

**PROCEEDINGS BEFORE ALLAN L. McVEY
INSURANCE COMMISSIONER
OF THE STATE OF WEST VIRGINIA**

IN RE: FIRST SURETY CORPORATION

Administrative Proceeding No.: 17-AP-FINCON-02013

**AGREED ORDER ADOPTING REPORT OF FINANCIAL
EXAMINATION AND DIRECTING ACTION**

COMES NOW Allan L. McVey, Insurance Commissioner of the State of West Virginia, and issues this Agreed Order Adopting Report of Financial Examination and Directing Action which adopts the Report of Financial Examination as of December 31, 2016, of First Surety Corporation (hereinafter sometimes referred to as the “Company”) based upon the following findings, to wit:

JURISDICTION

1. Allan L. McVey 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, all the stock of West Virginia Fire and Casualty Company was acquired by Jacobs Financial Group. Following the acquisition, the name of the Company was changed to First Surety Corporation. The Company operates as a surety targeting the energy industries in the eastern United States.

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.

FINDINGS OF FACT

1. This examination commenced on May 17, 2017 and is a multi-state, full scope, two-year examination pursuant to W. Va. Code §33-2-9(a) covering the period from January 1, 2015 through December 31, 2016, including any material transactions or events occurring subsequent to the examination date and noted during the course of the examination.

2. On September 18, 2017, the examiners filed a Report of Financial Examination of First Surety Corporation 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 Report of Financial Examination was forwarded to the Company on or about September 25, 2017, via certified mail. 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 submission, rebuttal, or objection concerning any matter contained in the report.

4. By letter dated October 2, 2017, the Company filed a written response to the Report of Financial Examination indicating that it had reviewed the Report of Financial Examination and noted its agreements, disagreements, concurrences and objections therein. A copy of the October 2, 2017 response from the Company, with its attached exhibit, is attached hereto as Exhibit B and incorporated herein as if set forth in full.

CONCLUSIONS OF LAW

1. W.Va. Code § 33-2-9(j)(2) provides that no later than sixty (60) days following completion of the examination, the examiner in charge shall file with the Insurance Commissioner a verified, written Report of Financial Examination under oath and, upon receipt of the verified report, the Insurance Commissioner shall transmit the Report of Financial Examination to the Company with a notice that shall afford the Company a reasonable opportunity of not more than

thirty (30) days to make a written submission or rebuttal.

2. W.Va. Code § 33-2-9(j)(3) provides that within thirty (30) days of the end of the period allowed for the receipt of written submissions or rebuttals the Insurance Commissioner shall fully consider and review the Report of Financial Examination, together with any written submissions or rebuttals and shall enter an ORDER adopting the Report of Financial Examination as filed or with modifications or corrections, enter an ORDER rejecting the Report of Financial Examination with directions to the examiners to reopen the examination or call for an investigatory hearing.

ORDER

Accordingly, it is therefore AGREED by the Parties and ORDERED as follows:

1. That the September 18, 2017 Report of Financial Examination of First Surety Company, attached hereto as Exhibit A, is ADOPTED and APPROVED by the Insurance Commissioner without modifications or corrections.

2. That a copy of this Agreed Order Adopting Report of Financial Examination and Directing Action, with exhibits, shall be mailed to the Company, via certified mail, return receipt, upon entry by the Insurance Commissioner.


3. That the Company shall file with the Insurance Commissioner, within thirty (30) days of the issuance of this Agreed Order, affidavits executed by each of its directors stating under oath that they have received a copy of the 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. That the Company shall take whatever actions are required to comply with the recommendations set forth in the Report of Financial Examination, if any, and shall demonstrate compliance to the satisfaction of the Insurance Commissioner, if necessary.

5. That the Company waives any right to any notice, administrative hearing or appeal therefrom for the actions taken by the Insurance Commissioner herein this Agreed Order Adopting Report of Financial Examination and Directing Action. The Company reserves 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. That this matter be dismissed from the administrative docket of the Insurance Commissioner.

Entered this 17th day of October, 2017.


Allan L. McVey, Insurance Commissioner
State of West Virginia

THE PARTIES DO SO AGREE:

State of West Virginia, Offices of the Insurance Commissioner,

By: 
Erin K. Hunter, Associate Counsel

Date: 10/17/17

First Surety Corporation,

By: Robert J. Kenney
[Print Name]

Signed: 

Its: President

Date: October 13, 2017

REPORT OF EXAMINATION
OF
FIRST SURETY CORPORATION
CHARLESTON, WV
NAIC #38504

AS OF DECEMBER 31, 2016



TABLE OF CONTENTS

SALUTATION.....1
SCOPE OF EXAMINATION2
SUMMARY OF SIGNIFICANT FINDINGS2
HISTORY3
MANAGEMENT AND CONTROL4
 BOARD OF DIRECTORS.....4
 OFFICERS5
 ORGANIZATIONAL CHART.....5
 AGREEMENTS6
TERRITORY AND PLAN OF OPERATION.....7
GROWTH OF COMPANY7
REINSURANCE8
FINANCIAL STATEMENTS8
 ASSETS9
 LIABILITIES, SURPLUS AND OTHER FUNDS10
 UNDERWRITING AND INVESTMENT EXHIBIT.....11
SUMMARY OF EXAMINATION CHANGES12
SUMMARY OF EXAMINATION RECOMMENDATIONS12
ACKNOWLEDGEMENT AND SIGNATURE14

SALUTATION

September 18, 2017
Charleston, West Virginia

The Honorable Allan L. McVey
West Virginia Insurance Commissioner
900 Pennsylvania Ave.
Charleston, West Virginia 25302

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, 2014. This examination commenced on May 17, 2017 and is a multi-state, full scope, two-year examination pursuant to W.Va. Code §33-2-9(a), as amended, covering the period from January 1, 2015 through December 31, 2016, 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 WVOIC. 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 Statements of Statutory Accounting Principles ("SSAP") 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, 2016.

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) The most recent financial statements of the Company's parent, Jacobs Financial Group, Inc. ("JFGI" or "Parent") were as of May 31, 2016, which indicated that financial statements were presented on the basis that JFGI is a going concern. No other subsequent financial statements of JFGI were available.
- 2) There was no formal comparison of present value of cash flows to determine if there is adequate transfer of risk. As such, due to very limited claims experience, it may not appear to be "self-evident" that there is a proper transfer of risk. SSAP 62R, paragraph 13 (b) states "indemnification of the ceding entity against loss requires that it is reasonably

possible that the reinsurer may realize a significant loss from the transaction.” SSAP 62R, paragraph 16 states that “Significance of loss shall be evaluated by comparing the present value of all cash flows... with the present value of the amounts paid or deemed to have been paid to the reinsurer.” Per SSAP 62R, paragraph 15: “An outcome is reasonably possible if its probability is more than remote.”

Additionally, examiner was not able to obtain documentation to assess the adequacy of its reinsurance program. Without formal transfer of risk analysis, no evidence of historical recoveries, lack of maintaining of "collateral warranty", and no written documentation to support that the company's broker solicits reinsurance coverage at other levels, we were not able to verify that the company's reinsurance program is effectively designed to the Company's benefit.

- 3) Based on review of Section 4 “Duties and Responsibilities” and Section 6 “Account and Payment of Commissions” of the existing agreement with Triangle Surety Agency, Inc. (“TSA”), there were certain provisions for which we were not able to obtain evidence that TSA provided these services. As such, we do not have enough evidence to verify that the Company operates in accordance with its current agreement.
- 4) The Company was not in compliance with W. Va. Code §33-3-5b “Capital and surplus requirements” in that the Company’s capital stock was below a minimally required amount of \$1,000,000. (See reclassification)
- 5) The Company responded “yes” to the 2016 Annual Statement interrogatory 28 disclosure regarding compliance with the *NAIC Financial Condition Examiner Handbook*. However, there was no valid custodial agreement in place between the Company and its custodian.

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 JFGI. The acquisition was approved by the WVOIC 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.

Capitalization

The Company has issued 1,000 common stock shares at \$5 par value per share. However, it reported \$1,000,000 as “Common Stock”, instead of \$5,000 in “Common Stock”. Paid in capital of the company related to the common stock was \$955,000 at December 31, 2016. A reclassification entry was recorded in Summary of Examination Changes.

During 2015, 10% of FSC stock was acquired from JFG by two families – Mary and Gary Richards, and Karen and Robert Litman, each family holding 5%. During 2016, 15% of FSC stock

was acquired by Applied Mechanics, Corp., resulting in JFGI holding the remaining 75% of the stock.

On November 10, 2016, ERP Environmental Fund, Inc. ("ERP") purchased 5,000 shares of Series A, at \$0.01 par value per share, preferred stock for \$5,000,000. However, it reported \$5,000,000 as "Preferred Stock", instead of \$50 in "Preferred Stock", and \$4,999,950 in "Additional Paid-in Capital". A reclassification entry was recorded in Summary of Examination Changes.

Subsequent to the exam date, on January 6, 2017, ERP, a bonded principal, purchased an additional 3,000 shares of Series A, \$0.01 par value share, preferred stock for \$3,000,000. These preferred shares have preferences over common shares with respect to dividends and liquidation and have no voting rights.

Dividends to Stockholder

In 2015 the Company declared and paid \$173,000 to the Company's parent, JFGI, consisting of \$75,000 on February 11, and \$98,000 on March 13. WVOIC determined that \$75,000 was paid before the allowable date of payment was not approved for payment by the WVOIC. There were no dividends declared or paid in 2016.

MANAGEMENT AND CONTROL

BOARD OF DIRECTORS

The corporate powers of the Company are vested in the Board of Directors consisting of not less than five nor more than nine members in compliance with Article II, Section 1 of the Company's Bylaws and in compliance with W. Va. Code §33-5-3. The individuals serving as members of the Board of Directors on December 31, 2016 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 |
| John M. Jacobs* PO Box 3523 Charleston, WV 25325 | President and Chairman Jacobs Financial Group | 2006 |
| 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 |
| Charles L. Stout** PO Box 4609 Bridgeport, WV 26330 | President, Applied Mechanics, Inc. | 2016 |

* Chairman resigned August 31, 2017

** Resigned August 2, 2017

Refer to Subsequent Events for change in the Board composition as of August 31, 2017.

OFFICERS

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. Officers elected at the August 10, 2016 Board of Directors Meeting and serving as of December 31, 2016, were as follows:

| Name | Title |
|----------------------|-----------|
| Robert Joseph Kenney | President |
| C. David Thomas | Secretary |
| Jason M. McCoy | Treasurer |

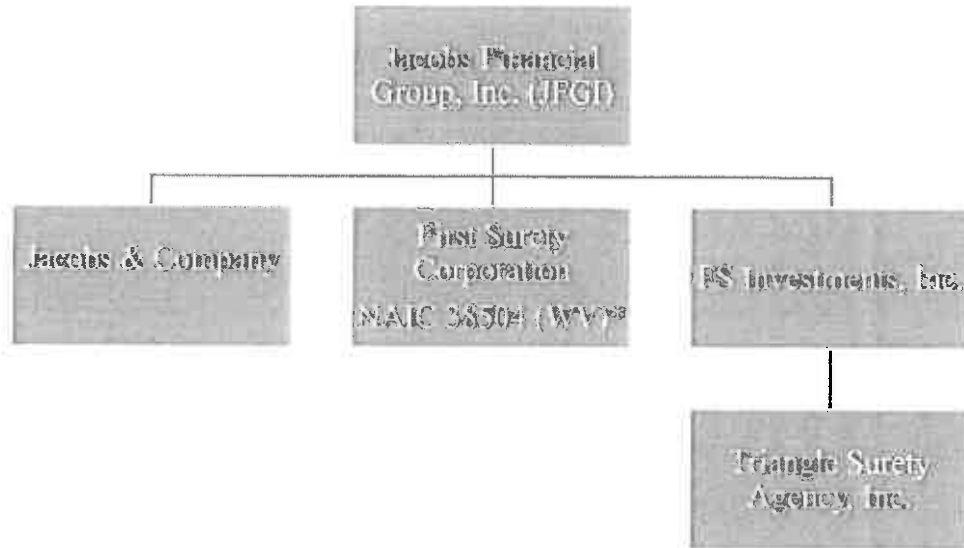
It was observed that the Company's President oversees substantially all the Company's daily operations.

COMMITTEES

The Bylaws require no formal committees. However, the Company does informally operate utilizing an Investment Committee and Underwriting Committees.

ORGANIZATIONAL CHART

At December 31, 2016, the following entities were the members of the holding company group:



*The Company is 15% owned by Applied Mechanics, Corp., 75% owned by JFGI, and remaining 10% ownership is equally split between two families. Mr. Stout, who has ownership of Applied Mechanics, Corp. did not file Disclaimer of control. The entities were deemed to be affiliated at December 31, 2016.

At December 31, 2016, ERP has not filed a Disclaimer of Control form. As such, the entity holds only non-voting preferred stock and is not considered an affiliate under the definition contained in W. Va. Code §33-27-2.

Based on review of the May 31, 2016 financial statements of FSC's parent company, JFGI the independent CPA firm disclosed that the parent's financial statements were presented on the basis that JFGI is a going concern. There was no financial statement available after May 31, 2016.

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 \$730,879 and \$234,281 under this agreement in 2016 and 2015, respectively. The increase in the current year is due to the Company obtaining a material book of business from ERP which significantly increased the commission expense during 2016.

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 \$53,953 and \$51,375 for 2016 and 2015, 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 \$21,123 and \$24,975 for 2016 and 2015, respectively.

Programming and Computer Services Agreement

The Company has a Programming and Computer Services Agreement with its affiliate, J&C, whereby J&C provides programming and computer services as outlines in various module statement. The agreement was effective June 1, 2010. Amounts paid by the Company under the Agreement were \$331 and \$0 for 2016 and 2015, respectively.

Tax Sharing Agreement

The Company entered in to a Tax Sharing Agreement with its parent effective January 1, 2006. In 2016 and 2015, payments made to the parent under the Agreement amounted to \$0 and \$80,529, respectively. After September 30, 2016, non-controlling ownership changes in the Company resulted in the Company filing a separate tax return for the tax period covering October 1, 2016 through December 31, 2016, and subsequent tax years ending December 31. Tax sharing agreement between JFG and the Company will no longer apply to the Company.

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. 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, 2016 and for the period under examination.

| | <u>2016</u> | <u>2015</u> |
|-------------------------|-------------|-------------|
| Direct Premiums Written | 3,017,774 | 1,353,262 |
| Ceded Premiums Written | 1,000,056 | 42,889 |
| Net Premiums Written | 2,017,718 | 1,310,373 |
| Net Income | (155,832) | (762,295) |
| Total Net Assets | 32,869,184 | 13,381,015 |
| Total Liabilities | 22,835,437 | 8,357,848 |
| Policyholders Surplus | 10,033,747 | 5,023,167 |

As shown in the exhibit above, the Company's premium volume has experienced some significant increase during 2016. At December 31, 2016, the Company had 97 surety bonds outstanding with a face value of \$51,784,000. Written premiums associated with these bonds amount to \$1,424,060 for the year ended December 31, 2016.

REINSURANCE

Effective January 1, 2016 the Company entered in to a reinsurance contract with various syndicates at Lloyds of London for its coal reclamation surety bonding programs. Initial termination date of the contract was December 31, 2016. The contract was extended to April 1, 2017.

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 plus 20% of each bond's face value (minimal collateral). 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. At December 31, 2016, the Company filed a reinsurance claim and expected that \$85,000 recovery on its loss paid. However, subsequent to year-end, after the treaty was extended, the Company withdrew its reinsurance claim, and for the contract year ended March 31, 2017 the Company recorded a No Claims Bonus of \$329,048.

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, 2016

| Assets | Per Company | Adjustments | Per Examination |
|--|----------------------|-------------|----------------------|
| Bonds | \$ 7,773,775 | \$ - | \$ 7,773,775 |
| Preferred Stocks | 132,970 | - | 132,970 |
| Common Stocks | 1,771,950 | - | 1,771,950 |
| Cash and Short-term Investments | 21,800,122 | - | 21,800,122 |
| Investment Income Due and Accrued | 57,420 | - | 57,420 |
| Uncollected Premium and Agents' Balances | 613,147 | - | 613,147 |
| Net deferred tax asset | 719,061 | - | 719,061 |
| Electronic Data Processing Equipment | 739 | - | 739 |
| Aggregate Write-Ins - Salvage and Subro | - | - | - |
| Total Assets | \$ 32,869,184 | \$ - | \$ 32,869,184 |

**LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2016**

| Liabilities | Per Company | Adjustments | Per Examination |
|---|----------------------|----------------|----------------------|
| Losses | \$ 2,178,060 | | \$ 2,178,060 |
| Other Expenses Due or Accrued | 464,611 | - | 464,611 |
| Taxes, Licenses and Fees | 48,986 | - | 48,986 |
| Unearned Premiums | 1,282,871 | - | 1,282,871 |
| Advance Premiums | 19,700 | - | 19,700 |
| Ceded Reinsurance Premium Payable | 580,056 | | 580,056 |
| Amounts Withheld for Account of Others | 18,017,834 | | 18,017,834 |
| Payable to PSA | 190,496 | | 190,496 |
| Derivatives | 52,825 | | 52,825 |
| Total Liabilities | \$ 22,835,439 | \$ - | \$ 22,835,439 |
| Common Capital Stock | 1,000,000 | \$ (995,000) | 5,000 |
| Preferred Capital Stock | 5,000,000 | \$ (4,999,950) | 50 |
| Gross Paid In and Contributed Surplus | 4,522,086 | \$ 5,994,950 | 10,517,036 |
| Unassigned Funds (Surplus) | (488,339) | | (488,339) |
| Surplus as Regards Policyholders | 10,033,747 | - | 10,033,747 |
| Total Liabilities, Surplus and Other Funds | \$ 32,869,186 | \$ - | \$ 32,869,186 |

UNDERWRITING AND INVESTMENT EXHIBIT
DECEMBER 31, 2016

UNDERWRITING INCOME

| | |
|--------------------------------------|------------------|
| Premiums Earned | \$ 1,166,839 |
| Losses Incurred | 370,488 |
| Other Underwriting Expenses Incurred | 1,234,353 |
| Aggregate Write-Ins | (10,000) |
| Total Underwriting Deductions | <u>1,594,841</u> |
| Net Underwriting Gain (Loss) | (428,002) |

INVESTMENT INCOME

| | |
|------------------------------|---------------|
| Net Investment Income Earned | 233,274 |
| Net Realized Capital Gains | <u>45,377</u> |
| Net Investment Gains | 278,651 |

OTHER INCOME

| | |
|--|-----------------|
| Net gain (loss) from agents' or premium balances charged off | (144) |
| Aggregate Write-ins for Other Income | <u>(35,347)</u> |
| Total Other Income | (35,491) |

| | |
|--------------------------------------|---------------------|
| Net Income Before Federal Income Tax | (184,842) |
| Federal Income Tax | <u>(29,011)</u> |
| Net Income | <u>\$ (155,831)</u> |

CAPITAL AND SURPLUS ACCOUNT

| | |
|--|---------------------|
| Capital and Surplus, December 31, 2015 | <u>\$ 5,023,168</u> |
| Net Income | (155,831) |
| Net Unrealized Gains or (Losses) | 53,030 |
| Change in Net Deferred Income Tax | 68,627 |
| Change Non-admitted Assets | 9,448 |
| Capital changes - paid in | 5,000,000 |
| Aggregate Write-in for gains and losses in surplus | <u>(523,698)</u> |
| Change In Surplus As Regards to Policyholders | <u>4,451,576</u> |
| Capital and Surplus as of December 31, 2016 | <u>\$ 9,474,744</u> |

SUMMARY OF EXAMINATION CHANGES

The following adjustments were made to the Company's financial statements as a result of this examination:

1. Balance of "Capital Stock", reported on line 30 of the Liabilities, Surplus and Other Funds page of the 2016 Annual Statement was reduced by \$995,000, with corresponding increase to line 34 "Additional Paid in Capital". There was no impact on surplus from this reclassification.
2. Balance of "Preferred Stock", reported on line 31, of the Liabilities, Surplus and Other Funds page of the 2016 Annual Statement was reduced by \$4, 999,950, with corresponding increase in line 34 "Additional Paid in Capital". There was no impact on surplus from this reclassification.

SUBSEQUENT EVENTS

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

1. On its March 31, 2017 quarterly statements, the Company reported a balance of \$200K in unsecured notes. The balance should be a non-admitted asset per W. Va. Code §33-7-3(b) unless secured.
2. On August 31, 2017, the Company's Board elected two new Board members, Mr. Ben Robertson and Mr. Bill Faulkes. Effective the same meeting, the Company's Chairman, John Jacobs, resigned and Bradley W. Tuckwiller was elected Chairman.

SUMMARY OF EXAMINATION RECOMMENDATIONS

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

- 1) FSC's parent, JFGI, should be prepared to provide financial statements subsequent to May 31, 2016 to evidence its ability to financially support FSC as its wholly owned subsidiary.
- 2) We recommend that on a going forward basis, to ensure compliance with SSAP 62R, the Company obtain a transfer of risk analysis from a qualified independent party (actuary or reinsurance specialist), approved by the Commissioner. If determined by the analysis that the treaty is exempted from risk transfer requirements, then the actuary or reinsurance specialist needs to attest that risk transfer is reasonably self-evident. Additionally, the Company shall request its broker to provide with several retention/reinsurance options and quote prices based on several scenarios, as commonly done by other insurers. These

various options shall be considered and documented by the management and/or the Board to determine desired level of exposure, related reinsurance coverage and costs associated with such coverage.

- 3) Examiners recommend that FSC management reevaluate their contract with TSA to include provisions and requirements that TSA actually provides. New agreement, with documentation of time and resources used by Triangle to produce the business, and justification for the cost, shall be re-submitted to the Department for approval. This information will be used to ensure that cost of the services is fair and reasonable as required by WV Code §33-27-5.
- 4) We recommend that the Company complies with W. Va. Code §33-3-5b "Capital and surplus requirements" and maintains at least one million dollars in its capital stock account.
- 5) We recommend that the Company executes a written custodial agreement with its custodian. The agreement shall include all required provisions as listed in the *NAIC Financial Condition Examiner Handbook*. Accurate disclosure of information shall be made in the Annual Statement General Interrogatory 28 regarding the custodian agreements.

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 David Palmer, CFE, Ryne Davison, CFE, Examiner, Mario Ascic, 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, 2016.

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, 2016 as determined by this examination

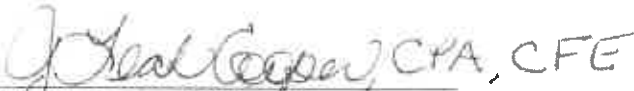
Respectfully Submitted,



Katerina Bolbas, CFE
Financial Examiner

Lewis & Ellis

Representing the WV Offices of the Insurance Commissioner



J. Leah Cooper, CPA, CFE
Director / Chief Financial Examiner

Financial Conditions Division

WV Offices of the Insurance Commissioner