the overall premium receivable balance growing steadily. The Company has no written policy for writing off premium receivables or complying with Statutory Accounting Principles SSAP 6 and 5R. See the Subsequent Event section for further details.

7) Based on review of premium receipts in Q1-2015 and Q2-2015, concerns remain over the Company's cash flow and adequacy of premium collections given the significant percentage of premium receipts that are attributable to draws from the collateral accounts as opposed to current premium payment by principals. See the Subsequent Event section for further details.

8) The Company maintains a list referred to as a "Watch List" of bondholders that demonstrate some type of financial distress or potential reclamation issues that could indicate possibility of default. The Company has no clearly documented procedures that

ensure the updating or completeness of the Watch List. See the Subsequent Event section for further details.

9) Based on subsequent discussions with management, some case reserves have been established to date for some of the "likely losses" or "high risk exposures" identified. Based on SSAP 55, loss and LAE should be recognized (through establishment of case reserves) "when a covered event or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs." For additional insights, SSAP 5 also states that "a liability is defined as a certain or probable* future sacrifices of economic benefits arising from present obligations...". *Probable indicates that "which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain or proved". Therefore, a reserve strengthening of $820,402 is warranted and the percentage for recording future reserves is to be increased from 12% to 23%. See the Subsequent Event section for further details.

HISTORY

The Company was incorporated and began business on November 19, 1979 as West Virginia Fire and Casualty Company, owned by its parent Celina Mutual Insurance Company. On December 31, 2005 all of the stock of West Virginia Fire and Casualty Company was acquired by Jacobs Financial Group, Inc. (JFG). The acquisition was approved by the Insurance Commissioner of the State of West Virginia by its Consent Order dated December 23, 2005. Following the acquisition, the name of the Company was change to First Surety Corporation. The Company operates as a surety targeting the energy industries in the eastern United States. Currently the Company is licensed in Ohio, Indiana and West Virginia.

MANAGEMENT AND CONTROL

Board of Directors

The corporate powers of the Company are vested in the Board of Directors consisting of five members in compliance with Article II, Section 1 of the Company's Bylaws and in compliance with WV Code §33-5-3. The annual meeting of the Board must be held no later than 225 days following the fiscal year-end. At this meeting, the Board is required to elect a Chairman, President, Treasurer and Secretary who, when designated so, may be the same person. The individuals serving as members of the Board of Directors on December 31, 2014 were as follows:

Name and Address	Business Affiliation	Board Member Since
Linda G. Aguilar PO Box 195 Ansted, WV 25812	Retired Senior Vice President City National Bank	2006

PO Box 3523 Charleston, WV 25325	Jacobs Financial Group	
Timothy A. Maddox 1572 Virginia Street, E. Charleston, WV 25311	President Silverstein & Maddox Insurance, Inc.	2006
C. David Thomas 48 Cedar Drive Hurricane, WV 25526	Vice President Friedlander Company	2006
Bradley W. Tuckwiller PO Box 1294 Lewisburg, WV 24901	President Red Dot, Inc.	2010

* Chairman

Officers

Officers elected at the August 12, 2014 Board of Directors Meeting and serving as of December 31, 2014, were as follows:

Name	Title
John Michael Jacobs	Chairman
Robert Joseph Kenney	President and Treasurer
Timothy Allen Maddox	Secretary

It was observed that the Company's President/Treasurer oversees substantially all of the Company's daily operations.

Committees

The Bylaws require no formal committees. However, the Company does informally operate utilizing an Underwriting Committee comprised of Mr. Tuckwiller and Mr. Thomas with participation from Mr. Kenney and Mr. Jacobs.

Agreements

Agency Agreement
The Company has a General Agency Agreement with its affiliate, Triangle Surety Agency (TSA) effective June 1, 2007 whereby TSA receives commission on premium written in the amount of 15% on renewal business and 30% on new business. All policies are directly underwritten by the Company. The Company incurred expenses of $241,331 and $231,709 under this agreement in 2014 and 2013, respectively.

Investment Management Agreement
The Company has an Investment Management Agreement with its affiliate, Jacobs & Company (J&C) whereby J&C receives investment advisory fees based on established fee schedules. The

Company incurred investment management expenses in the amount of $52,222 and $50,764 for 2014 and 2013, respectively.

Expense Sharing Agreement
The Company has an Expense Sharing Agreement among its parent and affiliates that specifically addresses cost allocations and reimbursement of expenses. This agreement was effective June 1, 2007. Amounts paid by the Company under the Agreement were $19,566 and $78,842 for 2014 and 2013, respectively. The decrease in the current year is due to the Company paying some of its allocated expenses (i.e. rent and payroll) directly.

Tax Sharing Agreement
The Company entered in to a Tax Sharing Agreement with its parent effective January 1, 2006. In 2014 and 2013, payments made to the parent under the Agreement amounted to $73,906 and $64,143, respectively.

The Board approved and paid estimated taxes, purportedly under the JFGI Tax Sharing Agreement, prior to their due date to the parent at the request of the Board Chairman. Based on review of the executed Tax Sharing Agreement, there is no provision for early payments made by FSC to JFGI. As a result, this transaction is considered by the WV OIC as an unapproved short term loan. These transactions were occurring on an approximately monthly basis rather than estimated taxes being settled quarterly in compliance with the provisions of the agreement

TERRITORY AND PLAN OF OPERATION

The Company writes surety bond coverage primarily in the coal reclamation industry in West Virginia. The Company is also licensed in Ohio and Indiana. The Company began writing coal reclamation surety bonds in Ohio in 2009. The Company is licensed in Indiana, but it does not have authority to write surety bonds in Indiana.

GROWTH OF COMPANY

The following amounts represent growth of the Company and other financial comparisons for the year ended December 31, 2014 and for the period under examination.

	2014	2013	2012	2011	2010
Direct Premiums Written	1,352,720	1,248,077	1,130,016	1,447,397	1,468,740
Ceded Premiums Written	490,000	490,000	490,000	514,528	551,961
Net Premiums Written	862,720	758,077	640,016	932,869	916,779
Net Income	232,338	198,376	350,214	378,455	201,684
Total Net Assets	10,252,584	10,162,169	7,814,406	7,958,843	7,361,460
Total Liabilities	4,404,004	4,093,659	1,771,868	1,657,996	1,330,189
Policyholders Surplus	5,848,580	6,068,509	6,042,539	6,300,847	6,031,271

As shown in the exhibit above, the Company's premium volume has experienced some significant fluctuations ranging from a high in 2010 of $1.47million to a low in 2012 of $1.13million. The Company completed 2014 on an upward trend with direct premium of $1.35million. Net income has also fluctuated for the exam period ranging from a low of approximately $198,000 to a high of $378,000. Interestingly, the net income trend does not appear to correlate with the premiums written trend. This is likely attributable to fluctuations in expenses as they relate to affiliated agreements and/or the stabilization of reinsurance costs in the latter part of the exam period.

REINSURANCE

Effective April 1, 2009, the Company entered in to a reinsurance contract with various syndicates at Lloyds of London and one Bermuda based reinsurer for its coal reclamation surety bonding programs. The agreement has been renewed annually for expanded surety bond business covered with various syndicates at Lloyd's of London, with the most recent renewal effective October 1, 2014 - October 1, 2015.

The reinsurance agreement is an excess of loss contract. The first level of coverage protects the Company against losses up to $1.2 million over the Company's retention of $300,000. The second level of coverage protects the Company against losses up to $4.8 million over the Company's retention of $1,890,000. The Company retains the gap from $1.2 million first layer to $1,890,000 in second layer. The maximum recoverable for the first and second layer of coverage by the Company is $10 million or 500% of premium, whichever is lesser.

The contract calls for a premium rate of 35% of gross net written premium, subject to a minimum premium of $490,000. Under the terms of this reinsurance contract, the Company is entitled to a No Claims Bonus from the reinsurers for each contract year in which no losses are discovered as defined in the contract. The bonus is 20% of the annual reinsurance premium and is to be recorded upon the completion of each contract year. For the contract year ended September 30, 2014 the Company recorded a No Claims Bonus of $98,000.

The Company's reinsurance was obtained through a reinsurance intermediary. It was determined that all reinsurers and the reinsurance intermediary were properly licensed or authorized to conduct business in the State of West Virginia.

FINANCIAL STATEMENTS

The statements on the following pages present the financial condition and operations of the Company for the period under examination. The amounts shown on the balance sheet are those determined by this examination.

ASSETS
DECEMBER 31, 2014

Assets	Per Company	Adjustments	Per Examination
Bonds	$ 6,839,065	$ -	$ 6,839,065
Preferred Stocks	153,610	-	153,610
Common Stocks	1,040,117	-	1,040,117
Cash and Short-term Investments	1,899,025	-	1,899,025
Investment Income Due and Accrued	47,328	-	47,328
Uncollected Premium and Agents' Balances	33,197	-	33,197
Net deferred tax asset	140,707	-	140,707
Electronic Data Processing Equipment	1,492		1,492
Aggregate Write-Ins	98,042		98,042
Total Assets	$ 10,252,583	$ -	$ 10,252,583

LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2014

Liabilities	Per Company	Adjustments	Per Examination
Losses	$ 1,390,383	$ -	$ 1,390,383
Other Expenses Due or Accrued	188,309	-	188,309
Taxes, Licenses and Fees	8,915	-	8,915
Unearned Premiums	18,361	-	18,361
Advance Premiums	123,880	-	123,880
Ceded Reinsurance Premium Payable	420,000		420,000
Amounts Withheld for Account of Others	2,176,280		2,176,280
Payable to PSA	60,619		60,619
Derivatives	17,257		17,257
Total Liabilities	**$ 4,404,004**	**$ -**	**$ 4,404,004**
Common Capital Stock	1,000,000		1,000,000
Gross Paid In and Contributed Surplus	4,522,086		4,522,086
Unassigned Funds (Surplus)	326,494	-	326,494
Surplus as Regards Policyholders	**5,848,580**	**-**	**5,848,580**
Total Liabilities, Surplus and Other Funds	**$ 10,252,584**	**$ -**	**$ 10,252,584**

UNDERWRITING AND INVESTMENT EXHIBIT
DECEMBER 31, 2014

UNDERWRITING INCOME	
Premiums Earned	$ 899,196
Losses Incurred	163,707
Other Underwriting Expenses Incurred	669,987
Aggregate Write-Ins	(98,000)
Total Underwriting Deductions	735,694
Net Underwriting Gain (Loss)	163,502
INVESTMENT INCOME	
Net Investment Income Earned	190,625
Net Realized Capital Gains	36,017
Net Investment Gains	226,642
OTHER INCOME	
Aggregate Writeins for Other Income	(138,289)
Total Other Income	(138,289)
Net Income Before Federal Income Tax	251,855
Federal Income Tax	19,517
Net Income	$ 232,338
CAPITAL AND SURPLUS ACCOUNT	
Capital and Surplus, December 31, 2013	$ 6,068,510
Net Income	232,338
Net Unrealized Gains or (Losses)	(40,607)
Change in Net Deferred Income Tax	103,174
Change Non-admitted Assets	(316,833)
Dividends to Stockholders	(198,000)
Change In Surplus As Regards to Policyholders	(219,928)
Capital and Surplus as of December 31, 2014	$ 5,848,582

SUMMARY OF EXAMINATION CHANGES

There were no adjustments made to the Company's financial statements as a result of this examination.

SUBSEQUENT EVENTS

The following finding was noted during the completion of the standard subsequent events procedures as part of the financial examination:

1) Based on 2015 Board minute review, the Board approved and paid estimated taxes, purportedly under the JFGI Tax Sharing Agreement, prior to their due date to the parent at the request of the Board Chairman. Based on review of the executed Tax Sharing Agreement, there is no provision for early payments made by FSC to JFGI. The only related provision in the agreement appears to address the event of a delay in payment from FSC to JFGI. As a result, this transaction is considered by the WV OIC as an unapproved short term loan. It appears that these transactions were occurring on an approximately monthly basis rather than estimated taxes being settled quarterly in compliance with the provisions of the TSA.

   Recommendation: The Company should discontinue the extension of short term loans to its parent and remain in compliance with the terms of the approved Tax Sharing Agreement with JFGI.

   Subsequent Update: On July 15, 2015 the Company filed an amendment to the TSA requesting approval to pay estimated tax provisions more frequently than on a quarterly basis. The WV OIC approved this filing on August 14, 2015 to allow for monthly payments.

As a result of prospective risks identified during the financial exam with a scope ending December 31, 2014, the WV OIC requested that the exam team perform scope expansion procedures to gain a further understanding of the prospective risks and the possible effects on the Company's financial condition. As a result of these scope expansion procedures, which considered prospective risks and financial condition through June 30, 2015, the following findings and accompanying recommendations were noted.

1) Based on aging of premium receivable balances reported as of YE-2014, Q1-2015 and Q2-2015, it appears that collections of non-admitted premium receivable balances are not producing results with the overall premium receivable balance growing steadily.

   Recommendation: The Company should increase its efforts to collect premium receivable through legal actions, cease issuing bonds to delinquent companies in arrears, and update (and formally document) Underwriting Guidelines to establish more stringent underwriting standards that would exclude underwriting to financially troubled or operationally unstable principals by being more proactive in identifying them once they

become financially troubled. These Underwriting Guidelines should include procedures that once a bondholder indicates financial impairment, the Company has in place aggressive measures to minimize the risk to the Company.

2) The WV OIC analyst performed an analysis of the Receivables Aging Schedule compared to the Outstanding Bond Listing by invoice number as of July 31, 2015. This analysis revealed that the Company has not written off receivables associated with invoices dating back as far as mid-2013 with many dating back to mid-2014. The analysis also considered the two principals currently in bankruptcy as principals with premium due that should likely be written off. The Company currently has no documented policy for the write off of premium receivable and has not written off any of the premium receivable balances. Additionally, Statutory Accounting Principles ("SAP") 6 and 5R indicate that the uncollectible premiums need to be disclosed and any reasons for not writing them off should be described.

   Recommendation: The Company should establish a policy for writing off premium receivables based on aging and other factors. Additionally, the Company should comply with SAP 6 and 5R in disclosing why certain premium receivable balances are not written off by management. Examiners would suggest, at a minimum, the write off of premium receivables, as documented in the policy, under the following conditions:
   - Aged in excess of six months
   - Due from principals who have filed bankruptcy (any chapter)
   - Due from principals who have not actively operated under the permits for six months

3) Based on review of premium receipts in Q1-2015 and Q2-2015, concerns remain over the Company's cash flow and adequacy of premium collections given the significant percentage of premium receipts that are attributable to draws from the collateral accounts as opposed to current premium payment by principals.

   Recommendation: The Company should increase its efforts to collect premium receivable through legal actions, cease issuing bonds to delinquent companies in arrears, and update (and formally document) Underwriting Guidelines to establish more stringent underwriting standards that would exclude underwriting to financially troubled or operationally unstable principals by being more proactive in identifying them once they become financially troubled. These Underwriting Guidelines should include procedures that once a bondholder indicates financial impairment, the Company has in place aggressive measures to minimize the risk to the Company.

   Regarding the instance of one unique Collateral Agreement between the Company and participating bondholders, the proceeds from investment gains associated with the collateral held by the Company should be used to strengthen the Company's collateral position only, whether in a general collateral account or specific to the participants to the Collateral Agreement. This treatment should prevent any investment gains from streaming through the Company's income, which generally results in forfeiture to the parent in the form of dividends. Additionally, the investment management fees due to

Jacobs & Company also should be not paid through these gains. Any investment gains attributable to this arrangement should also be excluded from the Tax Sharing Agreement.

4) Based on discussions of the justification for removal of some bondholders from the Company document labeled "Watch List" from March to August 2014, examiners did agree that it appeared approximately 4 of the 6 removals were appropriate. However, management did disclose that 2 of the 6 bondholders that were removed were, as of the dates of these discussions, not current on premium and/or not operating. As such, this raises concerns on management's ability to subjectively determine which risks should and should not be included on the Watch List. No written procedures were provided to examiners for the criteria used to maintain the bondholders who qualify for remaining on the Watch List or their removal. The Watch List is currently the primary control used in monitoring of troubled bondholders so its completeness is considered extremely pertinent to the risk management and/or loss control functions of the Company.

   The Company acknowledged they did not perform stress test analysis as criteria for inclusion on the Watch List, so the Examiner performed an analysis to verify what examiners would expect to be a minimum completeness test given the Company's lack of documented risk management standards that would dictate a bondholder's inclusion on the Watch List. To perform this analysis, for illustration the examiners obtained the Premium Receivable Aging Detail as of 6/30/2015 and compared the Aging Detail to the listing of Total Bond Exposure, by principal. Examiners used a $100,000 threshold for exposure (face value of bond). For any principals with exposure exceeding $100,000 on any given bond and with premium receivable due in excess of 30 days, examiners reviewed the Watch List to determine if these bondholders were included on the Watch List as of July 29, 2015. Based on this analysis, examiners identified another 5 bondholders that should be included on the Watch List using this simple comparison.

   Recommendation: The Company should establish stringent risk management standards, including relevant metrics, which dictate a bondholders' presence on the Watch List accompanied by standard procedures for more periodic and systematic scrutiny and consideration for obtaining more capital.

5) Based on discussions with management regarding the current status of bondholders on the Watch List in addition to the examiner's analysis of the completeness of the 2015 Watch List, examiners compiled a summary of "likely losses" and "high risk exposures". The "likely losses" were defined as any expected losses from principals included on the Watch List provided by the Company as of July 29, 2015. The "high risk exposures" were defined as additional principals identified through the analysis of the Premium Receivable Aging Detail to Total Bond Exposure performed by examiners to assess the completeness of the Watch List (see discussion in #4 above). These principals were not included in the Watch List provided by the Company as of July 29, 2015 but were also deemed higher risk for losses to the Company.

Based on subsequent discussions with management, some case reserves have been established to date for some of the "likely losses" or "high risk exposures" identified. Based on SSAP 55, loss and LAE should be recognized (through establishment of case reserves) "when a covered event or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs." For additional insights, SSAP 5 also states that "a liability is defined as a certain or probable* future sacrifices of economic benefits arising from present obligations...". *Probable indicates that "which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain or proved".

Recommendation: Based on examiner's analysis and lack of the Company's analysis of the Company's known estimates for losses/LAE associated with Watch List principals, accompanied by the probability of additional losses/LAE associated with principals who are not currently included in the Watch List, the Company should be recognizing a liability in the form of loss/LAE case reserves for the probable expenses to address the identified "likely losses" and "high risk exposures".

The Company should record a reserve strengthening adjustment as of December 31, 2014 in the amount of $820,402, based on an analysis performed by the examination actuary. Loss reserves reported at year end 2014 were $1,390,383 and based on the reserve analysis reserves should have been reported at $2,210,785. Included in this amount are case reserves in the amount of $1,682,637 that were established for five (5) bonds held for principles that have been identified as likely losses.

Based on reserve history and the exposures as they are currently understood as well as prospective loss/LAE risk given the status of the coal industry in West Virginia, the Company should increase its percentage of premium booked to reserves from 12% to 23%.

Additionally, the Company should establish and document clear metrics and indicators, specific to the niche business in which the Company writes that would mandate the establishment and updating of case reserves in a timely and accurate manner.

Part of the clear metrics and indicators mentioned above is a suggested Stress Test or various Stress Tests. Stress testing would provide the Company the opportunity to document certain assumptions and then calculate the effect on the Company's financial position based on the outcome of those assumptions. Regular and realistic stress testing can provide insights for the Company on necessary underwriting and reserving changes in order to protect its ongoing operations and surplus position.

SUMMARY OF EXAMINATION RECOMMENDATIONS

As a result of the traditional scope financial examination, the following recommendations are made:

1) FSC should maintain documentation to support additional bond amounts resulting in additional premium amounts.

2) The Company should update its Underwriting Guidelines to provide more specific guidance on factors for collateral establishment and updating that may include specific benchmarks on the bondholders financial position as well as "on the ground" exposures.

3) FSC's parent, JFGI, should be prepared to provide financial statements to evidence its ability to financially support FSC as its wholly owned subsidiary.

4) FSC should, at a minimum, obtain all necessary approvals from the WV OIC prior to issuing or paying dividends to its parent. Additionally, FSC may consider discontinuing dividends at least temporarily, in efforts to retain capital to pay likely losses and in preparation for continued trends in the coal market that call to question the ability of principals to maintain current premium payments and perform their obligations under each bond.

ACKNOWLEDGEMENT AND SIGNATURE

This is to certify that the undersigned is a duly qualified Examiner appointed by the West Virginia Offices of the Insurance Commissioner. The undersigned, assisted Lindsey Pittman, Examiner and Patrick Glenn, Actuary, of Lewis & Ellis and by Leah Cooper, CPA, CFE, Jamie Taylor, CFE and Rob Hrezo, of the West Virginia Offices of the Insurance Commissioner, performed an examination of First Surety Corporation as of December 31, 2014.

The examination was performed in accordance with those procedures authorized by the NAIC Financial Condition Examiner's Handbook and other procedures appropriate for this examination. The attached report of examination is a true and complete report of financial condition of First Surety Corporation as of December 31, 2014 as determined by this examination

Respectfully Submitted,

Dave Palmer, CFE
Financial Examiner
Lewis & Ellis
Representing the WV Offices of the Insurance Commissioner