REPORT OF EXAMINATION
OF THE

AMERICAN CONTRACTORS
INDEMNITY COMPANY

AS OF
DECEMBER 31, 2008

Participating State
and Zone:

California

Filed June 1, 2010

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Los Angeles, California
March 12, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

AMERICAN CONTRACTORS INDEMNITY COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 601 South Figueroa Street, 16th Floor, Los Angeles, California 90017.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2008. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2008, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

On February 20, 2009, the California Department of Insurance approved the Company's acquisition of 100% of the common stock of Surety Company of the Pacific (SCP). Effective March 1, 2009, the Company completed the transaction and SCP was merged into the Company.

The SCP transaction was recorded using the statutory merger method. As a result, the Company's 2009 Annual Statement restated prior year amounts as if the merger had occurred as of January 1, 2008.

COMPANY HISTORY

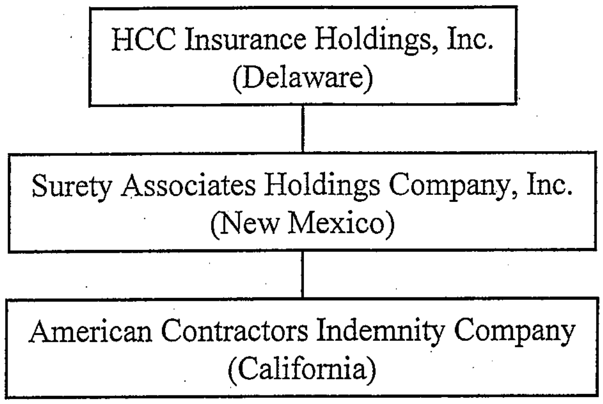
The Company has 100,000 shares of $70 par value common stock authorized and 30,000 shares issued and outstanding.

During the examination period, the Company paid ordinary dividends to its parent, Surety Associates Holding Company, Inc., as shown in the following schedule:

Year	Amount
2006	$ 3,000,000
2007	9,600,000
2008	15,000,000
Total	$27,600,000

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent and its ultimate parent, depicts the Company's relationship within the holding company system:



Management of the Company is vested in a four-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2008 follows:

Directors

Name and Residence	Principal Business Affiliation
Jerome F. Cruitt (*) Houston, Texas	Senior Vice President, Treasurer, and Chief Financial Officer American Contractors Indemnity Company
Edward H. Ellis, Jr. (**) Spring, Texas	Executive Vice President and Chief Financial Officer HCC Insurance Holdings, Inc.
Adam S. Pessin Encino, California	President and Chief Executive Officer American Contractors Indemnity Company

Name and Residence	Principal Business Affiliation
Randy D. Rinicella Houston, Texas	Executive Vice President and General Counsel HCC Insurance Holdings, Inc.

Principal Officers

Name	Title
Adam S. Pessin	President and Chief Executive Officer
Jeannie J. Kim	Vice President, Secretary, and Chief Compliance Officer
Jerome F. Cruitt (*)	Senior Vice President, Treasurer and Chief Financial Officer

(*) resigned January 1, 2010, replaced by Peter W. Carman
(**) resigned September 9, 2009, replaced by William T. Whamond

Management Agreements

Intercompany Service and Cost Allocation Agreement: The Company and its affiliates entered into an Intercompany Service and Cost Allocation Agreement with HCC Service Company, Ltd. (HCCSC) a wholly-owned subsidiary of HCC Insurance Holding, Inc., effective January 31, 2004. Under the terms of the agreement, HCCSC provides personnel and administrative services. All costs incurred by HCCSC are allocated to members of the group, on actual costs incurred plus ten percent for administrative and overhead costs. In 2008, 2007 and 2006 the Company paid $2.7 million, $2.2 million and $1.6 million, respectively, in fees to HCCSC. The agreement was approved by the California Department of Insurance (CDI) on March 19, 2004.

Tax Allocation Agreement: HCC Insurance Holdings, Inc. (HCC) and its subsidiaries and affiliates, including the Company, entered into a Tax Allocation Agreement, effective January 31, 2004. Under the terms of the agreement, HCC files consolidated federal income tax returns and pays estimated consolidated federal income taxes due. Each member pays HCC its estimated separate federal income tax liability. The intercompany tax balance is settled within 120 days subsequent to the filing of the consolidated return. The agreement was approved by the CDI on April 30, 2004.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to transact surety insurance which consisted of contract bonds, bail bonds, court and commercial bonds, license and permit bonds, and custom bonds. Business is written in the District of Columbia, Guam, Northern Mariana Islands, and all states except Massachusetts, New Hampshire, North Carolina, and Vermont.

In 2008, the Company wrote $87.4 million of direct premiums. Of the direct premiums written, $50.5 million, or 57.8%, was written in California, $5.2 million, or 6.0%, in Washington, $3.1 million, or 3.5%, in Oregon and $28.6 million, or 32.7%, was written in the remaining states.

The business is produced through approximately 4,700 agents and brokers.

REINSURANCE

Assumed

The Company cancelled its quota share assumed reinsurance treaties with Suretec Insurance Company, an affiliate, and Minnesota Surety and Trust Company as of April 1, 2007 and February 1, 2008, respectively. There were immaterial assumed reinsurance premiums of $40,000 reported as of December 31, 2008 from this run-off business.

Ceded

The following is a summary of the principal ceded reinsurance treaties as of December 31, 2008:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Aggregate Limits
XOL Surety per Principal 1st Excess of Loss	Hannover Rueckversicherungs – 50% Odyssey America Re Corp – 10% R+V Versicherung A.G. – 40%	$2 million per principal/group limit	$5 million per principal/group limit ($15 million in aggregate)
XOL Surety per Principal 2nd Excess of Loss	Hannover Rueckversicherungs – 50% Odyssey America Re Corp – 20% R+V Versicherung A.G. – 30%	$7 million per principal/group limit	$8 million per principal/group limit ($24 million in aggregate)
XOL Surety per Principal 3rd Excess of Loss	Hannover Rueckversicherungs – 50% Odyssey America Re Corp – 20% R+V Versicherung A.G. – 30%	$15 million per principal/group limit	$10 million per principal/group limit ($20 million in aggregate)

The above contracts were effective May 1, 2008 and were placed through Benfield reinsurance brokers, a licensed intermediary.

The Company also participates in the Surety Bond Guaranty Program, which is administered by the U. S. Small Business Administration (SBA). The SBA can guarantee bonds for contracts up to $2 million, covering bid, performance and payment bonds for small and emerging contractors who cannot obtain surety bonds through regular commercial channels. The SBA guarantees, 90 percent of the losses incurred on bonds up to $100,000 to socially and economically disadvantaged contractors, and 80 percent on other bonds written under this program.

The SBA program is governed by the Code of Federal Regulation – Title 13. The total reinsurance recoverable from the SBA program for paid and unpaid losses was approximately $5.5 million as of December 31, 2008.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2008

Underwriting and Investment Exhibit for the Year Ended December 31, 2008

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2008

Reconciliation of Examination Changes as of December 31, 2008

Statement of Financial Condition
as of December 31, 2008

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 212,380,849	$	$ 212,380,849	
Mortgage loans on real estate: First liens	52,639		52,639	
Cash and short-term investments	15,813,762		15,813,762	
Investment income due and accrued	1,969,718		1,969,718	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	10,247,407	4,981,208	5,266,199	
Amounts recoverable from reinsurers	2,823,452		2,823,452	
Federal income tax recoverable	1,782,488		1,782,488	
Net deferred tax asset	5,717,848	545,510	5,172,338	
Electronic data processing equipment	117,793	6,313	111,480	
Furniture and equipment	149,683	149,683		
Aggregate write-ins for other than invested assets	206,636	206,636		
Total assets	$ 251,262,275	$ 5,889,350	$ 245,372,925	
Liabilities, Surplus and Other Funds				
Losses			$ 30,486,871	(1)
Loss adjustment expenses			3,958,838	(1)
Commissions payable			(35,815)	
Other expenses			2,597,137	
Taxes, licenses and fees			212,216	
Unearned premiums			44,303,812	
Advance premium			1,270,213	
Ceded reinsurance premiums payable			66,669	
Amounts withheld or retained by company for account of others			99,357,679	
Provision for reinsurance			29,688	
Payable to parents subsidiaries and affiliates			1,632,812	
Total liabilities			183,880,120	
Common capital stock		$ 2,100,000		
Gross paid-in and contributed surplus		21,008,227		
Unassigned funds (surplus)		38,384,577		
Surplus as regards policyholders			61,492,804	
Total liabilities, surplus and other funds			$ 245,372,925	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2008

Statement of Income

Underwriting Income		
Premiums earned		$ 87,418,917
Deductions:		
Losses incurred	$ 19,163,974	
Loss expense incurred	7,838,179	
Other underwriting expenses incurred	47,589,542	
Total underwriting deductions		74,591,695
Net underwriting gain		12,827,222
Investment Income		
Net investment income earned	$ 8,244,860	
Net realized capital gains	275,048	
Net investment gain		8,519,908
Other Income		
Net loss from agents' balances charged off	$ (1,050,958)	
Finance and service charges not included in premiums	56,310,315	
Aggregate write-ins for miscellaneous fees	(56,191,810)	
Total other income		(932,453)
Net income before federal income taxes		20,414,677
Federal income taxes incurred		8,068,830
Net income		$ 12,345,847

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		$ 63,397,104
Net income	$ 12,345,847	
Change in deferred income taxes	(586,238)	
Change in nonadmitted assets	1,238,230	
Change in provision for reinsurance	(21,518)	
Surplus: Paid in	119,379	
Dividend to stockholders	(15,000,000)	
Change in surplus as regards policyholders		(1,904,300)
Surplus as regards policyholders, December 31, 2008		$ 61,492,804

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2008

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2005, per Examination			$ 43,196,217
Net income	$ 43,924,220	$	
Change in net deferred income tax	339,845		
Change in nonadmitted assets	1,515,198		
Change in provision for reinsurance		2,055	
Surplus paid-in	119,379		
Dividend to stockholders		27,600,000	
Totals	$ 45,898,642	$ 27,602,055	
Net increase in surplus as regards policyholders for the examination			18,296,587
Surplus as regards policyholders, December 31, 2008, per Examination			$ 61,492,804

Reconciliation of Examination Changes
as of December 31, 2008

	Per Company	Per Examination	Surplus Increase (Decrease)	Notes
Liabilities				
Losses	$24,726,871	$30,486,871	$ 5,760,000	(1)
Loss adjustment expenses	3,608,838	3,958,838	350,000	(1)
Net decrease to surplus as regards policyholders			(6,110,000)	
Surplus as Regards Policyholders, December 31, 2008 per Company			67,602,804	
Surplus as Regards Policyholders, December 31, 2008 per Examination			$61,492,804	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company's loss and loss adjustment expense reserves were reviewed by a Casualty Actuary from the California Department of Insurance. The Company's reserves for loss and loss adjustment expense were determined to be deficient by $6.1 million, based on an eight-month development, through August 31, 2009, of the year-end 2008 reserves by the Company.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Accounts and Records - Unclaimed Property (Page 8): It was recommended that the Company establish written escheatment procedures and file all unclaimed property with the State Controller's Office. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

______/S/__________________

Sam Sohrab, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California