REPORT OF EXAMINATION
OF THE
ZENITH 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

ZENITH 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 subsidiary, ZNAT Insurance Company.

COMPANY HISTORY

The Company 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 has 20,000 shares of $210 par value common stock authorized, issued, and outstanding. The Company also had 20,000 shares of $5 par value preferred stock authorized of which none are issued or outstanding.

Capital Contributions

In June 2013, the Company's immediate parent, ZNIC, made a cash capital contribution to the Company of $10 million.

Dividends Paid to Parent

The Company paid ordinary dividends to ZNIC of $50 million in August 2014. During 2015, the Company paid ordinary dividends in March and September of $10 million and $50 million, respectively.

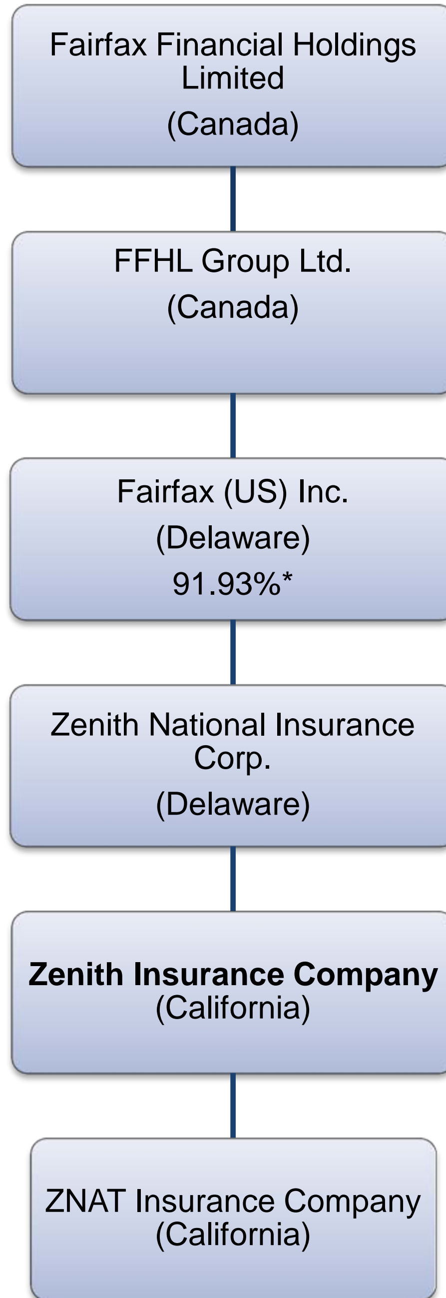
Dividends Received from Subsidiary

In April 2015, the Company's subsidiary, ZNAT Insurance Company, paid an ordinary dividend of $2.7 million to the Company.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Zenith National Insurance Corp. (ZNIC) which 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 (except as otherwise noted, 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

Claims Administration Agreement – Riverstone: The Company entered into a Claims Administration Agreement, effective March 1, 2013, with TIG Insurance Company, Fairmont Insurance Company, Fairmont Specialty Insurance Company, and Fairmont Premier Insurance Company (RiverStone). The Agreement was approved by the California Department of Insurance (CDI) on February 27, 2013.

All of the companies that are party to this Agreement are indirect wholly-owned subsidiaries of Fairfax. Under the terms of the agreement, the Company administers primarily the RiverStone's workers' compensation claims. The Company also maintained a loss fund as of year-end 2014 of $1.9 million to process future workers' compensation claim payments under this Agreement.

The Company received $3.2 million and $6.4 million in service fees under the terms of the Agreement for 2013 and 2014, respectively, which were fully offset by costs of dedicated staff and allocated shared services.

Effective January 1, 2015, this Agreement was amended to reflect a change in the service fee to be paid to the Company as compensation for its services. The service fee is now comprised of the costs incurred by the Company to perform the services plus a pre-tax profit margin of 20% to the Company. The amendment was approved by the CDI on December 22, 2014.

Administrative Services Agreement – Various U.S. Affiliated Companies: Effective November 1, 2014, the Company and its wholly-owned subsidiary, ZNAT Insurance Company (ZNAT), 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 CDI on September 26, 2014.

Under the Agreement, the Company and ZNAT 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 the existing Administrative Services and Cost-Sharing Agreement between the Company and ZNAT dated January 1, 2008 as amended through December 30, 2013.

Administrative Services Agreement – United States Fire Insurance Company: Effective March 10, 2014, the Company entered into an Administrative Service Agreement with United States Fire Insurance Company (U.S. Fire), an indirect subsidiary of Fairfax. The Agreement was approved by the CDI on February 5, 2014.

Under the terms of the Agreement, each party may, from time to time, perform certain administrative and general services such as assistance with accounting, internal audit, tax calculations, preparation of regulatory reports and actuarial analysis on behalf of the other party, subject to conditions set out in the agreement.

Although this Agreement has a continuous term, it is subject to renegotiation at least every three years and may be terminated by either party by giving 60 days prior written notice to the other party.

The Company did not engage in any transactions under this Agreement with U.S. Fire in 2014.

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 $119,000 and $16.8 million, 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 $4.5 million and $4.9 million, 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, the Company received $31.4 million from ZNAT and paid ZNIC and Fairfax (US) Inc. $0.8 million and $0.1 million, respectively. During 2014, the Company received $4.1 million from ZNAT and paid ZNIC and Fairfax (US) Inc. $1.0 million and $0.1 million, respectively. The Administrative Services and Cost Sharing Agreement allocation between the Company and ZNAT and the intercompany pooling agreement should be considered in the aggregate.

Related Party Transactions

On August 8, 2014, the Company loaned $22.0 million to ZNIC in exchange for a promissory note due August 7, 2015 at an interest rate of 5% per annum. On August 26, 2014, the outstanding principal of $22.0 million was repaid plus interest of $54,247.

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 District of Columbia and the following 48 states:

Alabama	Hawaii	Massachusetts	New Mexico	Tennessee
Alaska	Idaho	Michigan	New York	Texas
Arizona	Illinois	Minnesota	North Carolina	Utah
Arkansas	Indiana	Mississippi	Ohio	Vermont
California	Iowa	Missouri	Oklahoma	Virginia
Colorado	Kansas	Montana	Oregon	Washington
Connecticut	Kentucky	Nebraska	Pennsylvania	West Virginia
Delaware	Louisiana	Nevada	Rhode Island	Wisconsin
Florida	Maine	New Hampshire	South Carolina	
Georgia	Maryland	New Jersey	South Dakota	

In 2014, the Company wrote $602 million of direct premiums. Of these direct premiums, $365 million (61%) were written in California, $133 million (22%) were written in Florida, $19 million (3%) were written in Pennsylvania, and $85 million (14%) were written in the remaining states.

The Company wrote $559 million or 93% of its direct premiums in the workers' compensation line of business with the remaining business in other property and casualty lines from its agribusiness operations.

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 insurance subsidiary, ZNAT Insurance Company, 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

In 2005, the Company exited the assumed reinsurance business and ceased writing and renewing assumed reinsurance contracts. All contracts fully expired at the end of 2006.

As of year-end 2014, the Company's assumed business consisted of the intercompany pooling agreement, certain voluntary and mandatory pools, and the runoff of the expired assumed reinsurance business.

The following schedule reflects assumed premiums written and known case losses and loss adjustment expense reserves reported by the Company as of December 31, 2014 (000's omitted):

Description	Assumed Premiums	Known Case Losses and LAE Reserves
Intercompany Pooling – ZNAT Insurance Company	$ 119,732	$ 92,163
Voluntary and Mandatory Pools	7,271	9,438
Runoff of Expired Assumed Business	0	5,169
Totals - Assumed	$ 127,003	$ 106,770

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 net reinsurance recoverables of $6.1 million 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 and property and casualty agriculture business:

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

Property and Casualty – Agriculture Business

The following is a summary of the principal ceded property and casualty reinsurance treaties in force as of December 31, 2014, covering the Company's property and casualty agriculture business:

Type of Contract	Reinsurer's Name (*)	Company's Retention	Reinsurer's Maximum Limits
1st Per Risk Excess of Loss	Hannover Ruckversicherung AG (25%) Arch Reinsurance Company (15%) Lloyds of London Syndicate #2001 (22.5%) Lloyds of London Syndicate #2014 (5%) Lloyds of London Syndicate #2987 (22.5%) Odyssey Reinsurance Corp (10%)	$3.5 Million	$6.5 Million XS of $3.5 Million
2nd Per Risk Excess of Loss	Hannover Ruckversicherung AG (25%) Arch Reinsurance Company (20%) Lloyds of London Syndicate #2001 (20%) Lloyds of London Syndicate #2014 (5%) Lloyds of London Syndicate #2987 (20%) Odyssey Reinsurance Corp (10%)	$-0-	$5 Million XS of $10 Million
Property Automatic Facultative	Arch Reinsurance Company	$15 Million	$20 Million XS of $15 Million (PC1-8) $15 Million XS of $15 Million (PC 9-10)
Property Automatic Facultative	Gen Reinsurance Corporation		Individual Policy Placement
Property Catastrophe	Hannover Ruckversicherung AG (25%) Lloyds of London Syndicate #2001 (25%) Lloyds of London Syndicate #2014 (15%) Lloyds of London Syndicate #2987 (25%) Odyssey Reinsurance Corp (10%)	$5 Million	$5 Million XS of $5 Million
Casualty Umbrella/Excess Liability Quota Share	Gen Reinsurance Corporation	$1 Million	10% of First $1 Million; 5% for Layers above $1 Million to $10 Million

(*) All listed reinsurers are authorized.

As of December 31, 2014, reinsurance recoverables (gross of reinsurance payables), for all ceded reinsurance (workers' compensation and property and casualty business) totaled $155.4 million or 27.5% of surplus as regards policyholders. The largest

recoverables are from General Reinsurance Corporation ($62.3 million) and Westport Insurance Corporation (part of the Swiss Re Group) ($45.8 million). Of the total reinsurance recoverables, $28.5 million (or 18.4%) was from affiliates. Recoverables from authorized reinsurers was $154.7 million or 99.5% of the total reinsurance recoverables.

Commutation of Ceded Reinsurance – 2015 Swiss Re Group

In July 2015, the Company, Zenith Star Insurance Company (previously merged with the Company), and ZNAT Insurance Company (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.

Retroactive Reinsurance

Pursuant to an Asset Purchase Agreement that was approved by the CDI on March 31, 1998, the Company 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, the Company 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. The Company paid $16.0 million for the coverage. The Agreement has been accounted for as retroactive reinsurance as required under SSAP No. 62R.

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 Company 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 98% share in these transactions.

The recoverable balance at year-end 2014 of $4.5 million was recorded as “Aggregate Write-ins for Special Surplus Funds.” Total collateral held was $12.4 million 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	$ 733,489,773	$	$ 773,489,773	
Preferred stocks	20,250,005		20,250,005	
Common stocks	411,245,726		411,245,726	
Mortgage loans on real estate	29,675,000		29,675,000	
Real estate	19,654,890		19,654,890	
Cash and short-term investments	383,708,805		383,708,805	
Derivatives	34,001,698		34,001,698	(1)
Other invested assets	70,337,905		70,337,905	
Receivable for securities	1,440,191		1,440,191	
Investment income due and accrued	8,864,261		8,864,261	
Premiums and agents' balances in course of collection	13,877,180	802,579	13,074,601	
Premiums, agents' balances and installments booked but deferred and not yet due (including $3,537,701 earned but unbilled premiums)	14,014,602	353,770	13,660,832	
Amounts recoverable from reinsurers	248,357		248,357	
Funds held by or deposited with reinsured companies	24,292		24,292	
Other amounts recoverable under reinsurance contracts	653		653	
Current federal and foreign income tax recoverable and interest thereon	4,320,766		4,320,766	
Net deferred tax asset	62,778,000		62,778,000	
Guaranty funds receivable or on deposit	6,222,171		6,222,171	
Electronic data processing equipment and software	3,467,059	2,008,916	1,458,143	
Furniture and equipment, including health care delivery assets	1,895,952	1,895,952	0	
Receivables from parent, subsidiaries and affiliates	13,767,779		13,767,779	
Aggregate write-ins for other than invested assets	11,911,830	6,040,955	5,870,875	
Total assets	$1,845,196,895	$ 11,102,172	$1,834,094,723	

Liabilities, Surplus and Other Funds			Notes
Losses and loss adjustment expenses		$1,132,907,558	(2)
Reinsurance payable on paid loss and loss adjustment expenses		31,264	
Commissions payable, contingent commissions and other similar charges		7,002,566	
Other expenses		13,263,915	
Taxes, licenses and fees		15,575,848	
Unearned premiums		70,915,019	
Advance premiums		3,578,306	
Ceded reinsurance premiums payable		1,725,760	
Funds held by company under reinsurance treaties		10,594	
Amounts withheld or retained by company for account of others		3,891,496	
Provision for reinsurance		793,888	
Derivatives		7,953,327	(1)
Payable for securities		1,746,039	
Aggregate write-ins for liabilities		10,164,381	
Total liabilities		1,269,559,961	
Aggregate write-ins for special surplus funds	$ 4,464,202		
Common capital stock	4,200,000		
Gross paid-in and contributed surplus	318,910,645		
Unassigned funds (surplus)	236,959,915		
Surplus as regards policyholders		564,534,762	
Total liabilities, surplus and other funds		$1,834,094,723	

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

Statement of Income

Underwriting Income		
Premiums earned		$700,018,870
Deductions:		
Losses and loss expenses incurred	$369,597,513	
Other underwriting expenses incurred	230,870,427	
Total underwriting deductions		600,467,940
Net underwriting gain		99,550,930
Investment Income		
Net investment income earned	$ 21,415,225	
Net realized capital gains	4,084,214	
Net investment gain		25,499,439
Other Income		
Net loss from agents' or premium balances charged off (amount recovered $1,186,341 amount charged off $1,991,202)	$ (804,861)	
Finance and service charges not included in premiums	64,347	
Aggregate write-ins for miscellaneous income	83,458	
Total other income		(657,056)
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		124,393,313
Dividends to policyholders		5,638,857
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		118,754,456
Federal and foreign income taxes incurred		8,030,142
Net income		$110,724,314

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2013		$515,787,760
Net income	$110,724,314	
Change in net unrealized capital gains or (losses), net of tax	(2,653,667)	
Change in net unrealized foreign exchange capital gain (loss)	(1,506,675)	
Change in net deferred income tax	(20,956,350)	
Change in nonadmitted assets	14,969,290	
Change in provision for reinsurance	41,329	
Surplus adjustments: Paid-in	1,172,537	
Dividends to stockholders	(50,000,000)	
Aggregate write-ins for gains and losses in surplus	(3,043,776)	
Change in surplus as regards policyholders for the year		48,747,002
Surplus as regards policyholders, December 31, 2014		$564,534,762

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			$ 443,709,348
Net income	$ 92,651,490	$	
Net unrealized capital gains	28,076,561		
Change in net foreign exchange capital losses		3,836,774	
Change in net deferred income tax		16,149,350	
Change in nonadmitted assets	61,783,664		
Change in provision for reinsurance	169,884		
Surplus adjustments: Paid-in	11,172,537		
Dividends to stockholders		50,000,000	
Aggregate write-ins for losses in surplus		3,042,598	
Total gains and losses	$ 193,854,136	$ 73,028,722	
Net increase in surplus as regards policyholders			120,825,414
Surplus as regards policyholders, December 31, 2014, per Examination			$ 564,534,762

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Derivatives

The following table summarizes the book/fair value of the Company's derivative contracts as of December 31, 2014 (in thousands):

Type of Contract	Fair Value of Derivative Assets	Fair Value of Derivative Liabilities
CPI-linked Derivatives	$ 19,944	
Total Return Swaps	445	$ 7,953
Foreign Exchange Forwards	13,379	
Equity Rights/Warrants	234	
Totals	$ 34,002	$ 7,953

The Company entered into an investment management agreement in May 2010 with its affiliate, Hamblin Watsa Investment Counsel (HWIC). Since then, the Company's investments have reflected the investment philosophy of HWIC as agreed to by the Company. HWIC follows a strategy based on the philosophy of long-term value investing and the Company's current portfolio focuses on long positions relating to U.S. Government securities, municipal bonds, cash, equities, and limited partnerships. The Company's current strategy also includes the use of the above-mentioned derivatives to hedge against its exposure to investment risks.

Derivative contracts entered into by the Company are considered economic hedges and are not designated as accounting hedges. The fair value of derivative contracts in a gain position is presented as a derivative asset on the balance sheet. The fair value of derivative contracts in a loss position is presented as a derivative liability on the balance sheet.

The Company purchases foreign exchange forward contracts (foreign exchange forwards) and derivative contracts referenced to the consumer price index in the United

States and Europe (CPI-linked derivatives) to protect the value of its investment portfolio against foreign currency fluctuations as well as the risk of deflation.

In addition, the Company purchases equity index total return swap derivative contracts (total return swaps) to protect a portion of the value of its equity and equity-linked investments against a major market downturn by way of short positions in the Russell 2000 Index. The Company's economic equity hedges are structured to provide a return which is inverse to changes in the fair values of the Russell 2000 Index. Accordingly, the Company's total return swaps derive their value primarily from changes in the fair value of the underlying Russell 2000 Index equity fund that is traded on the U.S. Stock Exchange. These swaps require no initial net cash investment and the fair value at inception is zero.

These total return swaps contain quarterly reset provisions requiring counterparties to settle in cash any fair value movements arising subsequent to the prior settlement date. On the contractual settlement dates, the Company is also required to pay dividends declared on the underlying equity index and is entitled to receive, or is required to pay, income on the notional amount at a stated interest rate. From 2011 through 2015 the Company has incurred $35.8 million of dividend and interest expense on its total return swaps, which was recorded as a reduction to investment income.

Settlements of the derivative contracts are recorded as net realized capital gains (losses) in the Statement of Income. Changes in fair value of the derivative contracts are recorded in the change in unrealized capital gains (losses) in unassigned surplus in the Statement of Income.

The following is a summary of the last five years net capital gains (losses) in surplus as a result of the Company's derivative investment activities (in thousands):

Type of Derivative	Net Capital Gains (Losses) in Surplus Year Ended December 31, 2011	2012	2013	2014	2015	Totals
Total Return Swaps	$ 9,685	$ (26,198)	$ (121,539)	$ (14,819)	$ 26,454	$ (126,417)
Foreign Exchange Forwards	2,556	(419)	(4,551)	25,116	16,491	39,193
CPI-linked Derivatives	(915)	(10,994)	(8,736)	1,025	1,189	(18,431)
Equity Rights/Warrants			520	2,316	28	2,864
Totals	$ 11,326	$ (37,611)	$ (134,306)	$ 13,638	$ 44,162	$ (102,791)

Total capital losses for the five-year period were $102.8 million with total return swaps generating most of the losses ($126.4 million). Although the past five-years results for the total return swaps (and all derivative transactions) have had a significant negative impact on surplus, the Company and its investment manager, HWIC, continue to believe that equity prices generally and significantly exceed their currently sustainable values and are willing to endure the cost of hedging in order to protect the Company against its exposure to a major market downturn as well as other investment risks.

(2) <u>Losses and Loss Adjustment Expenses</u>

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

Comments on Financial Statement Items – Vehicle Fraud Assessment (Page 24): It was recommended that the Company accurately count insured vehicles in accordance with the California Insurance Code and the California Code of Regulations. The Company has complied with the recommendation.

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/__________________________

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