Examination Warrant Number 12-00920-10673-R1

Report of Examination of

Penn-Star Insurance Company
Bala Cynwyd, PA

As of December 31, 2012

TABLE OF CONTENTS

Harrisburg, Pennsylvania
February 24, 2014

Honorable Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Commonwealth of Pennsylvania
Insurance Department
Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 12-00920-10673-R1, dated, February 29, 2012, an examination was made of

Penn-Star Insurance Company, NAIC Code: 10673

a Pennsylvania domiciled stock property and casualty insurance company, hereinafter referred to as "Company" or "PSIC." The examination was conducted at the Company's home office, located at 3 Bala Plaza East, Suite 300E, Bala Cynwyd, PA 19004.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Company was last examined as of December 31, 2007.

This examination covered the five-year period from January 1, 2008 through December 31, 2012, and consisted of a general survey of the Company's business practices, management, and operations, and an evaluation of the Company's financial condition as of the latter date. Material subsequent events were also reviewed.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance Department ("Department") and the National Association of Insurance Commissioners ("NAIC").

The format of this report is consistent with the current practices of the Department and the examination format prescribed by the NAIC. It is limited to a description of the Company, a discussion of financial items that are of specific regulatory concern, and a disclosure of other significant regulatory information.

For each year during the period under examination, the Certified Public Accounting ("CPA") firm of PricewaterhouseCoopers, LLP of Philadelphia, Pennsylvania, provided an unqualified audit opinion on the Company's year-end financial statements based on statutory accounting principles. Relevant work performed by the CPA firm, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination work papers.

The following companies were examined concurrently with the above examination:

Company	**NAIC Code**
United National Insurance Company (Pennsylvania)	13064
United National Specialty Insurance Company (Wisconsin)	41335
United National Casualty Insurance Company (Indiana)	11445
Diamond State Insurance Company (Indiana)	42048
Penn-America Insurance Company (Pennsylvania)	32859
Penn-Patriot Insurance Company (Virginia)	10121

HISTORY

The Company was incorporated in November 1996 under the Business Corporation Law of 1988 and commenced business in January 1997.

PSIC is currently authorized to transact those classes of insurance described in 40 P.S. § 382 (b)(1) Fire and Allied Lines, (b)(2) Inland Marine and Auto Physical Damage, (c)(2) Accident and Health, (c)(3) Glass, (c)(4) Other Liability, (c)(5) Boiler and Machinery, (c)(6) Burglary and Theft, (c)(9) Elevator, (c)(10) Livestock, (c)(11) Auto Liability and (c)(14) Workers' Compensation.

MANAGEMENT AND CONTROL

CAPITALIZATION

As of December 31, 2012, the Company's total capitalization was $61,667,822 which was comprised of common capital stock of $4,200,000 consisting of 840,000 shares of issued and outstanding common stock with a par value of $5 per share, gross paid-in and contributed surplus of $25,800,000 and unassigned funds (surplus) of $31,667,822.

The Company's minimum capital and minimum surplus requirements for the types of business for which it is licensed, pursuant to 40 P.S. § 386, is $1,800,000 in capital and $900,000 in surplus. The Company has met all governing capitalization requirements throughout the examination period.

STOCKHOLDER

Penn-America Insurance Company ("PAIC"), a Pennsylvania domiciled insurer, wholly owns the Company. During the examination period, the Company made the following dividend payments to its stockholder:

2008	$2,250,000
2009	$7,077,000
2010	$6,900,000
2011	$7,068,000
2012	$6,663,673

All dividends were approved by the Board of Directors and proper and timely notification was provided to the Department pursuant to 31 Pa. Code § 25.22. None of the dividends paid during the examination period were deemed to be extraordinary under the provisions of 40 P.S. § 991.1405(b).

INSURANCE HOLDING COMPANY SYSTEM

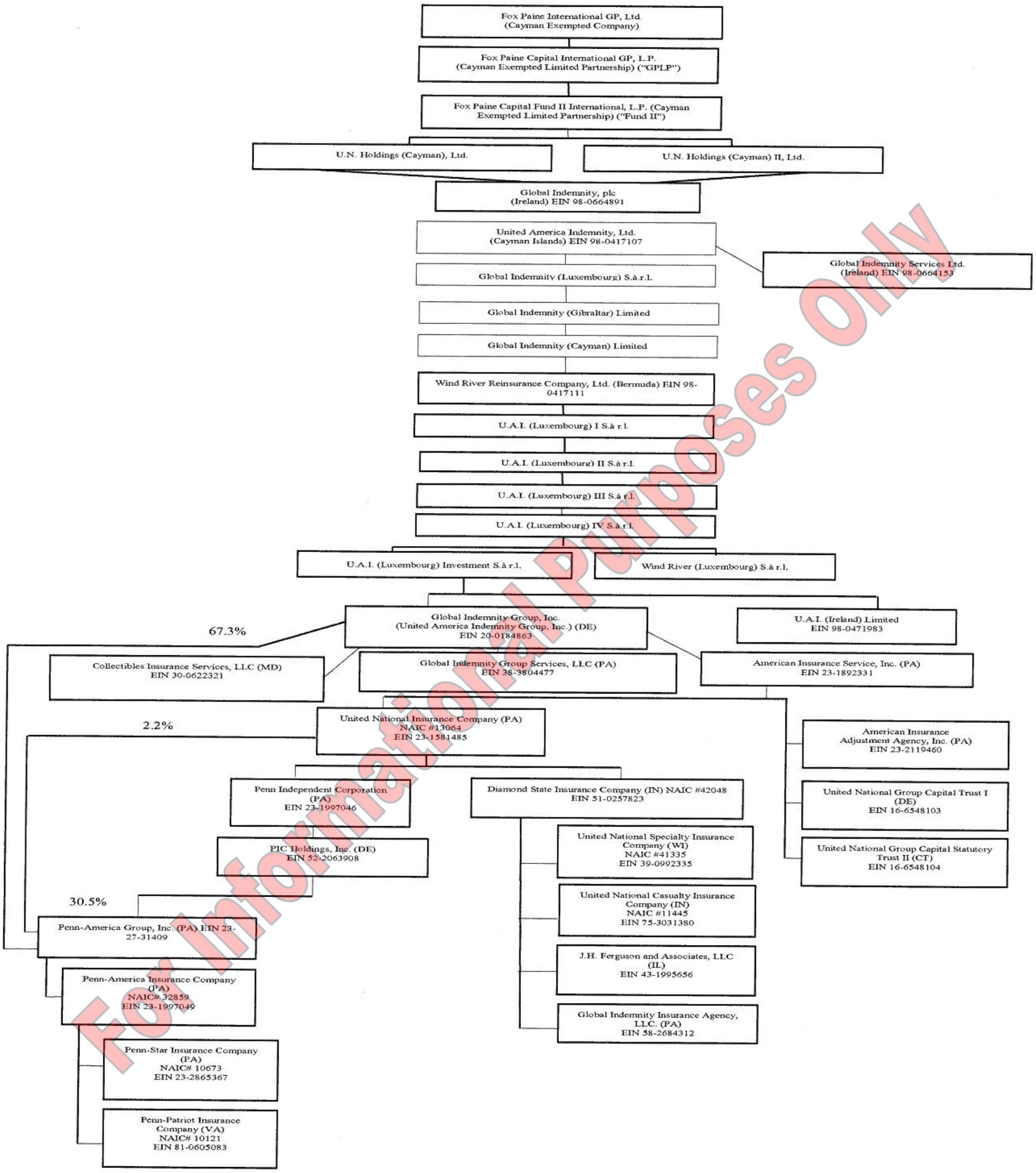
The Company is part of a holding company system in which its parent, PAIC, is 100% owned by Penn America Group, Inc. (PA). In turn, Penn America Group, Inc. is directly owned by Global Indemnity Group, Inc. (DE) (67.3%), United National Insurance Company (PA) (2.2%) and PIC Holdings, Inc.(DE) (30.5%). Global Indemnity Group, Inc. is an indirect subsidiary of Global Indemnity, plc ("GBLI") which was incorporated on March 9, 2010 and is domiciled in Ireland. GBLI replaced its predecessor, United America Indemnity, Ltd., as the ultimate parent company as a result of a re-domestication transaction. United America Indemnity, Ltd. was incorporated on August 26, 2003, and is domiciled in the Cayman Islands. United America Indemnity, Ltd. is now a subsidiary of GBLI and an Irish tax resident. The Fox Paine Capital Fund II International, L.P. ("Fund II") is considered the beneficial owner of PSIC. However, the Ultimate Controlling Person is Fox Paine International GP, Ltd. ("Fox Paine") which has the voting control. GBLI's A ordinary shares are publicly traded on the NASDAQ Global Select Market. On July 6, 2010, GBLI changed its trading symbol on the NASDAQ Global Select Market from "INDM" to "GBLI."

Global Indemnity Group, Inc. is the top U.S. holding company for the U.S. operations of GBLI and has both insurance and non-insurance subsidiaries. The insurance subsidiaries are as follows: United National Insurance Company ("UNIC") and its direct and indirect subsidiaries which includes Diamond State Insurance Company ("DSIC"), United National Casualty Insurance Company ("UNCIC"), United National Specialty Insurance Company ("UNSIC"), PAIC and its wholly owned subsidiaries PSIC and Penn-Patriot Insurance Company ("PPIC").

The Company met the requirements for filing an insurance holding company system registration statement, in compliance with the 40 P.S. §§ 991.1401-991.1413. The Company has filed the appropriate Holding Company System Annual Registration Statement Form for all years during the current examination period.

An organizational chart of the holding company system at December 31, 2012 is included on the following page.

Organizational Chart



BOARD OF DIRECTORS

The Company's By-laws specify the number of Directors of the Company shall range in number from seven (7) to no more than the maximum required by any state. The following were the Directors serving at December 31, 2012:

Name and Address	Principal Occupation
Stephen Allen Cozen Longport, New Jersey	Chairman, Attorney Cozen O' Connor, LLP
James William Crystal New York, New York	Insurance broker Frank Crystal & Company
Seth Jonathan Gersch Hillsborough, California	Advisory Panel Member Fox Paine & Company
Joseph Robert Lebens Burlington, Connecticut	Executive Vice President - Chief Underwriting & Actuarial Officer Global Indemnity Group, Inc.
Thomas Michael McGeehan King of Prussia, Pennsylvania	Executive Vice President & Chief Financial Officer Global Indemnity, plc
Matthew Benjamin Scott Berwyn, Pennsylvania	Executive Vice President - Chief Marketing Officer Global Indemnity Group, Inc.
Cynthia Yvonne Valko Collegeville, Pennsylvania	Chief Executive Officer Global Indemnity, plc

Directors, officers and key employees of the Company are required to complete annually, a Conflict of Interest questionnaire disclosing any conflicts or potential conflicts between the employee's interest and the Company's interest.

Board members are elected at the annual meeting of the shareholder and hold offices until the next annual meeting or until their successors are be elected.

COMMITTEES

The Company had the following committees and member directors that were elected to serve as of December 31, 2012:

Executive Committee
Seth J. Gersch
Matthew B. Scott
Cynthia Y. Valko

Finance Committee
Seth J. Gersch
Thomas M. McGeehan
Cynthia Y. Valko

Independent Committee
James W. Crystal
Seth J. Gersch
Stephen A. Cozen

In addition to its Board of Directors and board committees, the Company receives oversight from the board and board committees of GBLI. The GBLI board committees included an Audit Committee, Compensation & Benefits Committee, Enterprise Risk Management Committee, Executive Committee, Investment Committee, and a Nominating & Governance Committee.

40 P.S. § 991.1405(c)(3) Standards of management of an insurer within a holding company system, states: "not less than one-third of the directors of a domestic insurer and not less than one-third of the members of each committee of the board of directors of any domestic insurer shall be persons who are not officers or employees of such insurer or of any entity controlling, controlled by or under common control with such insurer and who are not beneficial owners of a controlling interest in the voting stock of such insurer of any such entity. At least one such person must be included in any quorum for the transaction of business of business at any meeting of the board of directors or any committee thereof." The Company meets this requirement.

40 P.S. § 991.1405(c)(4), Standards of management of an insurer within a holding company system states: "The board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by or under common control with the insurer and who are not beneficial owners of a controlling interest in the voting stock of the insurer or any such entity. The committee or committees shall have the responsibility for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating committees for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation of the principal officers." The Company meets this requirement.

OFFICERS

As of the examination date, December 31, 2012, the following officers were appointed and serving in accordance with the Company's By-laws as subsequently amended on May 28, 2013 (Please refer to the subsequent events section of this report):

Name	Title
Joseph R. Lebens	Executive Vice President - Chief Underwriting & Actuarial Officer
Linda C. Hohn	Vice President, Associate General Counsel & Secretary
Thomas M. McGeehan	Vice President &Treasurer
William J. Devlin	Executive Vice President - Chief Operations & Claims Officer
Matthew B. Scott	Executive Vice President - Chief Marketing Officer
Peter J. Livaich	Senior Vice President – Property
Mark DiGiovanni	Vice President – Claims
David Elliot	Vice President – Claims
Robert L. Johnson	Vice President – Underwriting
Noreen H. Marshall	Vice President – Operations
Kevin McCracken	Vice President – Underwriting – North Region
Brian J. Riley	Vice President & Controller
Andrea Seuren	Vice President – Product Management
Caroline M. Tate	Vice President – Human Resources
Patrick Walton	Vice President – Reinsurance

CORPORATE RECORDS

MINUTES

The Board of Directors, board committee and shareholder meeting minutes were reviewed for the period under examination through the fieldwork date and significant actions taken during each meeting were noted. In addition, a compliance review of corporate minutes determined the following:

- Quorums were present at all Board of Directors, board committee and shareholder meetings held.

- The Company's investment transactions are approved quarterly by the Board of Directors.
- All directors attend board meetings regularly.
- The board of director meeting minutes supported a review of matters and transactions related to the Company's reinsurance program.
- The sole shareholder ratified the actions of the directors.

In general, the Company held its board of director and shareholder meetings in compliance with the provisions of its By-laws. However, it was determined that the Company did not have recorded minutes supporting the occurrence of an annual meeting of the sole shareholder for years of 2010 and 2012. In addition, none of the annual meetings of the sole shareholder were held at the date specified in Article III of the By-laws.

It is recommended the Company hold shareholder meetings in accordance with the provisions of its By-laws and pursuant to the requirements of 15 Pa. C.S. § 1755 (a).

ARTICLES OF AGREEMENT

During the examination period there were no changes to the Company's Articles of Agreement.

BY-LAWS

During the examination period there were no changes to the Company's By-laws however, please refer to the Subsequent Events section of this report.

SERVICE AND OPERATING AGREEMENTS

Cost Allocation Agreement

The insurers within the holding company, including the Company, participate in a cost allocation agreement among themselves and with their non-insurance affiliates of GBLI, including: Global Indemnity Group, Inc., American Insurance Services, Inc., a Pennsylvania Corporation, Global Indemnity Group Services, LLC., a Pennsylvania Limited Liability Company; American Insurance Adjustment, Agency, Inc., a Pennsylvania Corporation; Global Indemnity Insurance Agency , LLC., a Pennsylvania Limited, Liability Company; J.H. Ferguson & Associates, LLC, an Illinois Limited Liability Company ("Ferguson"), Penn-America Group, Inc., a Pennsylvania Corporation ("PAG"), Penn Independent Corporation, a Pennsylvania Corporation ("PIC") and Collectibles Insurance Services, LLC, a Maryland Limited Liability Company. The parties have agreed to share in the purchase of certain goods and services from third parties and to allocate such expenses in a fair and equitable manner. Effective, January 1, 2010, the Billing and Settlement section was amended whereas each affiliate shall pay all amounts due to each party, as reflected in such affiliate's books as of the end of each calendar quarter reporting period, within sixty (60) days after the end of each calendar quarter.

Tax Sharing Agreement

The Company is party to a Tax Sharing Agreement dated January 25, 2005, and amended on August 12, 2010, by and among the affiliates of Global Indemnity Group, Inc. Under this Tax Sharing Agreement the federal tax liability determined at the end of the taxable year of any individual insurer member of the affiliated group will not be more than it would have paid if it had filed on a separate return basis. Intercompany tax balances are settled with payments made within thirty days of the filing of the affiliated groups' return and refunds are paid within thirty (30) days after receipt of any tax refund.

All intercompany agreements were determined to be fair and reasonable and met the requirements of 40 P.S. § 991.1405 (a)(1).

REINSURANCE

The Company's reinsurance program includes excess of loss, quota share, surplus share, casualty clash, property catastrophe, and facultative agreements. The Company obtains these coverages through reinsurance intermediaries, third party reinsurers and through agreements with its reinsurer affiliate, Wind River Reinsurance Company, Ltd. ("Wind River"). The Company is also a participant in an intercompany pooling agreement with its insurer subsidiaries and affiliates. The reinsurance program is described below.

As of December 31, 2012, the Company was utilizing the services of two reinsurance intermediaries. It was determined that both reinsurance intermediaries were properly licensed in accordance with 40 P.S. § 321.2(a). The Company's two reinsurance intermediaries have properly executed written authorizations between the Company and each reinsurance intermediary in accordance with 40 P.S. § 321.3.

In addition, all reinsurance contracts were determined to have proper insolvency and entire agreement clauses as required by SSAP No. 62R, paragraph 8a and 8c and 40 P.S. 443(a)(2).

CEDED

The Company ceded reinsurance under various contracts. A description of the most significant of these reinsurance contracts in effect as of December 31, 2012 is as follows:

Property Catastrophe Excess of Loss Reinsurance Contract

Effective June 1, 2012, the Company was reinsured under a property catastrophe excess of loss treaty which provided occurrence coverage for losses of $80.0 million in excess of $20.0 million through three layers. For the first and second layers, the Company retained 50% of $20.0 million in excess of $20.0 million and 20% of $50.0 million in excess of $40.0 million respectively. The Company did not retain any liability for the third layer which provided $10.0 million in excess of $90.0 million. This treaty replaced the treaty that expired on May 31, 2012, which provided occurrence coverage for 100% of losses of $80.0 million in excess of $20.0 million.

Property Per Risk Excess of Loss Reinsurance Contract

Effective January 1, 2013, the Company was reinsured under a property per risk excess of loss reinsurance contract which provided coverage of 50% of $13.0 million per risk in excess of $2.0 million per risk. This contract provides coverage in two layers: $3.0 million per risk in excess of $2.0 million per risk, and $10.0 million per risk in excess of $5.0 million per risk. The first layer is subject to a $6.0 million limit of liability for all risks involved in one loss occurrence, and the second layer is subject to a $10.0 million limit for all risks involved in one loss occurrence. This contract replaced the contract that expired December 31, 2012, which provided 100% of $13.0 million per risk in excess of $2.0 million per risk.

Casualty and Professional Liability Excess of Loss Reinsurance Contract

Effective May 1, 2012, the Company was covered under a casualty and professional liability excess of loss reinsurance contract. The casualty section provided coverage for $2.0 million per occurrence in excess of $1.0 million per occurrence for general liability and automobile liability. The professional liability section provided coverage of $4.0 million per policy/occurrence in excess of $1.0 million per policy/occurrence. For both sections, allocated loss adjustment expenses were included within limits.

Casualty Clash Excess of Loss Reinsurance Contract

Effective May 1, 2012, the Company was reinsured by a casualty clash excess of loss reinsurance contract which provided coverage of $10.0 million per occurrence in excess of $3.0 million per occurrence, subject to a $20.0 million limit for all loss occurrences.

Wind River Stop Loss Reinsurance Contract

Effective January 1, 2012, the Company renewed the stop loss reinsurance contract with its non-U.S. reinsurance affiliate Wind River. This reinsurance contract indemnifies the Company for its Ultimate Net Loss for losses occurring and/or claims made on or after January 1, 2012 under policies in-force at the inception of the treaty. The Company retains Ultimate Net Loss equal to 75% of Net Earned Premium for the term of the contract. Wind River indemnifies the Company for 100% of the Company's Ultimate Net Loss in excess of 75% of Net Earned Premium, up to a maximum limit of liability of 95% of Net Earned Premium. The contract excludes Workers Compensation policies and losses and loss adjustment expenses from named catastrophe storms.

Wind River Quota Share Reinsurance Contract

Effective January 1, 2012 the Company renewed its quota share reinsurance contract with Wind River. Under this contract the Company cedes 50% of its net retained business to Wind River. For this contract, "Net Retained Insurance Liability" is defined as that portion of the amount insured which the Company retains net for its own account, after cessions to any other reinsurance agreements including cessions under the Wind River stop loss reinsurance contract. The contract has exclusions for Workers Compensation policies and losses and loss adjustment expenses from named catastrophe storms.

INTERCOMPANY POOLING

Effective January 1, 2009, each of the Global Indemnity Group insurance companies participate in an intercompany pool whereby UNIC is the lead insurer. Under the terms of the Reinsurance Pooling Agreement, each of the insurers cedes 100% of its premiums and liabilities to UNIC net of third party reinsurance. UNIC then retrocedes net retained premiums and net retained liabilities to the pool members in the following participation percentages:

United National Insurance Company	40%
Diamond State Insurance Company	10%
United National Specialty Insurance Company	5%
United National Casualty Insurance Company	5%
Penn-America Insurance Company	25%
Penn-Star Insurance Company	10%
Penn-Patriot Insurance Company	5%
Total	100%

All intercompany reinsurance agreements were determined to be fair and reasonable and met the requirements of 40 P.S. § 991.1405 (a)(1).

ASSUMED

With the exception of the intercompany Reinsurance Pooling Agreement described above, the Company did not assume any significant reinsurance during the period covered by this examination.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2012, the Company was licensed in the following states: Georgia, Maryland, Oklahoma, Pennsylvania, South Carolina, Texas and Wyoming. The Company was formed initially to give PAIC greater flexibility in the non-standard personal auto insurance segment. The purpose has since been expanded to provide flexibility on the commercial side by having two licensed insurers. The Company and PAIC can choose on a state-by-state basis which insurer will act as an admitted carrier and which as a non-admitted carrier to best use the combined resources within the fifty-one (51) U.S. regulatory environments.

GBLI's multi-channel distribution network consists of U.S. and international operations. The U.S. operation consists of seven insurance companies: UNIC, DSIC, UNCIC, UNSIC, PAIC, PSIC and PPIC. The U.S. operation distributes property and casualty insurance products through a group of professional general agencies that have limited quoting and binding authority, as well as a number of wholesaler insurance brokers which in turn sell their insurance products to insureds through retail insurance brokers. There are three distinct U.S. operating divisions that provide specialty property and casualty for specialty risks, programs, and niches that are generally not offered by standard insurance and reinsurance companies. Each of the operating divisions target specific markets and distribution channels, providing the Company and its agents opportunities and flexibility in conducting business. The Company operates in the secondary or residual market called the "excess and surplus lines" or "E&S" market and primarily insures small businesses including restaurants, apartments, retail stores and service contractors and has also developed customized products and coverages for such businesses as day care facilities, fitness centers, and for special events.

The Company's 2012 net written premium by line of business was as follows:

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written Premium	Percentage of Total
December 31, 2012				
Fire	$ 1,700,542	$ 1,056,627	$ 643,915	7.6%
Allied lines	1,434,312	542,707	891,605	10.5%
Homeowners multiple peril	60,111	0	60,111	0.7%
Commercial multiple peril	21,856,026	18,883,346	2,972,680	35.0%
Ocean marine	7,149	0	7,149	0.1%
Inland marine	1,401,520	254,394	1,147,126	13.5%
Medical professional liability - occurrence	(56)	0	(56)	0.0%
Medical professional liability - claims-made	418	0	418	0.0%
Earthquake	9,869	0	9,869	0.1%
Workers' compensation	6,447	0	6,447	0.1%
Other liability - occurrence	13,864,787	12,080,309	1,784,478	21.0%
Other liability - claims-made	131,402	44,098	87,304	1.0%
Products liability - occurrence	1,682,365	1,423,623	258,742	3.0%
Comercial auto liability	529,957	0	529,957	6.2%
Auto physical damage	92,168	0	92,168	1.1%
Totals	$ 42,777,017	$ 34,285,105	$ 8,491,912	100.0%

During 2012, the Company's business was produced by seventy-four (74) wholesale general agents, eighteen (18) wholesale brokers, one aggregator and by an affiliate, Collectibles Insurance Services, LLC.

SIGNIFICANT OPERATING RATIOS AND TRENDS

The underwriting ratios summarized below are on an earned/incurred basis, and encompass the five-year period covered by this examination.

	Amount	Percentage
Premiums earned	$ 8,557,921	100.0 %
Losses incurred	$ 4,550,383	53.2 %
Loss expenses incurred	1,915,921	22.4 %
Other underwriting expenses incurred	3,583,754	41.9 %
Aggregate write-ins for underwriting deductions	(165,702)	(1.9)%
Net underwriting gain or (loss)	(1,326,435)	(15.5)%
Totals	$ 8,557,921	100.0 %

The Company reported the following net underwriting, investment and other gains or losses during the period under examination:

	2012	2011	2010	2009	2008
Admitted assets	$ 115,046,734	$ 117,636,029	$ 125,301,888	$ 130,470,393	$ 170,385,621
Liabilities	$ 53,378,912	$ 50,999,299	$ 54,618,943	$ 61,032,314	$ 99,605,622
Surplus as regards policyholders	$ 61,667,822	$ 66,636,730	$ 70,682,945	$ 69,438,079	$ 70,779,999
Gross premium written	$ 42,777,017	$ 44,947,349	$ 48,596,051	$ 65,705,053	$ 96,760,222
Net premium written	$ 8,491,912	$ 9,621,676	$ 9,370,824	$ 4,933,239	$ 27,079,694
Underwriting gain/(loss)	$ (1,326,435)	$ (1,089,640)	$ 2,010,480	$ (51,542)	$ 3,375,658
Investment gain/(loss)	$ 3,312,651	$ 4,703,871	$ 5,566,008	$ 6,503,199	$ 3,487,002
Other gain/(loss)	$ 25,169	$ (54,657)	$ (53,180)	$ 4,345	$ 35,000
Net income	$ 1,985,054	$ 2,858,997	$ 6,092,908	$ 6,729,341	$ 4,239,345

ACCOUNTS AND RECORDS

The Company's accounting procedures, practices, account records, and supporting data were reviewed and tested to the extent deemed necessary. The internal control structure was reviewed through management interviews, review and testing of Company prepared process narratives, and through a review of the Sarbanes-Oxley documentation and work prepared by the Company's internal audit department. The trial balance prepared from the Company's general ledger for the year ended December 31, 2012 was agreed to the 2012 Annual Statement without exception.

The Company's independent auditors issued unqualified opinions on the Company's audited Statutory Consolidated and Combined Financial Statements for each year during the examination period. The audited financial statement was agreed to the Combined Global Indemnity Group, Inc. Annual Statement for the year ended December 31, 2012 with no exceptions noted. All of the independent audit work papers were made available to the Department examiners during the examination.

The Company's accounts and records are maintained using electronic data processing with the exception of certain items entered manually into the general ledger. The Company maintains adequate supporting work papers which were reviewed during the examination. From a review of the internal controls and the Company's disaster recovery plan, it was determined that the current information system possesses most of the physical and internal controls as prescribed by the NAIC.

The Department examiners determined the Company's accounting procedures, practices, and account records were satisfactory.

PENDING LITIGATION

The Company is involved in various legal proceedings arising from its normal course of business. However, Company's management does not believe that any of these proceedings will have a material adverse effect on the Company's business, results of operations, or financial condition.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2012, and the results of its operations for the five-year period under examination, are reflected in the following statements:

Comparative Statement of Assets, Liabilities, Surplus and Other Funds;
Comparative Statement of Income;
Comparative Statement of Capital and Surplus; and
Comparative Statement of Cash Flow

Comparative Statement of Assets, Liabilities, Surplus and Other Funds As of December 31,

	2012	2011	2010	2009	2008
Bonds	$ 76,219,072	$ 92,689,475	$ 101,797,411	$ 109,773,640	$ 151,036,504
Cash, cash equivalents, and short term investments	5,489,085	4,130,824	3,997,549	1,965,452	4,260,578
Receivable for securities	15,625	7,172	17,750	320,369	0
Subtotals, cash and invested assets	81,723,782	96,827,471	105,812,710	112,059,461	155,297,082
Investment income due and accrued	556,029	742,943	857,651	964,176	1,347,037
Premiums and agents' balances due	8,785,081	6,873,533	7,017,919	7,374,030	5,661,517
Amounts recoverable from reinsurers	7,725,422	5,841,851	7,612,361	6,388,635	5,524,357
Current federal and foreign income tax recoverable and interest thereon	0	84,525	0	924,662	0
Net deferred tax asset	1,288,914	1,553,813	1,760,732	1,772,036	2,360,346
Receivable from parent, subsidiaries and affiliates	14,958,519	5,711,893	2,240,515	987,393	195,282
Aggregate write-ins for invested assets	8,987	0	0	0	0
Total	$ 115,046,734	$ 117,636,029	$ 125,301,888	$ 130,470,393	$ 170,385,621
Losses	$ 18,964,774	$ 21,101,975	$ 22,855,342	$ 28,855,299	$ 51,363,026
Reinsurance payable on paid loss and loss adjustment expenses	2,884,101	2,377,354	2,597,525	2,916,031	2,232,447
Loss adjustment expenses	8,555,534	9,434,669	10,623,406	13,716,905	26,728,428
Commissions payable, contingent commissions and other similar charges	1,419,000	1,796,000	1,694,000	715,000	934,000
Other expenses	0	0	25,680	24,200	3,833
Taxes, licenses and fees	40,262	38,225	36,839	33,926	87,915
Current federal and foreign income taxes	313,251	0	645,400	0	1,356,314
Unearned premiums	3,909,646	3,975,656	4,757,831	4,592,374	11,279,505
Ceded reinsurance premiums payable (net of ceding commissions)	5,872,058	5,827,333	6,208,298	6,031,862	5,262,581
Remittances and items not allocated	1,029,645	1,029,880	851,652	876,948	15,000
Provision for reinsurance	64,914	6,485	0	2,303,313	5,055
Payable to parent, subsidiaries and affiliates	10,186,223	5,067,204	4,123,145	798,704	80,407
Aggregate write-ins for liabilities	139,504	344,518	199,825	167,752	257,111
Total liabilities	53,378,912	50,999,299	54,618,943	61,032,314	99,605,622
Aggregate write-ins for special surplus funds	0	0	0	637,779	0
Common capital stock	4,200,000	4,200,000	4,200,000	4,200,000	4,200,000
Gross paid in and contributed surplus	25,800,000	25,800,000	25,800,000	25,800,000	25,800,000
Unassigned funds (surplus)	31,667,822	36,636,730	40,682,945	38,800,300	40,779,999
Surplus as regards policyholders	61,667,822	66,636,730	70,682,945	69,438,079	70,780,001
Totals	$ 115,046,734	$ 117,636,029	$ 125,301,888	$ 130,470,393	$ 170,385,621

Comparative Statement of Income
For the Year Ended December 31,

Underwriting Income	2012	2011	2010	2009	2008
Premiums earned	$ 8,557,921	$ 10,403,851	$ 9,205,367	$ 11,620,370	$ 32,657,857
Deductions:					
Losses incurred	4,550,383	5,296,943	1,881,437	4,612,565	13,537,507
Loss expenses incurred	1,915,921	2,094,329	1,162,505	2,695,751	6,318,977
Other underwriting expenses incurred	3,583,754	3,936,517	4,150,945	4,363,596	9,425,714
Aggregate write-ins for underwriting deductions	(165,702)	165,702	0	0	0
Total underwriting deductions	9,884,356	11,493,491	7,194,887	11,671,912	29,282,199
Net underwriting gain or (loss)	(1,326,435)	(1,089,640)	2,010,480	(51,542)	3,375,658
Investment Income					
Net investment income earned	2,725,038	3,504,892	4,074,844	6,440,889	7,692,237
Net realized capital gains or (losses)	587,613	1,198,979	1,491,164	62,310	(4,205,235)
Net investment gain or (loss)	3,312,651	4,703,871	5,566,008	6,503,199	3,487,002
Other Income					
Net gain or (loss) from agents' or premium balances charged off	(18,346)	(61,142)	(3,180)	(4,345)	0
Aggregate write-ins for miscellaneous income	43,515	6,485	(50,000)	0	35,000
Total other income	25,169	(54,657)	(53,180)	(4,345)	35,000
Net income before dividends to policyholders and before federal and foreign income taxes	2,011,385	3,559,574	7,523,307	6,447,312	6,897,660
Net income after dividends to policyholders and before federal and foreign income taxes	2,011,385	3,559,574	7,523,307	6,447,312	6,897,660
Federal and foreign income taxes incurred	26,331	700,577	1,430,399	(282,029)	2,658,315
Net income	$ 1,985,054	$ 2,858,997	$ 6,092,908	$ 6,729,341	$ 4,239,345

Comparative Statement of Capital and Surplus
For the Year Ended December 31,

	2012	2011	2010	2009	2008
Surplus as regards policyholders,					
December 31, previous year	$ 66,636,730	$ 70,682,945	$ 69,438,079	$ 70,780,001	$ 69,519,873
Net income	1,985,054	2,858,997	6,092,908	6,729,341	4,239,345
Change in net unrealized capital gains or (losses)	0	12,325	(12,326)	0	0
Change in net unrealized foreign exchange capital gain or (loss)	(464,768)	(58,315)	(544,594)	(2,740,678)	0
Change in net deferred income tax	232,909	215,263	305,564	3,084,078	512,630
Change in nonadmitted assets	0	0	0	0	(1,260,805)
Change in provision for reinsurance	(58,429)	(6,485)	2,303,313	(2,298,258)	18,958
Dividends to stockholders	(6,663,673)	(7,068,000)	(6,900,000)	(7,077,000)	(2,250,000)
Aggregate write-ins for gains and losses in surplus	0	0	0	960,596	0
Change in surplus as regards policyholder for the year	(4,968,907)	(4,046,216)	1,244,865	(1,341,921)	1,260,128
Surplus as regards policyholders,					
December 31, current year	$ 61,667,822	$ 66,636,730	$ 70,682,945	$ 69,438,079	$ 70,780,001

Comparative Statement of Cash Flow
For the Year Ended December 31,

	2012	2011	2010	2009	2008
Cash from Operations					
Premiums collected net of reinsurance	$ 6,782,941	$ 9,709,497	$ 9,671,321	$ 4,406,845	$ 27,401,116
Net investment income	3,899,166	4,360,207	4,669,924	6,788,687	8,199,409
Miscellaneous income	25,169	(54,655)	(53,180)	(4,345)	35,000
Total income	10,707,276	14,015,049	14,288,065	11,191,187	35,635,524
Benefit and loss related payments	7,351,408	5,661,971	9,423,626	27,300,987	18,101,877
Commissions, expenses paid and aggregate write-ins for deductions	6,588,071	7,307,579	7,423,556	20,323,491	17,778,276
Federal and foreign income taxes paid (recovered)	(84,526)	2,038,470	414,411	1,374,435	2,715,845
Total deductions	13,854,953	15,008,020	17,261,593	48,998,913	38,595,998
Net cash from operations	(3,147,678)	(992,972)	(2,973,528)	(37,807,726)	(2,960,474)
Cash from Investments					
Proceeds from investments sold, matured or repaid:					
Bonds	38,989,418	88,856,137	52,321,489	95,753,450	48,391,627
Net gains or losses on cash, cash equivalens or short-term investments	0	0	0	172	0
Misc. Proceeds	0	50,047	263,150	0	0
Total investment proceeds	38,989,418	88,906,184	52,584,639	95,753,622	48,391,627
Cost of investments acquired (long-term only):					
Bonds	22,631,701	78,669,530	42,800,900	53,540,048	34,006,567
Miscellaneous applications	10,828	0	0	320,369	0
Total investments acquired	22,642,529	78,669,530	42,800,900	53,860,417	34,006,567
Net cash from investments	16,346,889	10,236,654	9,783,739	41,893,205	14,385,060
Cash from Financing and Miscellaneous Services					
Other cash provided (applied):					
Dividends to stockholders	(6,663,673)	(7,068,000)	(6,900,000)	(7,077,000)	(2,250,000)
Other cash provided or (applied)	(5,177,277)	(2,042,407)	2,121,886	696,396	(10,517,058)
Net cash from financing and miscellaneous sources	(11,840,950)	(9,110,407)	(4,778,114)	(6,380,604)	(12,767,058)
Reconciliation of cash and short-term investments:					
Net change in cash and short-term investments	1,358,261	133,275	2,032,097	(2,295,125)	(1,342,472)
Cash and short-term investments:					
Beginning of the year	4,130,824	3,997,549	1,965,452	4,260,577	5,603,049
End of the year	$ 5,489,085	$ 4,130,824	$ 3,997,549	$ 1,965,452	$ 4,260,577

SUMMARY OF EXAMINATION CHANGES

There were no changes made to the Company's financial statements as a result of this examination.

NOTES TO FINANCIAL STATEMENTS

ASSETS

INVESTMENTS

As of December 31, 2012, the Company's invested assets were distributed as follows:

	Amount	Percentage
Bonds	$ 76,219,072	93.3 %
Cash	5,380,646	6.6 %
Short-term investments	108,439	0.1 %
Receivable for securities	15,625	0.0 %
Totals	$ 81,723,782	100.0 %

The Company's bond and short-term investment portfolio had the following quality and maturity profiles:

NAIC Designation	Amount	Percentage
1 - highest quality	$ 67,976,540	89.1 %
2 - high quality	8,350,971	10.9 %
Totals	$ 76,327,511	100.0 %

Years to Maturity	Amount	Percentage
1 year or less	$ 14,228,817	18.6 %
2 to 5 years	46,798,416	61.3 %
6 to 10 years	8,774,698	11.5 %
11 to 20 years	3,430,818	4.5 %
over 20 years	3,094,762	4.1 %
Totals	$ 76,327,511	100.0 %

The Company's investments consisted mainly of bonds which represented approximately 66% of its admitted assets as of December 31, 2012.

During the examination period, the Company held a majority of its investments with Brown Brothers Harriman & Co. The Company entered into a custodial agreement with Brown Brothers Harriman & Co. dated April 2, 2009, however the custodial agreement was not authorized by a resolution of either the Company's Board of Directors or an authorized committee of its Board of Directors as required under the provisions of 31 Pa. Code § 148a.3(a)(2). It was also noted, section 7.6.1 of the custodial agreement contained the following language: "in addition, in order to secure the obligations of the Company to pay or perform any and all obligations of the Company pursuant to this Agreement, including without limitation to repay any Advance made pursuant to this Agreement, grant to the Custodian a security interest in all Investments and proceeds thereof (as defined in the Uniform Commercial Code as currently in effect in the State of New York); and agree to take, and agree that the Custodian may take, in respect of security interest referenced above, any further actions that the Custodian may reasonably require." This language is contrary to the provisions of 31 Pa. Code § 148a.3(b)(2) which specifies the custodian may not have a security interest or lien in any securities held under the agreement.

> ***It is recommended that the Company amend the custodial agreement with Brown Brothers Harriman & Co., dated April 2, 2009, to comply with the provisions of 31 Pa. Code § 148a.3(b)(2). It is further recommended that the Company's Board of Directors or an authorized committee of its Board of Directors approve the custodial agreement pursuant to the requirements of 31 Pa. Code § 148a.3(a)(2).***

The Company has a written investment policy as required by the 40 P.S. § 653b (b). The investment policy is reviewed and approved on an annual basis by the Board of Directors. It was determined that the Company was following its investment policy during the period covered by this examination.

LIABILITIES

LOSSES AND LOSS ADJUSTMENT EXPENSES

The Company reported reserves in the amount of $18,964,774 for losses and $8,555,534 for loss adjustment expenses on the December 31, 2012 Annual Statement. These reserve amounts represent the Company's share of the intercompany pool.

For the examination period, the Company's appointed actuary for the years of 2008 to 2011 was Christopher K. Bozman, FCAS, MAAA, of Towers Watson. For 2012, Brian Z. Brown, FCAS, MAAA, of Milliman, Inc. was appointed as the Company's appointed actuary. For each year in the examination period, the appointed actuary issued a Statement of Actuarial Opinion ("Opinion") concluding that the Company's reserves make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company.

In order for the examination team to gain an adequate comfort level with the Company's loss and loss adjustment expense reserve estimates, the Department retained Merlinos & Associates, Inc. ("Merlinos") through The Thomas Consulting Group, Inc. to perform a risk-focused review of the Company's loss and loss adjustment expense reserves for all companies in the Global Indemnity Group. Based upon the procedures performed and results obtained, Merlinos obtained sufficient documentation that the Company's reported loss and loss adjustment reserve amounts are reasonably stated.

SUBSEQUENT EVENTS

Extraordinary Dividend

On January 17, 2014, the Department approved the Company's request to pay a dividend to its parent, Penn-America Insurance Company, in the amount of $38,300,000. The dividend was considered to be an "extraordinary" dividend as defined by 40 P.S. §991.1405(b)(2). The dividend was paid from the Company's paid-in and contributed surplus in the amount of $13,800,000 and $24,500,000 was paid from its unassigned funds.

In a meeting with the Department on December 11, 2013, the Company indicated that the dividend was requested primarily to redeploy capital within its holding company structure for the purpose of restructuring holding company debt, and to make capital available for potential acquisition opportunities, business growth, and protection from catastrophes.

Following a series of extraordinary dividends paid by GBLI's US insurers to their parents and ultimately to GBLI in January 2014, including the one noted above, it was determined that the capital and surplus of the Company, PPIC and UNSIC was below what was required for the purposes of doing business as surplus lines insurers in certain states (New York and California for the Company and Pennsylvania for PPIC and UNSIC). As a result, the Company filed a Form D with the Department that was received on March 10, 2014, in which it requested the Department's prior approval to "redistribute" capital so that it and its two other affiliates may become compliant. As disclosed in the Form D filing, PAIC intends to contribute gross paid-in capital of $25 million to the Company and $12 million to PPIC. The contribution consisted of a mix of bonds and cash and was made on March 31, 2014.

Sale of Affiliate

Effective December 31, 2013, the Company's insurer affiliate, UNCIC, was sold to CGB Enterprises, Inc., a Louisiana corporation, and its affiliates. The transaction was approved by the Indiana Department of Insurance on December 13, 2013.

As a result of the sale of UNCIC, the Company amended its intercompany agreements effective January 1, 2013, to remove UNCIC as a party to these intercompany agreements which included: Stop Loss Reinsurance Contract with Wind River, Quota Share Reinsurance Contract with Wind River, Reinsurance Pooling Agreement, Cost Allocation Agreement, and the Tax Sharing Agreement.

By-law Amendment

At year-end 2012, the Company did not have an officer serving as President as required by its By-laws. However, pursuant to director and shareholder consents, both dated May 28, 2013; Article V, paragraph 1, of the Company's By-laws was amended to specify that in the absence of a President, the directors shall appoint an Executive Vice President to fulfill the duties of the President.

RECOMMENDATIONS

PRIOR EXAMINATION

The prior examination report contained the following recommendations:

1. It is recommended that in compliance with 40 P.S. § 991.1406 the Company provide open access to books and records of all companies in the holding company system.

   The Company has complied with this recommendation.

2. It is recommended that, in accordance with good business practices, the Board of Directors review and approve all significant transactions, including reinsurance contracts, prior to implementation.

   The Company has complied with this recommendation.

3. It is recommended that, in accordance with good business practices, the Board of Directors review and approve all intercompany and related party agreements, including the Tax Allocation Agreement.

   The Company has complied with this recommendation.

4. It is recommended the Company prepare a five year strategic plan to ensure that the Company's vision is carried out.

   The Company has complied with this recommendation.

5. It is recommended that the Board of Directors review, update and approve the Investment Policy annually as provided by 40 P.S. § 653b (b).

   The Company has complied with this recommendation.

CURRENT EXAMINATION

As a result of the current examination, the following recommendations are being made:

1. It is recommended the Company hold shareholder meetings in accordance with the provisions of its By-laws and pursuant to the requirements of 15 Pa. C.S. § 1755 (a) (See "Minutes" page 8).

2. It is recommended that the Company amend the custodial agreement with Brown Brothers Harriman & Co., dated April 2, 2009, to comply with the provisions of 31 Pa. Code § 148a.3(b)(2). It is further recommended that the Company's Board of Directors or an authorized committee of its Board of Directors approve the custodial agreement pursuant to the requirements of 31 Pa. Code § 148a.3(a)(2). (See "Investments" page 19).

CONCLUSION

As a result of this examination, the financial condition of Penn-Star Insurance Company, as of December 31, 2012, was determined to be as follows:

	Amount	Percentage
Admitted assets	$ 115,046,734	100.0 %
Liabilities	$ 53,378,912	46.4 %
Surplus as regards policyholders	61,667,822	53.6 %
Total liabilities and surplus	$ 115,046,734	100.0 %

Since the previous examination, made as of December 31, 2007, the Company's assets decreased by $80,042,544, its liabilities decreased by $72,190,492, and its surplus decreased by $7,852,052.

This examination was conducted by Edward S. Fossa, CFE, John Mutyaba, CPA, CISA, CISSP, CIA, Aejaz A. Palejwala, CFE, Brandon C. Thomas, HISP, MCM, David L. Daulton, CFE, Cecil W. Thomas, CFE, CIE, MCM, and D. Patrick Huth, CFE, with the latter in charge.

Respectfully

Annette B. Szady

Annette B. Szady, CPA
Director, Bureau of Financial Examinations

David R. Evans

David R. Evans, CFE
Examination Manager

D. Patrick Huth

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Examiner-in-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However the CFE designation is the only designation recognized by the NAIC for the purposes of directing statutory Association examinations of insurance companies.