

REPORT OF EXAMINATION
OF THE
SURETEC INDEMNITY COMPANY
AS OF
DECEMBER 31, 2015

Filed on May 31, 2017

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION	1
COMPANY HISTORY:	2
Capitalization	2
MANAGEMENT AND CONTROL:.....	3
Management Agreements.....	4
TERRITORY AND PLAN OF OPERATION.....	6
REINSURANCE:	6
Quota Share Reinsurance Agreement – SureTec Insurance Company.....	6
Quota Share Reinsurance Agreement – Surety International SPC.....	7
Assumed.....	8
Ceded	8
ACCOUNTS AND RECORDS:.....	8
Information Systems Controls.....	8
FINANCIAL STATEMENTS:	9
Statement of Financial Condition as of December 31, 2015	10
Underwriting and Investment Exhibit for the Year Ended December 31, 2015	11
Reconciliation of Surplus as Regards Policyholders from February 13, 2013 through December 31, 2015.....	12
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	13
Losses and Loss Adjustment Expenses	13
SUBSEQUENT EVENTS	13
SUMMARY OF COMMENTS AND RECOMMENDATIONS:	13
Current Report of Examination	13
Previous Report of Examination	13
ACKNOWLEDGMENT	14

Los Angeles, California
May 22, 2017

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

SURETEC INDEMNITY COMPANY

(hereinafter also referred to as the Company) at its home office located at 1330 Post Oak Boulevard, Suite 1100, Houston, Texas 77056.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous qualifying examination of the Company was as of February 12, 2013. This examination covered the period from February 13, 2013 through December 31, 2015. 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, SureTec Insurance Company, by the Texas Department of Insurance, with the state of Texas serving as the lead state.

COMPANY HISTORY

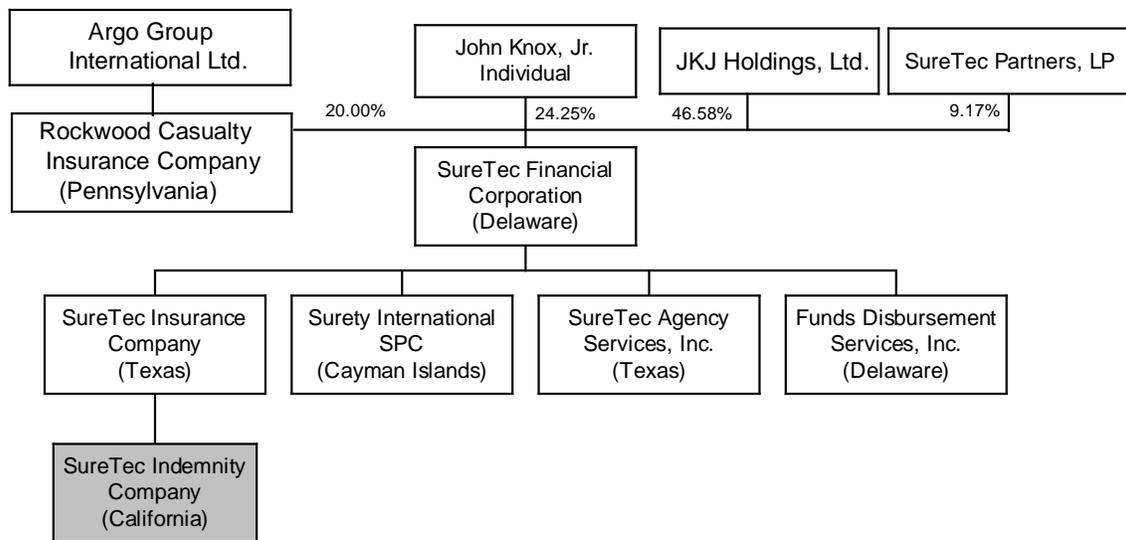
The Company was organized and capitalized in January 2012 with \$10 million capital investment from its immediate parent, SureTec Insurance Company (SIC), a Texas domiciled insurance company. On March 26, 2013, the Company received the Certificate of Authority from the California Department of Insurance, and commenced transacting business in April 2013. The Company is a wholly-owned subsidiary of SIC, and SIC is a wholly-owned subsidiary of SureTec Financial Corporation, a Delaware corporation. SureTec Financial Corporation is controlled by John Knox, Jr., the ultimate controlling person, through his ownership as an individual and his 67% ownership of JKJ Holdings, Ltd.

Capitalization

The Company is authorized to issue 100,000 shares of common stock with a par value of \$125 per share. As of December 31, 2015, there were 20,000 shares outstanding.

MANAGEMENT AND CONTROL

The Company is a member of a holding company system of which Mr. John Knox, Jr. is the ultimate controlling person. Following is an abridged organizational chart that depicts the interrelationship of the companies as of December 31, 2015: (All ownership is 100% unless otherwise noted)



The four 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, 2015:

Directors

Name and Location

Principal Business Affiliation

William J. Carr
Houston, Texas

President
Safire Solutions, LLC

Name and Location

Principal Business Affiliation

Robert E. Holloway
Houston, Texas

Senior Vice President
USI Insurance Services, Inc.

John T. Knox, Jr.
Houston, Texas

Chair, President, and Chief Executive
Officer
SureTec Financial Corporation

Hamendra P. Ojha
Houston, Texas

Managing Director
Callahan Advisors, LLC

Principal Officers

Name

Title

John T. Knox, Jr.
Michael C. Keimig
Steven D. Nelson
David A. Wisnoski
Ronald H. Ballard
Mary K. Weldon
Matthew B. Beaty

President and Chief Executive Officer
Executive Vice President
Executive Vice President
Chief Financial Officer and Treasurer
Vice President
Vice President
Secretary

Management Agreements

Tax Allocation Agreement: Effective April 1, 2013, the Company entered into a Tax Allocation Agreement with its indirect parent, SureTec Financial Corporation (SFC), its immediate parent, SureTec Insurance Company (SIC), and other non-insurance affiliates. Under the terms of the Agreement, the allocation of the consolidated tax liability shall be calculated based upon the ratio of each company's separate taxable income to the whole, not to exceed the tax liability as if each company filed on a separate company basis. The Agreement was approved by the California Department of Insurance (CDI) on May 7, 2013. For the years 2013, 2014, and 2015, federal income taxes paid by the Company totaled (\$96,000), \$738,600, and \$436,817, respectively.

Facilities and Services Agreement: Effective April 1, 2013, the Company entered into a Facilities and Services Agreement with its indirect parent, SFC. Under the terms of the

Agreement, SFC provides facilities and all necessary services to support the Company's activities as a surety insurance company. In consideration, the Company pays SFC the actual costs and expenses incurred in the performance of this Agreement. The Agreement was approved by the CDI on June 6, 2013. The Company paid SFC \$433,395, \$1,244,279, \$1,786,903, for the years 2013, 2014, and 2015, respectively.

Assumption Agreement: Effective April 1, 2013, the Company entered into an Assumption Agreement with its affiliate, Funds Disbursement Services, Inc. (FDSI), a Delaware corporation. FDSI provides escrow services for contractor performance bonds underwritten by SIC prior to April 1, 2013. Under the terms of the intercompany reinsurance agreement discussed in the "Reinsurance" section of this report, as of December 31, 2015, FDSI transferred all ongoing escrow services responsibilities, accompanying escrow balances, and individual bank escrow accounts related to contractor performance bonds underwritten by SIC to the Company. This Assumption Agreement was a one-time assumption arrangement and expired upon the transfer of all the escrow balances and accounts to the Company. There was no compensation paid to FDSI under this Agreement.

Agency Agreement: Effective June 27, 2013, the Company entered into an Agency Agreement with its affiliate, SureTec Agency Services, Inc. (STAS). Under the terms of the Agreement, STAS was appointed as a non-exclusive agent to solicit and submit applications for classes of bonds, for which the Company has rates approved by the jurisdiction, on behalf of the Company. The Agreement was approved by the CDI on July 22, 2013. In consideration, STAS retains 40% of the premium collected as compensation on the business placed with the Company. The Company paid STAS \$56,247, \$119,472, and \$88,572, for the years 2013, 2014, and 2015, respectively.

TERRITORY AND PLAN OF OPERATION

The Company is an admitted surety company domiciled in California that specializes in writing contractor's license bonds. The Company's underwriting activities are focused on writing surety bonds through a network of independent insurance agents and its affiliate, SureTec Agency Services, Inc., pursuant to the aforementioned Agency Agreement.

At December 31, 2015, the Company was licensed in the states of California and Texas. During 2015, the Company wrote \$8.6 million of premiums, all of which were written in California.

REINSURANCE

Quota Share Reinsurance Agreement – SureTec Insurance Company

Effective April 1, 2013, the Company entered into a Surety Quota Share Reinsurance Agreement with its immediate parent company, SureTec Insurance Company (SIC), whereby the Company assumed 100% of the premiums and the liabilities of SIC's California contractor's license bond (CLBs) business. The assumed business is a book of low limit (\$12,500) CLBs spread throughout the state of California, which SIC began writing in 2010. The bonds ensure a company or an individual would operate in accordance with governmental statutes, regulations, and ordinances. The bonds are typically required by the state for the issuance of an active contractor license, or at license renewal.

As discussed above, and upon the renewal of the CLBs, the Company became the direct writer for all future periods, and the Agreement would only remain in effect until all CLBs were transferred to the Company. Therefore, as of December 31, 2015, all of the renewed CLBs have been directly underwritten by the Company. This Agreement was approved by the California Department of Insurance (CDI) on June 19, 2013.

Quota Share Reinsurance Agreement – Surety International SPC

Effective June 1, 2014, the Company entered into a Quota Share Reinsurance Agreement with its affiliate, Surety International SPC (SPC), which is acting for and on behalf of J.E.P. Surety Reinsurance Segregated Portfolio (JEP), a Cayman Islands corporation. Under the terms and conditions of this Quota Share Reinsurance Agreement, the Company cedes 15% of its net losses on California's CLB business to SPC.

Upon request from the CDI, the Company and J.E.P. Capital, Inc., (JEP Capital), the owner of the non-voting segregated portfolio shares of JEP, entered into a Capital Commitment Agreement (Commitment Agreement) effective June 23, 2014. Under the terms and conditions of the Commitment Agreement, JEP Capital will guarantee the proper, full and punctual performance, satisfaction, and payment of capital into SPC as needed to address losses under the Quota Share Reinsurance Agreement. In addition, JEP Capital commits to maintaining at least \$100,000 in capital in JEP. The CDI approved both the Quota Share Reinsurance Agreement and the Commitment Agreement on July 11, 2014.

Pursuant to Title 10, Section 2303.8 of California Code of Regulations, an Irrevocable Standby Letter of Credit for the aggregate amount of \$250,000 was provided by the reinsurer, naming the Company as beneficiary, to secure the cessions made under the Quota Share Reinsurance Agreement. The Irrevocable Standby Letter was approved by the CDI on September 12, 2014.

On April 20, 2015, the Company filed a Form D application, pursuant to California Insurance Code Section 1215.5(b)(3), to replace the aforementioned Irrevocable Letter of Credit with a Trust Agreement. The Trust Agreement is made by SPC as the Grantor; the Company as the Beneficiary; and Frost Bank, a Texas state bank, as the Trustee. The Trust Agreement will be used for the exclusive benefit of the Company to secure cessions made under the aforementioned Quota Share Reinsurance Agreement between the Company and SPC. The Trust Agreement was approved by CDI with an

effective date of June 1, 2015.

As of the examination date, and under the terms of its reinsurance agreements, the Company reported total reinsurance recoverables of \$675,000, or 6% of the reported surplus. All of the recoverables are from unauthorized affiliated reinsurers.

Assumed

The Company did not assume any business, other than the aforementioned quota share reinsurance agreement, during the examination period.

Ceded

The Company did not cede any business, other than the aforementioned quota share reinsurance agreement, during the examination period.

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of this review, some findings were noted and were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information system controls.

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, 2015. 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, 2015

Underwriting and Investment Exhibit for the Year Ended December 31, 2015

Reconciliation of Surplus as Regards Policyholders from February 13, 2013
through December 31, 2015

Statement of Financial Condition
as of December 31, 2015

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 16,809,926	\$	\$ 16,809,926	
Cash and short-term investments	3,426,856		3,426,856	
Investment income due and accrued	101,167		101,167	
Premiums and agents' balances in course of collection	455,510	15,348	440,162	
Premiums, agents' balances and installments booked but deferred and not yet due	282,451	8,535	273,916	
Amount recoverable from reinsurers	5,485		5,485	
Current federal and foreign income tax recoverable and interest thereon	71,807		71,807	
Net deferred tax asset	<u>415,692</u>		<u>415,692</u>	
 Total assets	 <u>\$ 21,568,894</u>	 <u>\$ 23,883</u>	 <u>\$ 21,545,011</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 2,761,265	(1)
Reinsurance payable on paid loss and loss adjustment expenses			637	
Commissions payable, contingent commissions and other similar charges			47,434	
Other expenses			7,762	
Taxes, licenses and fees			7,303	
Unearned premiums			5,518,714	
Advance premiums			68,788	
Ceded reinsurance premiums payable			65,851	
Amounts withheld or retained by company for account of others			1,410,519	
Remittances and items not allocated			12,264	
Payable to parent, subsidiaries and affiliates			241,981	
Payable for securities			105,579	
Aggregate write-ins for liabilities			<u>2,882</u>	
 Total liabilities			 10,250,979	
 Common capital stock	 \$ 2,500,000			
Gross paid-in and contributed surplus		7,500,000		
Unassigned funds (surplus)		<u>1,294,032</u>		
Surplus as regards policyholders			<u>11,294,032</u>	
 Total liabilities, surplus and other funds			 <u>\$ 21,545,011</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2015

Statement of Income

Underwriting Income

Premiums earned		\$ 7,476,531
Deductions:		
Losses and loss expenses incurred	\$ 2,484,890	
Other underwriting expenses incurred	<u>4,718,700</u>	
Total underwriting deductions		<u>7,203,590</u>
Net underwriting loss		272,941

Investment Income

Net investment income earned	\$ 236,040	
Net realized capital gain	<u>1,034</u>	
Net investment gain		237,074

Other Income

Net loss from agents' or premium balances charged off (amount recovered \$609 amount charged off \$17,666)	\$ (17,056)	
Finance and service charges not included in premiums	146,734	
Aggregate write-ins for miscellaneous income	<u>40,605</u>	
Total other income		<u>170,283</u>
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		680,298
Federal and foreign income taxes incurred		<u>239,860</u>
Net income		<u>\$ 440,438</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2014		\$ 10,826,479
Net income	\$ 440,438	
Change in net deferred income tax	31,043	
Change in nonadmitted assets	<u>(3,928)</u>	
Change in surplus as regards policyholders for the year		<u>467,553</u>
Surplus as regards policyholders, December 31, 2015		<u>\$ 11,294,032</u>

Reconciliation of Surplus as Regards Policyholders
from February 13, 2013 through December 31, 2015

Surplus as regards policyholders, February 13, 2013				\$ 10,000,000
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>		
Net income	\$ 902,221	\$		
Change in net deferred income tax	415,693			
Change in nonadmitted assets	<u> </u>	<u>23,882</u>		
Total gains and losses	<u>\$ 1,317,914</u>	<u>\$ 23,882</u>		
Net increase in surplus as regards policyholders				<u>1,294,032</u>
Surplus as regards policyholders, December 31, 2015				<u>\$ 11,294,032</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The December 31, 2015 loss and loss adjustment expense reserves were evaluated by a Senior Casualty Actuary from the California Department of Insurance. Based on the analysis performed, the Company's reserves for losses and loss adjustment expenses were found to be reasonably stated and have been accepted for purposes of this examination.

SUBSEQUENT EVENTS

On February 22, 2017, Markel Corporation (Markel), a Virginia corporation, filed a Form A application, pursuant to California Insurance Code Section 1215.2, to acquire the control of the Company's indirect parent, SureTec Financial Corporation (SFC), and its wholly-owned subsidiaries SureTec Insurance Company and the Company. Under the proposed terms, MSRTY Corporation, a Delaware corporation and a wholly owned subsidiary of Markel, will merge with and into SFC with SFC being the surviving entity, and Markel as the ultimate controlling parent of SFC and its subsidiaries. The California Department of Insurance approved the application on April 17, 2017.

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/_____

Vivien Fan, CFE
Examiner-In-Charge
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California

/S/_____

Edward Aros, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California