BEFORE JAMES A. DODRILL, INSURANCE COMMISSIONER
OF THE STATE OF WEST VIRGINIA

In the Matter of:

FIRST SURETY CORPORATION (NAIC #38504)

ADMINISTRATIVE PROCEEDING NO. 21-IC-02181

FINDINGS OF FACT, CONCLUSIONS OF LAW & ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION

COMES NOW James A. Dodrill, Insurance Commissioner of the State of West Virginia, (hereinafter the "Insurance Commissioner") who, after consideration of the REPORT OF FINANCIAL EXAMINATION as of December 31, 2019, of FIRST SURETY CORPORATION, (hereinafter referred to as "Company") made the following findings of fact, conclusions of law and order.

FINDINGS OF FACT

1. An examination of the financial condition and operational affairs of the Company for the period beginning January 1, 2017, and ending December 31, 2019, was conducted in accordance with *W.Va, Code* §33-2-9(c) by an examiner in the employ of the Insurance Commissioner.

2. On July 1, 2021, 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 August 9, 2021, a true and accurate copy of the Report of Financial Examination was sent to the Company and received on August 11, 2021. A copy of the

transmittal letter is attached hereto as Exhibit B.

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, to make a submission, rebuttal or objection concerning any matter contained in the Report.

5. By letter dated August 21, 2021, management of the Company acknowledged that it had reviewed the Report of Financial Examination and submitted exceptions to the findings of the examination. A copy of the Company's letter of August 21, 2021, is attached hereto as Exhibit C.

CONCLUSIONS OF LAW

1. The Insurance Commissioner 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 is organized pursuant to provisions of Article 22 of Chapter 33 of the *West Virginia Code*.

3. The Company is authorized to transact business as a property and casualty company with lines of business in marine, fire, casualty, and surety under the provisions of Article 3 Chapter 33 of the *West Virginia Code*. The Company was organized on November 19, 1979.

4. *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.

5. *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

Based upon the foregoing findings of fact and conclusions of law, it is **ORDERED** as follows:

1. The Report of Financial Examination of the Company, attached hereto as Exhibit A, is hereby ADOPTED and APPROVED;

2. A copy of these FINDINGS OF FACT, CONCLUSIONS OF LAW & ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION and the Report of Financial Examination shall be mailed to the Company via certified mail, return receipt requested, upon entry by the Insurance Commissioner;

3. The Company 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 Report of Financial Examination and a copy of this FINDINGS OF FACT, CONCLUSIONS OF LAW & ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION in accordance with *W.Va. Code* §33-2-9(j)(4);

4. 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; and

5. Inasmuch as orders entered by the Insurance Commissioner are subject to judicial review in the Circuit Court of Kanawha County as set forth in *West Virginia Code* §33-2-14, any person aggrieved by any this ORDER may, within 30 days after it has been mailed or delivered to the persons entitled to receive the same, file an appeal.

ENTERED this 25th day of August, 2021.

James A. Dodrill
Insurance Commissioner

REPORT OF EXAMINATION

OF

FIRST SURETY CORPORATION

CHARLESTON, WV

NAIC #38504

AS OF DECEMBER 31, 2019

TABLE OF CONTENTS

SALUTATION

July 1, 2021
Charleston, West Virginia

The Honorable James A. Dodrill
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
179 Summers Street, Suite #307
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, 2016. The current examination commenced on October 3, 2019 and is a multi-state, full scope, three-year examination pursuant to W.Va. Code §33-2-9(a), as amended, covering the period from January 1, 2017 through December 31, 2019, 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 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, 2019.

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, 2018, 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) The Company was not in compliance with SSAP 5 – Revised "Liabilities, Contingencies and Impairments of Assets" in that its subrogation recoverable was not evaluated for impairment. Additionally, there were no proper disclosures and approvals obtained related to a promissory note between the Company and one of its owners pursuant to SSAP 25 "Affiliates and Other Related Parties". Specifically non-compliances are described below:

- Brushy Fork account had a recoverable of $280,000 at December 31, 2019. Initial balance of this recoverable was $455,000 (for the loss paid in August 2015). At the end of 2016 examination, a management letter was issued (dated September 18, 2017) which indicated that management expected a full recovery of $455,000 within "6 to 18 months" (18 months timeframe, starting with the date of the letter issuance, would be March 2019). During the current exam period, cumulative payments of $175,000 were made during 2017 and in January 2018. There were no payments made in the remainder of 2018, nor in 2019. As such, the balance would be deemed impaired under SSAP 5R, had there been an impairment analysis done at the end of 2018 or 2019. Current payment of $1,000 per month has been paid since March 2020. However, as of July 31, 2020, $272,242 is still outstanding as relates to this recoverable. No collateral is held for this claim. Based on the above considerations, examiners determined this balance to be impaired in accordance with SSAP 5R, and will reduce the balance of subrogation recoverable by $280,000 at 12/31/2019.

- Applied Mechanics Corporation ("Applied Mechanics") account reported a recoverable in the amount of $1,204,614 at December 31, 2019. In January 2018, the Company paid a claim on a performance bond on behalf of Applied Mechanics in the amount of $1,335,000, and the full balance of that bond has been established as a salvage reserve to be repaid with periodic payments from the bond principal, of which $130,386 was paid through the end of 2019 ($85,386 and $45,000 were repaid during 2018 and 2019, respectively).

  In order to recover payment from Applied Mechanics, the Company entered into a Promissory Note and Security Agreement ("Note") with Applied Mechanics dated January 29, 2018, whereby Applied Mechanics obligated itself to pay $1,335,000 to FSC. This was an on demand note with interest rate of 2.5%, with interest to be paid on a monthly basis commencing on March 1, 2018; failure of Applied Mechanics to pay any installment of interest or principal in accordance with the Note shall constitute an event of default. Payments received were applied to principal only, and examiners were not able to verify that the interest was paid by Applied Mechanics to FSC on a monthly basis. As such, in accordance with the terms of the Note, by its own definition, Applied Mechanics is currently in default on this loan by not making adequate interest payments.

  As of the end of 2019 year, Applied Mechanics Corporation owned 15% of the outstanding shares of the Company, which would deem it to be a principal owner of the Company. As such, the Note described above would deem to be a loan to a related party/principal owner, and is a subject to SSAP 25 compliance.

Specifically, SSAP 25, paragraph 8 requires that "loans … made by a reporting entity to its parent or principal owner shall be admitted if approval for the transaction has been obtained from the domiciliary commissioner and the loan is determined to be collectible based on the parent or principal owner's independent payment ability…"

The WVOIC had not received a notification related to this loan, nor was this arrangement formally approved by the WVOIC. Based on liquidity available to Applied Mechanics, had the Company requested the Note to paid repaid on demand at December 31, 2019, it is highly doubtful that Applied Mechanics had enough cash to pay in full.

On March 14, 2018, WVOIC analyst had inquired about the subrogation amount. The Company's response to the analyst was "we expect to be repaid in the next few month". At the time of this memo, there is no established timeframe for when the amount will be recovered, nor can management estimate a definitive timeframe for full repayment of the outstanding balance.

Additionally, Applied Mechanics provided collateral to the Note, which consists of the Company's own shares and Series B shares of JFGI, which, if the Company were to take possession of the collateral, would be a prohibited investments pursuant to the W. Va. Code §33-7-3, and non-admitted.

In light of the above considerations, examiners concluded that the Company was not compliance with SSAP 25, par 8, the Note is currently in default, and collateral backing the Note would result in non-admitted assets to the Company. As such, the balance of $1,204,614 shall be non-admitted (i.e. credit to losses shall be disallowed).

See NOTE 2 in the "Notes to Financial Statements" section of this report for adjustments.

3) Section 14 of Article 4 of the Annotated Code of West Virginia requires each insurer authorized to transact business in the State to annually file with the Commissioner a true statement of its financial condition, transactions and affairs as of the end of the preceding calendar year. The section further provides that the annual financial statements must be in such form and content as is approved or adopted for current use by the NAIC. The NAIC's *Annual Statement Instructions* specify the procedures to be followed in completing the Annual Statement. However, our examination disclosed certain instances where the Company did not complete its Annual Statement in accordance with the Instructions. For example:

a) Completion of the 2019 Underwriting and Investment Exhibit – Expenses ("Expense Exhibit") was found to be incomplete in the following regards:
   - There were no expenses allocated to the "Loss adjustment expenses" column.

   - "Investment expenses" column included the fee paid to an external investment advisor in the amount of $108,955, and management allocated a percentage of costs to this category from other general expenses in the amount of $56,935.

     We were not able to obtain a clear explanation of how the expenses are being allocated among the categories, as there doesn't seem to be a specific method in place to allocate the costs in a way that yields the most accurate results. Specifically, allocation of expenses between "loss adjustment expenses" and "investment" categories appears to be inconsistent. Effectively, the Company's LAE and Underwriting ratios are miscalculated.

   - Additionally, the A/S Instructions require that "the total management and service fees incurred attributable to affiliates and non-affiliates is reported in the footnote…". The footnote did not have such disclosure.

b) The Company's General Interrogatories did not disclose all the Company's investment transactions:
   - The Company answered "No" to question 26.1 (Does the reporting entity have any hedging transactions reported on Schedule DB?). We noted the Company has been engaged in hedging transactions during the examination period.
   - Further, the Company answered "N/A" to question 26.2. (If yes, has a comprehensive description of the hedging program been made available to the domiciliary state?); the Company should have described its hedging program in answering that question.

c) The 2019 Supplemental Investment Risks Interrogatories were not answered accurately in several instances:
   - Question 2 of Supplemental Investment Risks Interrogatories was not properly reported by listing the ten largest exposures to a single issuer/borrower/investment, was not properly reported. The Company prepared this list by identifying largest individual bonds and did not add up bonds that were issued by a single issuer.
   - Line 3.01 of Supplemental Investment Risks Interrogatories was not correct because not all of the Company's bonds are designated NAIC 1.
   - Lines 3.07-3.12 of Supplemental Investment Risks Interrogatories were not correct because Company did have preferred stocks, as reported on Schedule D-Part 2-Section 1.
   - Question # 13, Column 2, the Company reported actual cost of the respective equities, and not the book/carrying value.

4) The Company was not in compliance with SSAP 62 – Revised "Property and Casualty Reinsurance" in that its ceded unearned premium was not properly calculated. The

Company was subject to a minimum premium ceded of $1,170,000 for the reinsurance agreement in place from April 1, 2018 through October 1, 2019 (18 months contract, later extended through December 31, 2019). Based on the guidance from the NAIC, at the inception of the contract, the Company shall record the expected minimum premiums ($1,170,000) as Ceded Written Premium and record that same amount as ceded premium unearned against the Unearned Premium. However, the ceded unearned premium shall be prorated and reduced by the amount of the earned premium as of the year-end. As support for this guidance, the NAIC cited SSAP No. 62, paragraph 26: "Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of written and earned premiums by the ceding entity and shall be earned over the remaining contract period in proportion to the amount of reinsurance protection provided or, if applicable, until the reinsurer's maximum liability under the agreement has been exhausted. If the amounts paid are subject to adjustment and can be reasonably estimated, the basis for amortization shall be the estimated ultimate amount to be paid. Reinstatement premium, if any, shall be earned over the period from the reinstatement of the limit to the expiration of the agreement." Furthermore, the NAIC provided a reference to SSAP No 62R, Paragraph 32, to emphasize that reporting entity cannot cede more unearned premium than what the Company has, and the Company cannot take credit for more than what is ceded under the reinsurance agreement. At the end of 2018, ceded portion of UEP should have been $585,000 (not $1,017,042, which was the initial minimum ceded balance of $1,170,000 adjusted for calculated UEP at 12/31/2018 of $152,958). The balance of $585,000 is the remaining prorated balance of ceded UEP of $1,170,000 which was based on half of the balance being earned by 12/31/2018 (with remaining balance of $585,000 expected to be earned during the remainder of the reinsurance contract, January to September 2019). At the end of 2019, the Company reported net unearned premium liability of $453,573; the amount was offset by ceded reinsurance of $103,272. The ceded reinsurance amount of $103,272 for 2019 was computed using a ceded premium percentage (percentage of direct unearned premiums), even though the 2018-2019 reinsurance contract ended at 12/31/2019. Based on the confirmation from the NAIC, at the end of reinsurance coverage period (and in this case, the treaty was commuted), there should not be any ceded unearned premiums at year-end 2019. As such, the Company overstated its ceded unearned premiums (understated net UEP liability) by $103,272. See NOTE 3 in the "Notes to Financial Statements" section of this report for adjustments.

5) The Company was not in compliance with some of the terms of the Investment Management Agreement with Jacobs & Company, dated December 31, 2007, and amended effective June 1, 2010, which was previously filed and approved by the WVOIC. Specifically, the fees paid to Jacobs & Company was based on the entire amount of the invested portfolio, while the agreement specified fees based on fixed income accounts only. The fee schedule is silent on whether the investment fee should be charged on the equities, or any other invested assets.

6) The Company was not in compliance with some of the terms of the Expense Sharing Agreement dated June 1, 2007 related to the settlements of its expenses with JFGI. Based on the Agreement terms, payment of the amounts set forth in the Agreement shall be

payable 30 days following each month-end as expenses are incurred. The Company paid to JFGI in November 2019 for the first ten months of 2019, which is not in compliance with the settlement terms of the Agreement.

7) The Company made a salary advance to one of the Company's officers, which was described as "salary restructure", and in essence meets the definition of a loan. Since the Company did not receive written approval of the Commissioner to provide this loan to its officer, this is a violation of W. Va. Code §33-8-6 Loans to officers and directors.

8) During 2019 the Company paid $800 a month for a total annual payment of $9,600 to Andrew Jordon Rentals for rent of an apartment that was used by Company's officer. There is no formal employment agreement in place where this type of an expense is agreed to be paid by the Company on the officer's behalf, nor was this disclosed in the 2019 Annual Statement Supplemental Compensation Exhibit as part of the benefits.

9) The Company was not in compliance with SSAP No. 101 paragraph 7.e. which states that gross DTAs shall be reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not that some portion or all of the gross DTAs will not be realized. Based on review of supporting work related to the adjusted gross Deferred Tax Assets ("DTA") as of 12/31/2019, there was no evidence that a valuation allowance analysis was performed by the Company to determine if the Company had sufficient taxable income to realize its DTAs, as required by SSAP 101, paragraph 7.e. In light of existing negative factors, such as historical underwriting losses, operational volatility that the Company has been experiencing, loss of one of its major customers which reduced its revenues during the examination period, as well as general uncertainty and decline in the coal mining industry, it would seem that a valuation allowance analysis should have been performed. Examiners utilized available information subsequent to the period to estimate the Company's taxable income, which included actual 2020 results, projected results for 2021 ($263,174 for ordinary income and $500,555 for capital gains), and assumed that the Company will operate at no loss in 2022. With these assumptions, examiners estimated that projected taxable income would be approximately $900,000 for the period of 2020-2022, which would result in an estimated DTA amount able to be realized of about $189,000 (which is subject to admissibility teste under SSAP 101). Giving the Company credit for possibly able to realize some of its DTAs, the amount of 12/31/2019 DTA should be adjusted to $189,000 from $518,192. In light of high level of uncertainty in expected results, and a high probability that future taxable income could be very minimal, (which is supported by Company's history of NOLs), one could also make a case for why the entire amount of DTA should have been non-admitted at December 31, 2019.

10) Some of the case reserving and actuarial methodologies and factors were found to be deficient to ensure that the Company's loss and loss adjustment expense reserve was adequate. Specifically, examination actuary noted the following findings:

    a. The National Association of Insurance Commissioners Accounting Practices and Procedures Manual, SSAP 55, par. 4 states that "Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured even occurs." The loss adjustment expenses ("LAE") liability represents expenses that will be incurred in connection with the settlement of losses incurred but unpaid at the statement date and included two components, Defense and Cost Containment, which includes all defense and litigation-related expenses, whether internal or external to a company, and Adjusting and Other, which includes all other claims adjusting expenses, whether internal or external to a Company. As of December 31, 2019, the Company did not record any explicit loss adjustment expenses unpaid in financial statements because the reported loss adjustment expense liability was $0. As discussed elsewhere in this report, there are concerns that the expected loss and loss adjustment expense ratio assumptions used by the Company to derive reported reserves are less meaningful and likely understated due to examiner concerns identified; this inadequacy would also imply likely inadequacies in estimates of implied loss adjustment expenses unpaid. Further, examination findings indicated that loss adjustment expense unpaid was either not included or not clearly considered in case reserving. As a result, adjustments to the Company's total loss reserves and loss adjustment expense reserves, took this condition into consideration. See **NOTE 2** in the "Notes to Financial Statements" section of this report for adjustments.

b. The methodologies utilized by the Company to compute their reserves as of December 31, 2019, were reviewed by the Company's independent actuary who concluded that the reserves appeared to be sufficient. The reported reserves represent management's best estimate of the amounts necessary to pay all claims and related expenses that had been incurred but still unpaid as of December 31, 2019. The actuarial methodologies and assumptions utilized by the Company to compute its "Losses" liability as of December 31, 2019, were reviewed by our examination actuary. Our examination actuary determined that the "Losses" liability was inadequate because deficiencies with the Company's methodologies and assumptions utilized to compute the "Losses" liabilities were identified.

   The Company uses an expected loss ratio method to derive reported reserves for Losses and the Company's independent actuary derives an independent estimate and opines on the reported reserves for Losses. Exam Actuary understands the Company considers industry specific loss ratios from the Surety & Fidelity Association of America when selecting expected loss ratio assumptions to derive reported reserves using the expected loss ratio method. Due to Company specific concerns identified by examiners and risk factors specific to the Company, comparisons to industry sources, such as the Surety & Fidelity Association of America, look to be less meaningful. Examination concerns identified by examiners are related to inadequate case reserving procedures, pricing inadequacies, low cash collateral levels, and the magnitude of the difference between the Company's reported reserves relative to the Company's estimates of worst case scenarios. These findings resulted in the examination actuary not being comfortable with the 26% of gross premium bulk IBNR ratio used by the Company and implied in December 31, 2019 reserves. The examination actuary determined that the increased risk for estimation errors and increased risk for adverse deviation in the reserving process, more globally to the Company as a result of concerns identified, supported the inclusion of a risk margin as of December 31, 2019. See NOTE 2 in the "Notes to Financial Statements" section of this report for adjustments.

c. At December 31, 2019, the Company reported Case Basis Reserves ("case reserves") in Schedule P totaling $3,120,000. This amount represents management's selected estimate of its unpaid claims liability for principals on the Company's Watch List as of December 31, 2019 which totaled $3,119,886. The principals on the Company's Watch List as of December 31, 2019 were identified by the Company as principals at higher risk of claims.

   A clear and consistent case reserving methodology being applied was not apparent based on review of the information provided by the Company. Specifically, the following were unclear as they apply broadly to the case reserving procedures and resulted in concerns of overall inadequacies in case reserve levels:

   1. Whether loss adjustment expense costs were being explicitly included in selected case reserves.
   2. The reasons for management's selected estimates of some case reserves being reduced from the previous year.
   3. Whether cash collateral used to reduce liabilities in selecting case reserves was also being permitted for use in covering overdue premiums due (e.g., double dipping).
   4. Whether collateral used to reduce liabilities in selecting case reserves was non-cash collateral not meeting the criteria of an admissible asset.
   5. Whether case reserves were being consistently selected considering on the ground exposure estimates evaluated at pre-determined intervals (e.g., annually) or some other measures.

   A specific example of item 4 above is the principal, Reserve Resource Partners. The Company indicated in responses to examiner information requests that a reserve credit was assigned for non-cash collateral and available indirect cash offsets. It is unclear to examiners whether these credits meet statutory accounting guidelines due to other examination findings regarding non admissibility of other subrogation recoverables.

   A specific example involving items 1 through 5 above is the principal, DFM Coal. A review of information on paid claims related to this principal during 2020, available to examiners subsequent to year-end 2019, supported concerns related to the case reserving methodology behind management selected estimates. Specifically, the selected case reserve for DFM Coal appeared to have been inadequate to cover the paid loss in 2020, in part, due to a reduction in the case reserve below both the prior year case reserve level and the value of its own on the ground exposure estimates (item 2, 4, and 5 above). Secondly, it revealed that the Company is pursuing recoverable on this paid claim, but the December 31, 2019 selected case reserve did not include a provision for a loss adjustment expense reserve (item 1 above). Finally, the collateral available at the time of paid loss had been reduced from December 31, 2019, which put upward pressure on the amount by which the paid loss in 2020 exceeded the case reserve (item 3 above). See NOTE 2 in the "Notes to Financial Statements" section of this report for adjustments.

To provide a cushion to case reserves, companies often carry an additional reserve commonly referred to as Incurred but Not Reported reserves ("IBNR reserves"). The Company's actuary indicates performing a by claim case reserve review and judgmentally selecting additional IBNR reserves at the by principal level for principals on the Watch List in addition to a bulk IBNR reserve. The examination actuary was not comfortable selecting IBNR for specific principals due to the lack of transparency in the case reserving process as previously noted in items 1 to 5 above. The examination actuary determined the December 31, 2019 carried loss and adjustment expense reserves have inadequacies in the case reserving procedures that subjects total reported loss and loss adjustment expense reserves (i.e., case reserves + IBNR reserves) to additional risk and uncertainty.

Furthermore, to substantiate the concerns noted above, we note that during calendar year 2020, the Company experienced about $1,855,000 in adverse development on the loss and loss adjustment expense amounts incurred prior to 2020 when compared to what was booked as of December 31, 2019. This was due to the following based on responses examiners received from Company management:

- About $1.4 million of this amount was from adverse development from DFM Coal and Revelation Energy;
- The remaining adverse development was attributable to adverse development on the principals Covington Coal and Reserve Resource Partners which were reportedly increased by the Company in 2020 due to perceived declinations in circumstances.

11) The National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual* Statement on Statutory Accounting Principle No. 53 require insurers to establish a liability "Premium Deficiency Reserve" (PDR) when the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, and any future installment premiums on existing policies. In addition, the NAIC *Annual Statement Instructions for Property and Casualty Insurance Companies* (Instructions) for Note #30 to Financials, requires insurers to disclose the amount of the PDR, the date of the evaluation for a PDR, and whether anticipated investment income was utilized as a factor in the premium deficiency calculation. However, the Company's response to Note 30 in their filed 2019 year-end Annual Statement only stated that there was no PDR to report. The Company did not disclose the date of the evaluation for the PDR and whether anticipated investment income was utilized as a factor in premium deficiency calculation as required by the Instructions. Furthermore, it was noted by the examination actuary that the Company had not adopted a formal written methodology for calculating PDR, nor did the Company's auditor or opining actuary perform a PDR evaluation and/or calculation.

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, Utah and West Virginia.

Capitalization

The Company's Restated Certificate of Incorporation authorized the Company to issue 1,000 shares of common stock with a par value of $1,000 per share and 50,000 shares of preferred stock each with a par value of $1,000 per share. As of December 31, 2019, the Company had issued 1,000 shares of common stock with an aggregate par value of $1,000,000 and 8,000 shares of preferred stock with an aggregate par value $8,000,000.

Dividends to Stockholder

The Company declared and paid dividends in the amount of $976,068 and $640,000 to its stockholders during 2018 and 2019, respectively.

MANAGEMENT AND CONTROL

BOARD OF DIRECTORS

Members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2019:

Directors

Linda J. Aguilar, Chair Ansted, West Virginia	Retired Senior Vice President City National Bank
Timothy A. Maddox Charleston, West Virginia	President Silverstein & Maddox Insurance, Inc.
Phillip B. Robertson Clendenin, West Virginia	Retired Banker Poca Valley Bankshares

Charles D. Thomas — Hurricane, West Virginia — Retired Vice President, Friedlander Company

Bradley W. Tuckwiller — Lewisburg, West Virginia — President, First Surety Corporation

On July 28, 2020, James R. Stout was elected to serve on the Board of Directors.

Officers

Linda J. Aguilar	Chair of the Board
Bradley W. Tuckwiller	President
Jason M. McCoy	Treasurer
Charles D. Thomas	Secretary

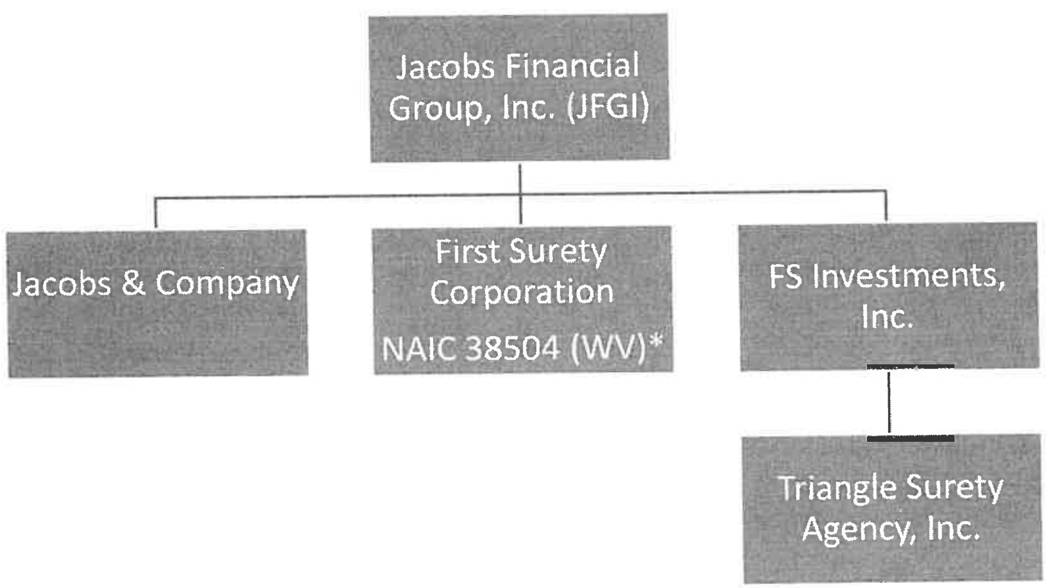
In 2020, Philip B. Robertson was elected to serve as Secretary to replace Mr. Thomas.

Committees

The Bylaws do not require any formal committees. On December 7, 2017, the Company's Board of Directors had established an Underwriting Committee, Investments Committee, and Compensation Committee. However, there were no records that the Committees were operational during the exam period.

ORGANIZATIONAL CHART

At December 31, 2019, the following entities were the members of the holding company group:



*As of 12/31/2019 the Company common shares ownership was as follows:

JFGI	50.75%
Applied Mechanics Corp.	15.00%
ERP Environmental Fund, Inc.	9.90%
Gregory A. Groves	6.00%
Robert & Karen Litman	5.00%
Gary & Mary Richards	5.00%
Betty Stout	3.00%
Eric Ridenour	1.60%
PENSCO Trust Company	1.50%
Noah E. Perry	1.50%
Stephen Summers	0.50%
Phillip B. Robertson	0.25%

All of the issued and outstanding preferred shares of the Company in the amount of 8,000 shares are owned by ERP Environmental Fund, Inc.

Based on review of the May 31, 2018 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 were no audited financial statements available after May 31, 2018.

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 $294,323 and $457,114 under this agreement in 2019 and 2018, respectively.

Investment Management Agreement
The Company has an Investment Management Agreement with its affiliate, Jacobs & Company ("J&C") effective December 31, 2007 whereby J&C receives investment advisory fees based on established fee schedules. The Company incurred investment management expenses in the amount of $108,955 and $156,358 in 2019 and 2018 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 $70,903 and $58,382 for 2019 and 2018 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 $26,250 and $26,250 for 2019 and 2018, respectively.

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 Utah. 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, 2019 and for the period under examination.

	2019	2018	2017
Direct Premiums Written	1,457,435	2,282,689	3,028,332
Ceded Premiums Written	0	1,170,000	954,904
Net Premiums Written	1,457,435	1,112,689	2,073,428
Net Income	(639,065)	823,439	1,248,661
Total Net Assets	18,623,531	20,799,719	37,654,904
Total Liabilities	7,131,311	8,132,931	23,877,628
Policyholder Surplus	11,492,220	12,666,789	13,777,276

REINSURANCE

Effective April 1, 2009, FSC entered into a reinsurance contract with various syndicates at Lloyd's of London for its coal reclamation surety bonding programs. The agreement has been renewed periodically for expanded surety bond business covered with various syndicates at Lloyd's of London, with the most recent renewal effective through the extended period ending December 31, 2019. The reinsurance agreement is an excess of loss contract which protects the Company against losses up to certain limits over stipulated amounts. The contract calls for a premium rate of 26%, subject to a minimum premium of $1,170,000. The Company's retention is $1,000,000 for each and every loss discovered, plus the collateral held on that specific bond. The Company shall maintain irrevocable letters of credit or cash collateral across all bonds covered to the value of a minimum of 20% of the outstanding individual bond amounts, or so deemed. In case of a loss, subject to reinsurance, any shortage related to collateral held being less than 20% would be an additional liability to the Company. The Company is entitled to a no claims bonus from the reinsurers for each contract year in which no losses are discovered.

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, 2019

Assets	Per Company	Adjustments	Per Examination
Bonds	$ 14,569,658	$ -	$ 14,569,658
Preferred Stocks	407,490	-	407,490
Common Stocks	1,776,313	-	1,776,313
Mortgage loans-First liens	615,100		615,100
Cash and Short-term Investments	377,570	-	377,570
Investment Income Due and Accrued	174,789	-	174,789
Uncollected Premium and Agents' Balances	77,329	(37,107)	40,222
Net deferred tax asset	518,192		518,192
Electronic Data Processing Equipment	2,421		2,421
Furniture and Equipment	-		-
Receivabled from PSA	-		-
Aggregate Write-Ins other-than-invested assets	104,669		104,669
Total Assets	**$ 18,623,531**	**$ (37,107)**	**$ 18,586,424**

LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2019

Liabilities	Per Company	Adjustments	Per Examination
Losses	$ 3,211,056	$ 2,488,614	$ 5,699,670
Other Expenses Due or Accrued	554,909	-	554,909
Taxes, Licenses and Fees	5,175	-	5,175
Unearned Premiums	453,573	109,000	562,573
Advance Premium	500	-	500
Amounts Withheld for Account of Others	2,842,632		2,842,632
Payable to PSA	48,572		48,572
Derivatives	14,893		14,893
Total Liabilities	**$ 7,131,310**	**$ 2,597,614**	**$ 9,728,924**
Common Capital Stock	1,000,000		1,000,000
Preferred Capital Stock	8,000,000		8,000,000
Gross Paid In and Contributed Surplus	4,522,086		4,522,086
Unassigned Funds (Surplus)	(2,029,866)	(2,634,721)	(4,664,587)
Surplus as Regards Policyholders	**11,492,220**	**(2,634,721)**	**8,857,499**
Total Liabilities, Surplus and Other Funds	**$ 18,623,530**	**$ (37,107)**	**$ 18,586,423**

STATEMENT OF INCOME
DECEMBER 31, 2019

UNDERWRITING INCOME	
Premiums Earned	$ 710,074
Losses Incurred	777,898
Other Underwriting Expenses Incurred	1,199,082
Aggregate Write-Ins	(103,322)
Total Underwriting Deductions	1,873,658
Net Underwriting Gain (Loss)	(1,163,584)
INVESTMENT INCOME	
Net Investment Income Earned	364,225
Net Realized Capital Gains	(39,097)
Net Investment Gains	325,129
OTHER INCOME	
Aggregate Writeins for miscellaneous income	202,477
Total Other Income	202,477
Net Income Before Federal Income Tax	(635,978)
Federal Income Tax	3,087
Net Income	$ (639,065)
CAPITAL AND SURPLUS ACCOUNT	
Capital and Surplus, December 31, 2018	$ 12,666,790
Net Income	(639,065)
Change in Net Unrealized Capital Gains or (Losses)	481,083
Change in Net Deferred Income Tax	163,539
Change Non-admitted Assets	(540,127)
Dividends to stockholders	(640,000)
Change In Surplus As Regards to Policyholders	(1,174,569)
Capital and Surplus as of December 31, 2019	$ 11,492,221

SUMMARY OF EXAMINATION CHANGES

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

1. Amount reported on line 15.1 of the Asset page of 2019 filed Annual Statement, "Uncollected Premiums and Agents Balances", was reduced by $37,107 to reflect amount of accounts receivables that have not been collected in 2020, but were considered admissible at December 31, 2019. The Company properly non-admitted these balances on its March 31, 2020 financial statements. *This adjustment reduced the Company's surplus, and was recorded directly through "Unassigned Funds" of capital and surplus.*

2. The Company reported "Losses" and "Loss adjustment expenses" reserves (collectively referred to as "Losses") totaling $3,211,056 and $0, respectively as of December 31, 2019. The actuarial methodologies and assumptions utilized by the Company to compute its "Losses" liability as of December 31, 2019, were reviewed by our examination actuary. Amount of "Losses", reported on line 1 of the Liabilities, Surplus and Other Funds page of the 2019 Annual Statement was increased by $2,488,614 for the following reasons:

    a. reflect disallowance of subrogation recoverable credit taken in the amount of $1,484,614;
    b. the examination actuary determined an upward adjustment to case reserves of $109,000 was reasonably justifiable for findings related to the DFM Coal principal on the Watch List for which more detailed information was available to examiners.
    c. the examination actuary recommends an explicit risk margin amount, which results in an additional upward adjustment to total loss and loss adjustment expense reserves of $895,000. The recommendation for an explicit risk margin was based on several factors, including the concerns related to inadequate case reserving procedures, pricing inadequacies, low cash collateral levels, and the magnitude of the difference between the Company's reported reserves relative to the Company's estimates of worst-case scenarios.

    This adjustment reduced the Company's surplus, and was recorded directly through "Unassigned Funds" of capital and surplus.

3. Balance of "Unearned Premium", reported on line 9 of the Liabilities, Surplus and Other Funds page of the 2019 Annual Statement was increased by $109,000. *This adjustment reduced the Company's surplus, and was recorded directly through "Unassigned Funds" of capital and surplus.*

SUBSEQUENT EVENTS

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

1. Effective November 1, 2020, the Company entered into a Surety Quota Share Reinsurance Agreement with Continental Indemnity Company and Pennsylvania Insurance Company,

whereby the Company will assume 100% of reclamation bond surety business written by Continental Indemnity Company and Pennsylvania Insurance Company through the Company's agency, Triangle Surety Agency, Inc. Related to the fronting arrangement, effective November 1, 2020, Continental Indemnity Company and Pennsylvania Insurance Company entered into General Agency Agreement with Triangle Surety Agency, Inc.

2. Effective March 3, 2021, the Company entered into a Surety Quota Share Reinsurance Agreement with Lexington National Insurance Corporation, whereby the Company will assume 50% of gross liability under surety bonds classified as Commercial Bond Surety, Contract Bond Surety Bonds, and 90% of gross liability for surety bonds classified as Coal Reclamation Surety Bonds. Related to this fronting arrangement, effective March 3, 2021, Lexington National Insurance Corporation entered into a Producer Agreement with Triangle Surety Agency, Inc. Reinsurance provided applies only to those bonds underwritten by Triangle Surety Agency, Inc.

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, 2018 to evidence its ability to financially support FSC as its wholly owned subsidiary.

2) We recommend that subrogation recoverables shall be evaluated for impairments as required by SSAP 5R, and, if applicable, any related party transactions shall be disclosed, as required by SSAP 25.

3) We recommend that the Company complete its Annual Statements in accordance with the provisions of W. Va. Code §33-4-14, the NAIC Annual Statement Instructions and Accounting Practices and Procedures Manual.

4) We recommend that on a going forward basis the Company shall comply with SSAP 62R guidance as relates to calculation and reporting of ceded unearned premiums balances from its existing reinsurance agreement. For multi-year reinsurance contracts:
    - At the end of year 1, the Company shall reflect ceded UEP in the amount of prorated minimum ceded premiums (based on length of the treaty), or calculated amount based on direct unearned premiums, whichever amount is higher.
    - At the end of year 2 (assuming the contract expired and/or commuted), the Company shall not record any ceded UEP.

In its subsequent statutory filings, starting with December 31, 2020, the Company did make appropriate corrections to account for its unearned premium reserve in accordance with the above guidance.

5) We recommend that the Company shall pay the fee based on the current terms of the Investment Management Agreement with Jacobs & Company which includes fixed income account only. Prospectively, we recommend that if the Company desires to deviate from the stated terms of an agreement previously approved by the Insurance Commissioner, then the Company shall adhere to the requirements set forth in W. Va. Code §33-27-5 and file the amendment/modification with the Commissioner for review via the Form D Filing process.

6) We recommend that the fee for shared office supplies and equipment be paid within 30 days of the end of each month-end when expenses are incurred, as required by Expense Sharing Agreement. Prospectively, we recommend that if the Company desires to deviate from the stated terms of the agreement previously approved by the Insurance Commissioner, then the Company shall adhere to the requirements set forth in W. Va. Code §33-27-5 and file the amendment/modification with the Commissioner for review via the Form D Filing process.

7) We recommend that the management requests written approvals from the Commissioner for any "salary restructures" or similar transactions that result in loans provided to the officers of the Company, as required by W.Va. Code §33-8-6 Loans to officers and directors.

8) We recommend that the Company stop paying personal and living expenses of its officers. If certain expenses are embedded as part of the compensation and benefits arrangement, we recommend that such terms and obligations are documented via a formal employment agreement. Additionally, the Company shall disclose any benefits paid on behalf of its employees in the Annual Statement Supplemental Compensation Exhibit.

9) We recommend that the Company comply with SSAP 101, paragraph 7.e by performing and documenting a valuation allowance analysis to determine a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not that some portion or all of the gross DTAs will not be realized. As noted in "Summary of Significant Findings", examiners estimated this balance to be in the range of $0 to $189,000. For purposes of this examination, we did not record an exam adjustment to reflect the reduction of estimated DTA to the examiner's range from $0 to $189,000. However, once the 2021 results are known, we recommend that management compare the actual 2021 results to projected 2021 results. If the 2021 actual ordinary and capital income materially differ from the 2021 projections ($263,174 for ordinary income and $500,555 for capital gains), management shall record a valuation allowance to the gross 2021 DTAs to reflect the fact that its prospective income projections, upon which DTAs are based, have not been historically accurate and usually are overly optimistic; as such, management shall support its future DTA calculations based on historical results rather than on projections that historically been overly optimistic, and materially deviated from actual results.

10) The Company should, in partnership with its appointed actuary where appropriate, revise certain underlying Company processes and revisit methodologies and assumptions for estimating "Losses", Specifically:

a. We recommend that in the future the Company record an explicit reserve for loss adjustment expenses unpaid separate from loss unpaid in financial statements to promote adequate loss adjustment expense liabilities and compliance with the National Association of Insurance Commissioners accounting rules.
b. We recommend that the Company revise its methodologies and assumptions for estimating "Losses" so that a more accurate and robust reserve may be established. We also recommend that the Company add an explicit risk margin to their estimate of "Losses" as of December 31, 2019 and potentially beyond.
c. To ensure that case reserves are based on clear processes, we recommend that the Company establish a more robust and transparent process for estimating case reserves for use in the reserving process, which includes clear documentation of criteria that results in a principal being included versus not included on the Company Watch List.

11) We recommend that the Company adopt a formal written methodology for the conclusions and calculations related to PDR and also disclose, in accordance with the NAIC Annual Statement Instructions for Property and Casualty Insurance Companies, the amount of the PDR, the date of the evaluation for a PDR, and whether anticipated investment income was utilized as a factor in the premium deficiency calculation.

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, Mario Ascic, CFE, Examiner, Lindsey Pittman, CFE, CISA, AES, IT Examiner, and Katie Koch, FCAS, MAAA, Actuary, of Lewis & Ellis, Inc. performed an examination of First Surety Corporation as of December 31, 2019.

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, 2019 as determined by this examination

Respectfully Submitted,

Katerina Bolbas, CFE
Financial Examiner
Lewis & Ellis
Representing the WV Offices of the Insurance Commissioner

Jamie Taylor, CFE, PIR, MCM
Chief Financial Examiner
Company Analysis and Examination Division
WV Offices of the Insurance Commissioner

STATE OF WEST VIRGINIA
Offices *of the* Insurance Commissioner

James A. Dodrill
Insurance Commissioner

August 9, 2021

VIA CERTIFIED MAIL: 7014 2120 0001 3016 7061

Brad Tuckwiller, President
First Surety Corporation
179 Summers Street, Suite 307
Charleston, WV 25301

RE: Report of Examination as of December 31, 2019
First Surety Corporation – NAIC #38504

Dear Mr. Tuckwiller:

Please find enclosed a copy of the ***Report of Examination*** of First Surety Corporation ("FSC"). This examination was performed in accordance with the provisions of Chapter 33, Article 2, Section 9 of the West Virginia Code of 1931, as amended. The ***Report of Examination*** reflects the financial affairs and condition of FSC as of December 31, 2019.

You have ten (10) working days from receipt of this letter to make written submissions or rebuttals with respect to any matter contained in the ***Report of Examination***.

Very truly yours,

James Dodrill
Insurance Commissioner

JAD/jot

Enclosure: Copy of Report of Examination

EXHIBIT
tabbies
B

Executive Office
Post Office Box 50540
Charleston, West Virginia 25305-0540

We are an Equal Opportunity Employer

Telephone (304) 558-3354
Facsimile (304) 558-0412
www.wvinsurance.gov

FIRST SURETY CORPORATION

179 Summers Street, Suite 307
Charleston, WV 25301
Telephone (304) 720-1985 Facsimile (304) 342-9726
brad@firstsuretycorp.com

August 21, 2021

The Honorable James A. Dodrill
West Virginia Insurance Commissioner
900 Pennsylvania Ave.
Charleston, West Virginia 25302

Dear Commissioner Dodrill,

We received your department's Report of Examination on August 11, 2021, and appreciate the opportunity to respond on sections of that report. Your third-party examiners were cordial and professional in our email and video exchanges. Regrettably, we did not have an opportunity to meet - perhaps some degree of understanding was lost by that distancing. We would like to meet with your staff prior to final adoption if time and circumstances permit.

Herewith are comments on the Report's *SUMMARY OF SIGNIFICANT FINDINGS*, with excerpts from the report in italics:

> *1) The most recent financial statements of the Company's parent, Jacobs Financial Group, Inc. ("JFGI" or "Parent") were as of May 31, 2018, 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.*

This is undisputed, and we expect a similar limiting qualification to continue for our majority owner. However, we note the company has had a going concern qualification of its financials since 2001, First Surety has not had any financial support from JFGI in the past, nor is any expected in the future. Should any support be necessary we have our own funding vehicle, First Surety Corporation's Series A Preferred, a non-voting stock with 42,000 shares unissued, entitled to a 3.50%, non-cumulative dividend.

> *2) The Company was not in compliance with SSAP 5 – Revised "Liabilities, Contingencies and Impairments of Assets" in that its subrogation recoverable was not evaluated for impairment. Additionally, there were no proper disclosures and approvals obtained related to a promissory note between the Company and one of its owners pursuant to SSAP 25 "Affiliates and Other Related Parties".*

We have concurred with the SSAP 5 non-compliance by removing the subrogation receivables as of December 31, 2020, and funding the associated amount(s) to loss reserves by adjustment to Unassigned Funds.

We disagree with application of SSAP 25 in the context of a subrogation recoverable. There was no loan to the Obligor; the promissory note serves as documentation for recovering

EXHIBIT 2

tabbies

a paid claim and acknowledgment of re-assignment of collateral previously pledged to the Obligee, now held to assure recovery of the paid claim. We do not interpret WV Code as requiring the Commissioner's approval prior to taking steps necessary to recover a paid claim; similarly, seeking approval after taking such steps is contrary to logic.

3) Section 14 of Article 4 of the Annotated Code of West Virginia requires each insurer authorized to transact business in the State to annually file with the Commissioner a true statement of its financial condition, transactions and affairs as of the end of the preceding calendar year. The section further provides that the annual financial statements must be in such form and content as is approved or adopted for current use by the NAIC. The NAIC's Annual Statement Instructions specify the procedures to be followed in completing the Annual Statement. However, our examination disclosed certain instances where the Company did not complete its Annual Statement in accordance with the Instructions.

a) Completion of the 2019 Underwriting and Investment Exhibit – Expenses ("Expense Exhibit") was found to be incomplete...:

We concur that portions of this exhibit were incomplete on the 2019 filing.

b) The Company's General Interrogatories did not disclose all the Company's investment transactions:.....

We concur that portions of general interrogatories were incomplete on the 2019 filing.

c) The 2019 Supplemental Investment Risks Interrogatories were not answered accurately in several instances...

We concur that answers to some sections of these interrogatories were inaccurate, and due to misunderstanding the instructions.

4) The Company was not in compliance with SSAP 62 – Revised "Property and Casualty Reinsurance" in that its ceded unearned premium was not properly calculated.

The Company had been following the calculation method prescribed in 2010 by the West Virginia Offices of the Insurance Commissioner. The calculation method had passed examination during two preceding exams. Nevertheless, we have changed calculation methods to comply with this examination and made the recommended adjustments.

5) *The Company was not in compliance with some of the terms of the Investment Management Agreement with Jacobs & Company, dated December 31, 2007, and amended effective June 1, 2010, which was previously filed and approved by the WVOIC. Specifically, the fees paid to Jacobs & Company was (sic) based on the entire amount of the invested portfolio, while the*

agreement specified fees based on fixed income accounts only. The fee schedule is silent on whether the investment fee should be charged on the equities, or any other invested assets.

We acknowledge the unintended inclusion of "fixed" in the compensation section of the Investment Management Agreement while noting all parties have understood the intent of the IMA. This is the sixth examination of the company since 2006 and the first to focus on the misplaced "fixed". As foundation for positing that all parties understood intent, the Offices of the Insurance Commissioner specifically approved calculations of the fee during the period October 15, 2019, through May 31, 2020. Nevertheless, we will submit a revised agreement on Form D for approval by the Commissioner.

6) *The Company was not in compliance with some of the terms of the Expense Sharing Agreement dated June 1, 2007, related to the settlements of its expenses with JFGI. Based on the Agreement terms, payment of the amounts set forth in the Agreement shall be payable 30 days following each month-end as expenses are incurred. The Company paid to JFGI in November 2019 for the first ten months of 2019, which is not in compliance with the settlement terms of the Agreement.*

We acknowledge lack of compliance. The monthly expenses are generally and had been grouped for efficiency. The routine will be corrected to comply.

7) *The Company made a salary advance to one of the Company's officers, which was described as "salary restructure", and in essence meets the definition of a loan. Since the Company did not receive written approval of the Commissioner to provide this loan to its officer, this is a violation of W. Va. Code §33-8-6 Loans to officers and directors.*

The Company's general counsel provided the examination team with opinion that WV Code 33-8-6 is not applicable in that the transaction was not a "loan". The annual salary paid during 2019 was the annual salary as budgeted. The only mention of "advance" in the Code section is in context of advancing expenses prior to incurring the expense, i.e., funds above the salary structure. Counsel requested the examination team to provide any authority to support its allegation; none was forthcoming. We continue to assert misapplication of WV Code and are willing to defend our position vigorously.

8) *During 2019 the Company paid $800 a month for a total annual payment of $9,600 to Andrew Jordon Rentals for rent of an apartment that was used by Company's officer. There is no formal employment agreement in place where this type of an expense is agreed to be paid by the Company on the officer's behalf, nor was this disclosed in the 2019 Annual Statement Supplemental Compensation Exhibit as part of the benefits.*

The apartment rental is an economical replacement for travel expense. The officer's residence is two hours from Company offices and prior to 2018 the officer had been reimbursed for lodging at Charleston area hotels with cost varying from $119 - $179/night depending on the season.

9) *The Company was not in compliance with SSAP No. 101 paragraph 7.e. which states that gross DTAs shall be reduced by a statutory valuation allowance adjustment if, based on the weight of available evidence, it is more likely than not that some portion or all of the gross DTAs will not be realized. Based on review of supporting work related to the adjusted gross Deferred Tax Assets ("DTA") as of 12/31/2019, there was no evidence that a valuation allowance analysis was performed by the Company to determine if the Company had sufficient taxable income to realize its DTAs, as required by SSAP 101, paragraph 7.e............*

The Company's external audit firm, Mazars USA LLP, assigns its tax department to review the amount of Deferred Tax Asset prior to issuing its audit opinion. The Company will collaborate with Mazars to assure the appropriate amount is recorded.

10) *Some of the case reserving and actuarial methodologies and factors were found to be deficient to ensure that the Company's loss and loss adjustment expense reserve was adequate. Specifically, examination actuary noted the following findings:*
    a. *The National Association of Insurance Commissioners Accounting Practices and Procedures Manual, SSAP 55, par. 4 states that "Claims, losses, and loss/claim adjustment expenses shall be recognized as expenses when a covered or insured even occurs"..........As of December 31, 2019, the Company did not record any explicit loss adjustment expenses unpaid in financial statements because the reported loss adjustment expense liability was $0.*

Loss and loss adjustment expenses had been minimal, less than $5,000 annually, prior to July 2019, therefore the procedure to reserve for such expenses was not in place. This will be corrected with going forward filings.

b. *The methodologies utilized by the Company to compute their reserves as of December 31, 2019, were reviewed by the Company's independent actuary who concluded that the reserves appeared to be sufficient. The reported reserves represent management's best estimate of the amounts necessary to pay all claims and related expenses that had been incurred but still unpaid as of December 31, 2019. The actuarial methodologies and assumptions utilized by the Company to compute its "Losses" liability as of December 31, 2019, were reviewed by our examination actuary. Our examination actuary determined that the "Losses" liability was inadequate because deficiencies with the Company's methodologies and assumptions utilized to compute the "Losses" liabilities were identified.*

Management continually reviews the facts and circumstances of each principal during the year, including the setting of case reserves if warranted. The minimum case reserve for a particular bond for a particular principal cannot necessarily be tied to a formula; our underwriting is customized to each principal, as is our estimate of reserves. The circumstances contributing to need for establishing reserves can change dramatically in a short period of time, as demonstrated in March 2020 with recognition of coronavirus pandemic, decline of coal necessary for electricity use, shut down of mining and termination of purchase/sale agreements.

c) ....A clear and consistent case reserving methodology being applied was not apparent based on review of the information provided by the Company. Specifically, the following were unclear as they apply broadly to the case reserving procedures and resulted in concerns of overall inadequacies in case reserve levels:

1. Whether loss adjustment expense costs were being explicitly included in selected case reserves.

2. The reasons for management's selected estimates of some case reserve being reduced from the previous year.

3. Whether cash collateral used to reduce liabilities in selecting case reserves was also being permitted for use in covering overdue premiums due (e.g., double dipping).

4. Whether collateral used to reduce liabilities in selecting case reserves was noncash collateral not meeting the criteria of an admissible asset.

5. Whether case reserves were being consistently selected considering on the ground exposure estimates evaluated at pre-determined intervals (e.g., annually) or some other measures.

The minimum case reserve for a particular bond for a particular principal cannot necessarily be tied to a formula; our underwriting is customized to each principal, as is our establishment of reserves.

1) We acknowledge that improvement in LAE reserving will begin.

2) Case reserving is contemporaneous with the Obligor's and market conditions.

3) Releasing collateral for payment of premium is case-by-case for each Obligor's situation.

4) We only consider cash collateral when establishing case reserves.

5) We routinely review and compare Obligor's liabilities with collateral amounts.

11) The National Association of Insurance Commissioners' (NAIC) Accounting Practices and Procedures Manual Statement on Statutory Accounting Principle No. 53 require insurers to establish a liability "Premium Deficiency Reserve" (PDR) when the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, and any future installment premiums on existing policies.

We will develop a PDR analysis for implementation effective at the 2021 year-end.

FIRST SURETY CORPORATION

Here are comments on the Report's *SUMMARY OF EXAMINATION CHANGES,* with excerpts from the report in italics:

SUMMARY OF EXAMINATION CHANGES

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

1. Amount reported on line 15.1 of the Asset page of 2019 filed Annual Statement, "Uncollected Premiums and Agents Balances", was reduced by $37,107 to reflect amount of accounts receivables that have not been collected in 2020, but were considered admissible at December 31, 2019. The Company properly non-admitted these balances on its March 31, 2020, financial statements. This adjustment reduced the Company's surplus, and was recorded directly through "Unassigned Funds" of capital and surplus.

Accepted and completed for December 31, 2020, year-end filing, due August 30, 2021.

2. The Company reported "Losses" and "Loss adjustment expenses" reserves (collectively referred to as "Losses") totaling $3,211,056 and $0, respectively as of December 31, 2019. The actuarial methodologies and assumptions utilized by the Company to compute its "Losses" liability as of December 31, 2019, were reviewed by our examination actuary. Amount of "Losses", reported on line 1 of the Liabilities, Surplus and Other Funds page of the 2019 Annual Statement was increased by $2,488,614 for the following reasons:

> *a. reflect disallowance of subrogation recoverable credit taken in the amount of $1,484,614;*
> *b. the examination actuary determined an upward adjustment to case reserves of $109,000 was reasonably justifiable for findings related to the DFM Coal principal on the Watch List for which more detailed information was available to examiners.*
> *c. the examination actuary recommends an explicit risk margin amount, which results in an additional upward adjustment to total loss and loss adjustment expense reserves of $895,000. The recommendation for an explicit risk margin was based on several factors, including the concerns related to inadequate case reserving procedures, pricing inadequacies, low cash collateral levels, and the magnitude of the difference between the Company's reported reserves relative to the Company's estimates of worst-case scenarios.*

This adjustment reduced the Company's surplus, and was recorded directly through "Unassigned Funds" of capital and surplus.

Accepted (after adjustment for 2020 payments) and completed for December 31, 2020, year-end, due August 30, 2021.

3. Balance of "Unearned Premium", reported on line 9 of the Liabilities, Surplus and Other Funds page of the 2019 Annual Statement was increased by $109,000. This adjustment reduced the Company's surplus, and was recorded directly through "Unassigned Funds" of capital and surplus.

FIRST SURETY CORPORATION

Accepted (adjusted for 2020 -2021 contract; amount shown for 2019 became moot) and completed for the December 31, 2020, year-end filing.

We appreciate the opportunity to respond to the Examination Report and will work diligently to implement improvements.

Sincerely,

Bradley W. Tuckwiller
President