REPORT OF EXAMINATION

OF THE

ZNAT INSURANCE COMPANY

AS OF

DECEMBER 31, 2014

Filed on April 29, 2016

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Los Angeles, California
March 18, 2016

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

ZNAT INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office and the primary location of its books and records, at 21255 Califa Street, Woodland Hills, California 91367.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2012. This examination covered the period from January 1, 2013 through December 31, 2014.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Company.

This examination was conducted concurrently with the examination of the Company's parent, Zenith Insurance Company.

COMPANY HISTORY

The Company's parent, Zenith Insurance Company (ZIC), is a wholly-owned subsidiary of Zenith National Insurance Corp. (ZNIC). On May 20, 2010, Fairfax Financial Holdings Limited (Fairfax), through its affiliates, completed the acquisition of all of the outstanding shares of ZNIC common stock that it did not already own for $38 per share in cash.

Capitalization

As of December 31, 2014, the Company had 25,000 shares of $240 par value common stock authorized, of which 13,000 were issued and outstanding.

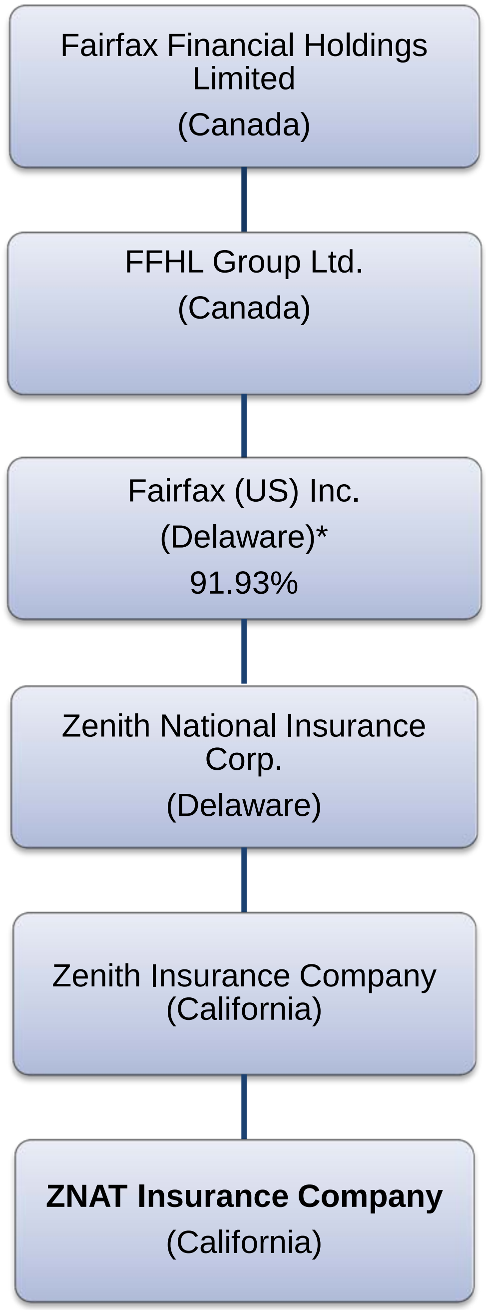
Dividends Paid to Parent

In April 2015, the Company paid an ordinary dividend of $2.7 million to its parent, Zenith Insurance Company.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Zenith Insurance Company (ZIC) which is a wholly-owned subsidiary of Zenith National Insurance Corp. (ZNIC). ZNIC is a wholly-owned indirect subsidiary of Fairfax Financial Holdings Limited (Fairfax), a Canadian financial services holding company, whose common stock is publicly traded on the Toronto Stock Exchange. Fairfax is principally engaged in property and casualty insurance, reinsurance, and associated investment management.

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system (all ownership is 100%):



*Fairfax (US) Inc. owns 91.93% of ZNIC. The balance of the ownership is held by various United States domiciled insurance companies and insurance service providers, all of which are 100% indirectly owned by Fairfax.

Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2014 follows:

Directors

Name and Location	Principal Business Affiliation
Kari L. Van Gundy Chatsworth, California	Chief Executive Officer and President Zenith Insurance Company
Michael E. Jansen Agoura Hills, California	Executive Vice President and General Counsel Zenith Insurance Company
Jack D. Miller Moraga, California	Chairman of the Board Zenith Insurance Company

Principal Officers

Name	Title
Kari L. Van Gundy	Chief Executive Officer and President
William J. Owen	Executive Vice President, Chief Financial Officer, and Treasurer
Michael E. Jansen	Executive Vice President and General Counsel
Jason T. Clarke	Executive Vice President and Chief Actuary
Davidson M. Pattiz	Executive Vice President and Chief Operations Officer

Audit Committee

In June 2014, the audit committee of Zenith National Insurance Corp. (ZNIC) was designated as the audit committee of the Company for purposes of complying with the audit committee requirements of the California Insurance Code Section 900.2 and the California Code of Regulations Section 2309.3. The ZNIC Audit Committee replaced the previously designated Fairfax Audit Committee as the audit committee of the Company. The Company's Audit Committee comprised of: David Bonham, Peter Clarke and Paul Rivett. The Fairfax Audit Committee continues to participate in the oversight of the Company, such that if a material weakness, significant deficiency and/or significant solvency concern is identified at the level of the Company, the Fairfax Audit Committee is to be involved in addressing the issue and overseeing the remediation.

Management Agreements

Administrative Services Agreement – Various U.S. Affiliated Companies: Effective November 1, 2014, the Company and its parent, Zenith Insurance Company (ZIC), entered into an Administrative Services Agreement with various United States domiciled insurance companies and insurance service providers, all of which are 100% directly or indirectly owned by Fairfax. The Agreement was approved by the California Department of Insurance (CDI) on September 26, 2014.

Under the Agreement, the Company and ZIC agree to provide to and accept from the other parties, certain administrative and general services and facilities at cost, subject to the terms of the Agreement. Specifically, one insurance company may provide, among other services, the following services: (a) accounting services; (b) underwriting services; (c) claims services; (d) reinsurance services; (e) actuarial services; (f) telecommunications services and electronic data processing services; (g) legal services; (h) preparation of reports to regulatory agencies and the maintenance of company records; (i) purchase or contracting services and/or access to contracted vendors or services; (j) human resources services, and (k) other administrative services or tasks.

The Agreement is continuously in force subject to renegotiation at least every three years, however, a party may withdraw (and/or terminate an arrangement established pursuant to the agreement) at any time upon giving 60 days prior written notice to the other relevant parties. The Company did not engage in any transactions under this

Agreement in 2014.

This Agreement does not alter or impact an existing Administrative Services and Cost-Sharing Agreement between the Company and ZIC dated January 1, 2008 as amended through December 30, 2013.

Inter-Company Tax Allocation Agreement: The Company is a party to an Inter-Company Tax Allocation Agreement, effective May 21, 2010. The Agreement was approved by the CDI on June 14, 2010.

The Agreement provides for participants to file a consolidated federal income tax return with ZNIC. Allocation of taxes is based upon separate return calculations with inter-company tax balances payable or receivable being settled in amounts equal to the amounts which would be due to or from federal taxing authorities if separate returns were filed.

During 2013 and 2014, the Company incurred federal and foreign income taxes of $16,000 and $311,000, respectively.

Investment Management Agreement: The investment portfolio of the Company is managed by Hamblin Watsa Investment Counsel, Ltd. (HWIC), the investment manager for the Fairfax Group of companies, under an Investment Management Agreement dated May 20, 2010 and approved by the CDI on June 14, 2010. During 2013 and 2014, the Company paid HWIC $159,000 and $177,000, respectively, in fees under the terms of the Agreement.

Administrative Services and Cost Sharing Agreement: ZNIC and its insurance subsidiaries are parties to an Administrative Services and Cost Sharing Agreement dated January 1, 2008 (amended October 9, 2008, December 28, 2009, September 30, 2011, and December 30, 2013). The current Agreement, which includes all of its amendments, was approved by the CDI on December 19, 2013.

Under the terms of the Agreement, costs of shared facilities, services, and expenses incurred by the Company are allocated to each party using actual and reasonable costs. The December 30, 2013 amendment states that the tax support services and information technology support provided by Fairfax and its affiliates are to be included as group expenses, effective January 1, 2014.

During 2013 and 2014, the Company paid ZIC $31.4 million and $4.1 million, respectively. The Administrative Services and Cost Sharing Agreement allocation between the Company and ZIC and the intercompany pooling agreement should be considered in the aggregate.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2014, the Company was licensed to transact multiple lines of property and casualty insurance in the following 24 states:

Alabama	Georgia	Mississippi	North Carolina	Texas
Arizona	Illinois	Missouri	Oklahoma	Utah
Arkansas	Indiana	Nebraska	Pennsylvania	Virginia
California	Iowa	Nevada	South Carolina	West Virginia
Delaware	Kentucky	New Jersey	Tennessee	

In 2014, the Company wrote $121 million of direct premiums. Of these direct premiums, $75 million (62%) were written in California, $12 million (10%) were written in Texas, $11 million (9%) were written in Georgia, $10 million (8%) were written in North Carolina, and $13 million (11%) were written in the remaining states. All direct premiums written were in the workers' compensation line of business.

The Company's business is written through approximately 1,500 independent licensed insurance agents. The Company and its insurance affiliate maintain branch offices in Los Angeles, San Diego, Pleasanton, Roseville, San Francisco, Fresno, and Orange, California. Additionally, the Company maintains branch offices in Austin and Dallas, Texas; East Norriton, Pennsylvania; Springfield and Itasca, Illinois; Sarasota, Orlando and Hollywood, Florida; Charlotte, North Carolina; and Birmingham, Alabama.

REINSURANCE

Intercompany Pooling Agreement

The Company is party to an Amended and Restated Reinsurance and Pooling Agreement with its parent, Zenith Insurance Company (ZIC), effective January 1, 2008. Under this agreement, business is pooled and premiums, losses and expenses are reapportioned and shared by the companies as follows:

Pool Member	Percentage
Zenith Insurance Company	98%
ZNAT Insurance Company	2%

Both parties to the pooling agreement are named participants in all workers' compensation reinsurance agreements with non-affiliated reinsurers and have a contractual right of direct recovery from the non-affiliated reinsurers.

The current agreement, which includes all of its amendments, was approved by the California Department of Insurance (CDI) on February 21, 2008.

Assumed

Under the pooling agreement mentioned above, the Company assumed $14.4 million of written premiums in 2014 and recorded $13.6 million of assumed known case losses and loss adjustment expense reserves as of December 31, 2014. Included in the pooling assumed balances are premiums and losses related to the parent company's commercial property and casualty agriculture business.

Other than the pooling agreement, the Company has no active reinsurance assumed business.

Ceded

The Company maintains excess of loss and catastrophe reinsurance which provides protection up to $100 million for its workers' compensation losses including catastrophe losses arising out of California earthquakes and acts of terrorism excluding nuclear, biological, and chemical attacks. In 2014, the Company retained the first $20 million of each loss. In 2015, the Company retained the first $10 million of each loss arising from industrial accidents only in its California agriculture business. For all other business classes, the Company retained the first $20 million of each loss.

The Company also continues to be a party to various reinsurance treaties with affiliates of Fairfax Financial Holdings Limited that were entered into in the ordinary course of business, primarily consisting of a quota share reinsurance agreement with Odyssey Reinsurance Company (Odyssey) in which the Company ceded 10% of its workers' compensation premiums written from January 1, 2002 through December 31, 2004. Odyssey also participates in the Company's excess of loss reinsurance agreements from 2010 through 2015. At December 31, 2014, the Company recorded total net reinsurance recoverables of $93,000 related to these reinsurance agreements.

The following is a summary of the Company's principal ceded reinsurance treaties in force as of December 31, 2014 covering its workers' compensation business:

Type of Contract	Reinsurer's Name (*)	Company's Retention	Reinsurer's Maximum Limits
1st Excess of Loss	Hannover Ruckversicherung AG (15%) ACE Property & Casualty Insurance Company through ACE Tempest Re USA, LLC (1.5%) Arch Reinsurance Company, Munich Re. America Inc. (7%) Partner Reinsurance Company of the U.S. (5%) Swiss Reinsurance America Corporation (12.5%) Transatlantic Reinsurance Company (7%) Lloyds of London (25%) Aspen Insurance UK Ltd (7.5%) Munich Reinsurance America, Inc. (4.5%) Odyssey Reinsurance Corp. (15%)	$20 Million	$20 Million XS of $20 Million (1)
2nd Excess of Loss	Ace Tempest Reinsurance Ltd. (2%) Hannover Ruckversicherung AG (5%) ACE Property & Casualty Insurance Company (2%) Arch Reinsurance Company, Munich Re. America Inc. (7%) Partner Reinsurance Company of the U.S. (5%) Swiss Reinsurance America Corporation (7.5%) Aspen Insurance UK Ltd.(12.3%) Lloyds of London (34.7%) Transatlantic Reinsurance Company (3.5%) Munich Reinsurance America, Inc. (6%) Odyssey Reinsurance Corp. (15%)	$-0-	$35 Million XS of $40 Million (1)
3rd Excess of Loss	Hannover Re. Ltd. (15%) Arch Reinsurance Company (3.75%) Partner Reinsurance Company of the U.S. (5%) Swiss Reinsurance America Corporation, (17.5%) Aspen Insurance UK Ltd. (9.75%) Lloyds of London (19%) Odyssey Reinsurance Corp. (30%)	$-0-	$25 Million XS of $75 Million (1)

(*) All listed reinsurers are authorized.
(1) Excludes all terrorism and nuclear, biological, and chemical (NBC) coverage.

As of December 31, 2014, reinsurance recoverables (gross of reinsurance payables), for all ceded reinsurance totaled $156.9 million or 583.3% of surplus as regards policyholders. The largest recoverables are from the Company's parent, ZIC ($150.8 million), under the terms of the intercompany pooling agreement.

Commutation of Ceded Reinsurance – 2015 Swiss Re Group

In July 2015, the Company, Zenith Star Insurance Company (previously merged with ZIC), and ZIC (collectively, the companies) entered into a Commutation and Release Agreement (Commutation Agreement) with Swiss Reinsurance America Corporation, Westport Insurance Corporation, and Swiss Re Europe S.A., UK (collectively, Swiss

Re) that fully settled all reinsurance agreements incepting in 2014 and/or prior underwriting years.

The total reserves ceded to Swiss Re at the commutation date were estimated to be $38.7 million. Under the Commutation Agreement, Swiss Re paid the companies, in total, $38.7 million in exchange for a complete discharge of all Swiss Re's obligations/liabilities under the reinsurance agreements. Thus, no gain or loss was recorded since the cash received was equal to the companies' estimate of the amount recoverable from Swiss Re. The Company accounted for this commutation in accordance with the Statements of Statutory Accounting Principles (SSAP) No. 62R. The Company participates in an intercompany pooling agreement and has a 2% share in these transactions.

Retroactive Reinsurance

Pursuant to an Asset Purchase Agreement that was approved by the CDI on March 31, 1998, the Company's parent, ZIC acquired substantially all of the assets and certain liabilities of RISCORP, Inc. (RISCORP) and certain of its subsidiaries related to its workers' compensation business.

In connection with the RISCORP acquisition, ZIC entered into an aggregate excess of loss reinsurance agreement with Inter-Ocean Reinsurance Company, Ltd. (Inter-Ocean) on August 1, 1998, which provided ceded reinsurance for unpaid loss and allocated loss adjustment expenses assumed from RISCORP up to $50 million in excess of $182 million. ZIC paid $16.0 million for the coverage. The agreement has been accounted for as retroactive reinsurance as required under the SSAP No. 62R. The Company participates in an intercompany pooling agreement and has a 2% share in these transactions.

The amount of the expected recoveries in excess of $16.0 million paid under the agreement was recorded as special surplus. At December 31, 2014, this surplus gain was $14.9 million and is being amortized to unassigned funds using the recovery method. Through December 31, 2014, the ZIC has received $26.3 million from Inter-Ocean pursuant to the agreement and $1.9 million was amortized into unassigned funds for the year ended December 31, 2014. The Company participates in an intercompany pooling agreement and has a 2% share in these transactions.

The recoverable balance at year-end 2014 of $91,000 was recorded as “Aggregate Write-ins for Special Surplus Funds.” Total collateral held was $253,000 at year-end 2014.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2014. The accompanying comments to the amounts reported in the annual statements should be considered an integral part of the financial statements. There were no examination adjustments made to surplus as a result of the examination.

Statement of Financial Condition as of December 31, 2014

Underwriting and Investment Exhibit for the Year Ended December 31, 2014

Reconciliation of Surplus as Regards Policyholders from December 31, 2012 through December 31, 2014

Statement of Financial Condition
as of December 31, 2014

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 4,978,604	$	$ 4,978,604	
Cash and short-term investments	61,125,649		61,125,649	
Investment income due and accrued	7,725		7,725	
Premiums and agents' balances in course of collection	283,208	16,340	266,868	
Premiums, agents' balances and installments booked but deferred and not yet due (including $72,198 earned but unbilled premiums)	286,012	7,220	278,792	
Amounts recoverable from reinsurers	5,069		5,069	
Funds held by or deposited with reinsured companies	496		496	
Other amounts recoverable under reinsurance contracts	13		13	
Current federal and foreign income tax recoverable and interest thereon	3,333		3,333	
Net deferred tax asset	1,000,000		1,000,000	
Guaranty funds receivable or on deposit	126,983		126,983	
Aggregate write-ins for other than invested assets	75,037	2,400	72,637	
Total assets	$67,892,129	$25,960	$67,866,169	

Liabilities, Surplus and Other Funds			
Losses and loss adjustment expenses		$23,120,562	(1)
Reinsurance payable on paid loss and loss adjustment expenses		638	
Commissions payable, contingent commissions and other similar charges		142,910	
Other expenses		270,692	
Taxes, licenses and fees		317,874	
Unearned premiums		1,447,245	
Advance premiums		73,027	
Ceded reinsurance premiums payable		35,220	
Amounts withheld or retained by company for account of others		71,844	
Payable to parent, subsidiaries and affiliates		15,423,798	
Aggregate write-ins for liabilities		57,675	
Total liabilities		40,961,485	
Aggregate write-ins for special surplus funds	$ 91,106		
Common capital stock	3,120,000		
Gross paid-in and contributed surplus	1,175,000		
Unassigned funds (surplus)	22,518,578		
Surplus as regards policyholders		26,904,684	
Total liabilities, surplus and other funds		$67,866,169	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2014

Statement of Income

Underwriting Income		
Premiums earned		$14,286,099
Deductions:		
Losses and loss expenses incurred	$7,542,806	
Other underwriting expenses incurred	4,711,642	
Total underwriting deductions		12,254,448
Net underwriting gain		2,031,651
Investment Income		
Net investment income earned	$ 191,839	
Net realized capital gains	21,484	
Net investment gain		213,323
Other Income		
Net loss from agents' or premium balances charged off (amount recovered $24,211 amount charged off $40,637)	$ (16,426)	
Total other income		(16,426)
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		2,228,548
Dividends to policyholders		115,079
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		2,113,469
Federal and foreign income taxes incurred		310,707
Net income		$ 1,802,762

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2013		$25,489,409
Net income	$1,802,762	
Change in net deferred income tax	(337,000)	
Change in nonadmitted assets	(12,299)	
Aggregate write-ins for losses in surplus	(38,188)	
Change in surplus as regards policyholders for the year		1,415,275
Surplus as regards policyholders, December 31, 2014		$26,904,684

Reconciliation of Surplus as Regards Policyholders from December 31, 2012 through December 31, 2014

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2012 per Examination			$ 24,950,161
Net income	$ 2,495,818	$	
Change in net deferred income tax		488,400	
Change in nonadmitted assets		14,707	
Aggregate write-ins for losses in surplus		38,188	
Total gains and losses	$ 2,495,818	$ 541,295	
Net increase in surplus as regards policyholders			1,954,523
Surplus as regards policyholders, December 31, 2014, per Examination			$ 26,904,684

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2014 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

None.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

__/S/__________________________

Richard M. Stone, CFE
Examiner-In-Charge
Contract Insurance Examiner
Department of Insurance
State of California

__/S/__________________________

Aram Shahenian, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California