

Report of Examination of

Century Surety Company
Westerville, Ohio

As of December 31, 2010

Table of Contents

Subject	Page
Salutation	1
Description of Company	1
Scope of Examination	1
Management and Control:	
Board of Directors	2
Officers	3
Insurance Holding Company System	3
Territory and Plan of Operations	3
Reinsurance	4
Significant Operating Results	5
Financial Statements:	
Statement of Assets, Liabilities, Capital and Surplus	6
Statement of Income	8
Statement of Changes in the Capital and Surplus Account	9
Notes to Financial Statements:	
Investments	9
Loss and Loss Adjustment Expense Reserves	9
Conclusion	10
Subsequent Events	10
Acknowledgement	10

Columbus, Ohio
January 31, 2012

Mr. Joseph Torti, III
National Association of Insurance Commissions
Financial Condition (E) Committee
Deputy Director and Superintendent of Insurance
Rhode Island Department of Business Regulation Division of Insurance Regulation
1511 Pontiac Avenue, Building 69-2
Cranston, Rhode Island 02920-4407

Honorable Mary Taylor
Lt. Governor/Director
State of Ohio
Department of Insurance
50 West Town Street
3rd Floor – Suite 300
Columbus, Ohio 43215

Dear Madam and Sir:

In accordance with Section 3901.07 of the Ohio Revised Code (“ORC”), the Ohio Department of Insurance (“Department”) conducted an examination of

Century Surety Company

an Ohio domiciled, stock, property and casualty insurance company, hereinafter referred to as the “Company”.

Scope of Examination

The Department last examined the Company as of December 31, 2005. The Department’s current examination covers the period of January 1, 2006 through December 31, 2010.

Representatives of the Michigan Office of Financial & Insurance Regulation, as the coordinating state regulator of the insurance company affiliates of Meadowbrook Insurance Group, Inc., led the multi-state coordinated examination that included representatives from the States of Missouri, Ohio, and Texas. The examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”). The Handbook requires that the Department plan and perform the examination to evaluate the Company’s financial condition and identify prospective risks including corporate governance, identify and assess inherent risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

For the years under examination of 2006 and 2007, the Certified Public Accounting firm KPMG LLP provided an unqualified opinion on the Company's financial statements based on Statutory Accounting Principles. For the remaining years under examination of 2008, 2009, and 2010, the Certified Public Accounting firm of Ernst & Young LLP provided an unqualified opinion on the Company's financial statements based on Statutory Accounting Principles. The audited financial reports were reviewed during the examination.

Management and Control

Board of Directors

Management of the Company is vested in its Board of Directors, which was comprised of the following members as of the examination date:

Name	Principal Occupation
Robert S. Cubbin	Chairman of the Board, CEO & President, Meadowbrook Insurance Group, Inc.
Christopher J. Timm	President, Century Surety Company
James P. Flood	Senior Vice President of Operations, Century Surety Company
James M. Mahoney	Senior Vice President of Field Operations, Meadowbrook Insurance Group, Inc.
Joseph E Mattingly	Senior Vice President of Insurance Company Operations, Meadowbrook Insurance Group, Inc.
Archie S. McIntyre	Senior Vice President of Business Development, Meadowbrook Insurance Group, Inc.
Karen M. Spaun	Senior Vice President and Chief Financial Officer, Meadowbrook Insurance Group, Inc.
Nathan K. Voorhis	Senior Vice President of the General Agency Group, Century Surety Company
Angelo L. Williams	Vice President of Corporate Compliance, Meadowbrook Insurance Group, Inc.

Officers

As of the examination date, the following officers were serving in the designated position:

Name	Title
Robert S. Cubbin	Chairman
Christopher J. Timm	President
Michael G. Costello	Senior Vice President, General Counsel & Secretary
Steven C. Divine	Vice President & Treasurer
James P. Flood	Senior Vice President of Operations
Karen M. Spaun	Vice President
Nathan K. Voorhis	Vice President
Angelo L. Williams	Vice President

Insurance Holding Company System

The Company is a member of an insurance holding company system as defined by ORC Section 3901.32. Century Surety Company (“Century”) became a member of the Insurance Holding System effective July 31, 2008, when its parent, ProCentury Corporation, was merged into MBKPC, Corp., a Michigan corporation and wholly owned subsidiary of the Meadowbrook Insurance Group, Inc. On August 1, 2008, MBKPC, Corp., was renamed ProCentury Corporation and 100% of the outstanding stock of Century is owned by ProCentury Corporation.

Territory and Plan of Operations

The Company is licensed to operate in five states (Arizona, Indiana, Ohio, West Virginia and Wisconsin) and approved to write Surplus Lines in the remaining 45 states and the District of Columbia. The Company is a specialty insurance company that primarily writes general liability, commercial property, environmental, garage commercial multi-peril, commercial auto, surety, and marine insurance. The business is primarily in the excess and surplus lines market and is distributed through a select group of general agents.

During 2010, the largest states in terms of direct premium written were as follows: Florida, \$45.9 million (24.4%); California, \$33.3 million, (17.8%); Texas, \$25.3 million (13.5%); and Louisiana, \$11.8 million (6.3%). The following schedule illustrates the Company’s premium written in 2010 by line of business:

<u>Line of Business</u>	<u>Direct</u>	<u>Assumed</u>	<u>Ceded</u>	<u>Net</u>
Fire	\$ 22,129,657	\$ 6,100,120	\$ 22,129,657	\$ 6,100,120
Allied lines	4,776,888	1,299,759	4,776,888	1,299,759
Homeowners multiple peril	0	(1,784)	0	(1,784)
Commercial multiple peril	46,123,602	29,153,538	46,123,602	29,153,538
Ocean marine	2,311,451	986,438	2,311,451	986,438
Inland marine	2,011,286	3,228,709	2,011,286	3,228,709
Medical professional liability – occurrence	0	331,163	0	331,163
Medical professional liability – claims-made	0	3,600,765	0	3,600,765
Workers’ compensation	0	84,788,502	0	84,788,502
Other liability – occurrence	78,014,230	26,919,028	78,014,230	26,919,028
Other liability – claims-made	5,228,785	3,124,906	5,228,785	3,124,906
Excess workers’ compensation	0	6,348,524	0	6,348,524
Product liability – occurrence	0	761,356	0	761,356
Product liability – claims-made	0	62,469	0	62,469
Private passenger auto liability	0	518,034	0	518,034
Commercial auto liability	19,980,821	26,185,667	19,980,821	26,185,667
Auto physical damage	6,735,462	7,194,821	6,735,462	7,194,821
Aircraft (all perils)	0	215,037	0	215,037
Fidelity	12,424	4,773	12,424	4,773
Surety	314,749	807,525	314,749	807,525
Boiler and machinery	<u>198,070</u>	<u>(47)</u>	<u>198,070</u>	<u>(47)</u>
Totals	<u>\$ 187,837,425</u>	<u>\$ 201,629,303</u>	<u>\$ 187,837,425</u>	<u>\$ 201,629,303</u>

Reinsurance

Effective January 1, 2009, the Company and its United States affiliates (Star Insurance Company (“Star”), Ameritrust Insurance Corporation, Savers Property & Casualty Insurance Company, Williamsburg National Insurance Company, and ProCentury Insurance Company) became participants in an Intercompany Reinsurance Agreement, whereby each participating affiliate cedes 100% of its gross business to Star. Subsequent to Star assuming 100% of its affiliates’ business pursuant to the Intercompany Reinsurance Agreement, Star cedes premium to outside reinsurers under pro-rata and excess-of-loss contracts thereby diversifying the Company’s business and minimizing its losses arising from large risks or from hazards of an unusual nature. Thereafter, Star retro cedes to each participating affiliate, based on their respective participation. All business written by each participant is subject to the Intercompany Reinsurance Agreement. The participants and their respective participations as of December 31, 2010 are as follows:

<u>Name of Insurer</u>	<u>NAIC Code</u>	<u>Percentage Participation</u>
Star Insurance Co. (Lead insurer)	18023	35.83%
Century Surety Co	36951	29.07%
Savers Property & Casualty Ins. Co.	16551	13.04%
ProCentury Insurance Co.	21903	9.44%
Williamsburg National Ins. Co.	25780	6.72%
Ameritrust Insurance Corp.	10665	5.90%

Significant Operating Results

The Company reported the following net underwriting results during the examination period, reported in thousands.

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Premiums earned	<u>\$191,815,354</u>	<u>\$156,862,400</u>	<u>\$173,167,093</u>	<u>\$195,805,672</u>	<u>\$192,901,160</u>
Losses incurred	91,646,721	71,906,244	68,570,388	82,669,595	87,174,042
Loss adjustment exp. incurred	24,476,462	23,415,678	43,465,123	30,569,675	31,760,489
Underwriting expenses incurred	<u>68,215,555</u>	<u>53,869,944</u>	<u>63,492,444</u>	<u>62,201,585</u>	<u>63,953,689</u>
Total underwriting deductions	<u>184,338,738</u>	<u>149,191,866</u>	<u>175,527,955</u>	<u>175,440,855</u>	<u>182,888,220</u>
Net underwriting gain (loss)	<u>\$7,476,616</u>	<u>\$7,670,534</u>	<u>\$ (2,360,862)</u>	<u>\$20,364,817</u>	<u>\$10,012,940</u>
Pure Net loss ratio	47.8	45.9	39.6	42.2	45.2
Pure Net LAE Ratio	<u>12.8</u>	<u>14.9</u>	<u>25.1</u>	<u>15.6</u>	<u>16.5</u>
Net Loss Ratio	60.6	60.8	64.7	57.8	61.7
Expense Ratio	<u>33.8</u>	<u>31.9</u>	<u>36.5</u>	<u>33.9</u>	<u>33.3</u>
Combined ratio	<u>94.4</u>	<u>92.7</u>	<u>101.2</u>	<u>91.7</u>	<u>95.0</u>

Financial Statements

The financial condition and the results of its operations for the period under examination as reported and filed by the Company with the Department and audited by the Company's external auditors, are reflected in the following:

Statement of Assets, Liabilities, Capital and Surplus

Statement of Income

Statement of Changes in the Capital and Surplus Account

**Statement of Assets, Liabilities, Capital and Surplus
December 31, 2010**

Bonds	\$ 347,889,976
Preferred stock	14,643,649
Common stocks	48,307,314
Cash, cash equivalents, and short-term investments	<u>5,062,332</u>
Subtotal, cash and invested assets	415,903,271
Investment income due and accrued	3,765,284
Uncollected premiums in course of collection	59,775,614
Deferred premiums booked and not yet due	1,006,615
Amounts recoverable from reinsurers	27,467,940
Current federal and foreign income tax recoverable	3,281,240
Net deferred tax asset	13,124,592
Guaranty funds receivable or on deposit	744
Electronic data processing equipment and software	3
Receivables from parent, subsidiaries, and affiliates	30,383
Miscellaneous receivable	1,496,239
Goodwill	223,510
Security Deposits	281,452
Loan Receivable	<u>503,372</u>
Total admitted assets	<u>\$ 526,860,259</u>

**Statement of Assets, Liabilities, Capital and Surplus
December 31, 2010**

Losses	\$ 176,153,096
Reinsurance payable on paid losses and loss adjustment expenses	23,893,133
Loss adjustment expenses	51,814,429
Commissions payable, contingent commissions, and other charges	1,476,871
Other expenses	136,478
Taxes, licenses and fees	666,315
Unearned premiums	94,296,219
Ceded reinsurance premiums payable (net of ceding commissions)	28,615,390
Amounts withheld or retained by company for accounts of others	2,693,387
Payable to parent, subsidiaries and affiliates	1,807,261
Miscellaneous payable	970,836
Deferred income	47,124
Escheat claims	<u>149,139</u>
Total liabilities	382,719,678
Aggregate write-ins for special surplus funds	3,408,985
Common capital stock	3,000,000
Gross paid in and contributed surplus	104,914,778
Unassigned funds	<u>32,816,818</u>
Total capital and surplus	<u>144,140,581</u>
Total liabilities, capital and surplus	<u>\$ 526,860,259</u>

Statement of Income
As of December 31, 2010

Premiums earned	<u>\$ 191,815,354</u>
Losses incurred	91,646,721
Loss adjustment expenses incurred	24,476,462
Other underwriting expenses incurred	<u>68,215,555</u>
Total underwriting deductions	<u>184,338,738</u>
Net underwriting gain	<u>7,476,616</u>
Net investment income earned	16,290,705
Net realized capital gains	<u>391,451</u>
Net investment gain	<u>16,682,156</u>
Net loss from balances charged off	(818,620)
Miscellaneous income	<u>65,599</u>
Total other income	<u>(753,021)</u>
Net Income before federal income taxes	23,405,751
Federal income taxes incurred	<u>7,694,613</u>
Net income	<u>\$ 15,711,138</u>

Statement of Changes in the Capital and Surplus Account
(in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Capital and surplus, beginning of the year	\$144,812	\$122,941	\$153,455	\$137,515	\$121,818
Net income (loss)	15,711	26,622	(5,081)	27,363	18,368
Change in net unrealized cap. gains (losses)	5,768	2,972	(391)	(4,799)	851
Change in net deferred income tax	2,285	(12,168)	7,666	305	2,438
Change in non-admitted assets	1,292	13,483	(6,127)	(4,887)	(4,193)
Change in provision for reinsurance	0	482	(130)	629	(629)
Change in accounting principles	0	253	0	0	0
Surplus adjustment	0	0	913	2,329	3,512
Dividends to stockholders	(26,622)	(12,294)	(27,364)	(5,000)	(2,500)
Aggregate write-ins for surplus	<u>895</u>	<u>2,521</u>	<u>0</u>	<u>0</u>	<u>(2,150)</u>
Change in surplus during the year	<u>(671)</u>	<u>21,871</u>	<u>(30,514)</u>	<u>15,940</u>	<u>15,697</u>
Capital and surplus, end of the year	<u>\$144,141</u>	<u>\$144,812</u>	<u>\$122,941</u>	<u>\$153,455</u>	<u>\$137,515</u>

Notes to Financial Statements

Investments

The Company's investments were in compliance with ORC Section 3925.08 and valued in accordance with the relevant Statements of Statutory Accounting Principles and the NAIC Securities Valuation Office.

Loss and Loss Adjustment Expense Reserves

The Company's Board of Directors appointed Christopher Tait, FCAS, MAAA, of Milliman, Inc., to provide the Company's Statement of Actuarial Opinion ("Opinion"). Mr. Tait prepared an Actuarial Report supporting the Opinion in connection with the preparation of the Company's December 31, 2010 Annual Statement.

Paradigm Actuaries ("PA") was appointed by the Michigan Office of Financial and Insurance Regulation ("OFIR") to provide a full actuarial evaluation of the loss and loss adjustment expense ("LAE") reserves of the companies in the Meadowbrook Insurance Group Pooling Agreement in connection with the Department's examination of the Company.

Mary D. Miller, FCAS, MAAA, Assistant Director, Product Regulation and Actuarial Services, with the Department, reviewed the actuarial report provided by Mr. Tait and the PA reserve analysis. Based on her review, Ms. Miller determined the loss and LAE reserves presented in the Company's 2010 Annual Statement appear to be reasonably stated.

Conclusion

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2010, and is summarized as follows:

Total Assets	<u>\$ 526,860,259</u>
Liabilities	382,719,678
Capital and Surplus	<u>144,140,581</u>
Total Liabilities, Capital and Surplus	<u>\$ 526,860,259</u>

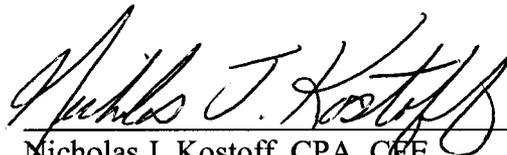
Subsequent Events

There have been no events subsequent to the examination date which would have a material effect on the financial condition of the Company.

Acknowledgement

In addition to the undersigned, David Finkler, CPA, CFE; Ryan Gibson, CFE, FLMI; Mary Miller, FCAS, MAAA; Brad Schroer, Jeffrey Ferris, CFE, CISA, AES, Larry Rice, CFE, CPA, CISA, AES and Patricia Severs, CPA, CPC, of the Department, participated in this examination.

Respectfully,



Nicholas J. Kostoff, CPA, CFE
Examiner-In-Charge
Office of Risk Assessment
Ohio Department of Insurance



David A. Cook, CFE
Assistant Chief Examiner
Office of Risk Assessment
Ohio Department of Insurance

Verification

As required by Section 3901.07 of the Ohio Revised Code, the undersigned hereby attest to the best of their knowledge and belief that the attached is a true Report of Examination as of December 31, 2010.

Nicholas J. Kostoff 1/31/12 John C. ... 1/31/12
Examiner-In-Charge Date Assistant Chief Examiner Date

State of Ohio

County of Franklin

Personally appeared before me the above named Nicholas J. Kostoff personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his/her knowledge and belief.

Subscribed and sworn to before me this 31 day of 2012, 2012.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2012
My Commission Expires

Personally appeared before me the above named David A. Cook personally known to me, who executed the above instrument and that the statements and answers contained therein are true and correct to the best of his/her knowledge and belief.

Subscribed and sworn to before me this 31 day of 2012, 2012.

Elizabeth Chase
(Notary Public)
ELIZABETH CHASE
NOTARY PUBLIC, STATE OF OHIO
MY COMMISSION EXPIRES MAY 22, 2012
My Commission Expires