

Examination Warrant Number 11-00000-34541-R1

**Report of Examination of
Allegheny Surety Company
Pittsburgh, Pennsylvania
As of December 31, 2011**

For Informational Purposes Only

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Harrisburg, Pennsylvania
April 24, 2013

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 11-00000-34541-R1 dated February 25, 2011, an examination was made of

Allegheny Surety Company, NAIC Code # 34541

a Pennsylvania domiciled stock property and casualty ("P&C") company, hereinafter referred to as "Company." The examination was conducted at the Company's home office, located at 4217 Steubenville Pike, Pittsburgh, Pennsylvania 15205.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Company was last examined as of December 31, 2006.

This examination covered the five-year period from January 1, 2007 through December 31, 2011, 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 Braund, Eiler, and Vasko 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 its work papers were incorporated into the examination.

HISTORY

The Company was licensed by the Department and commenced business on June 15, 1988. The Company was originally owned by sixteen (16) shareholders until July 14, 1999, when Paul C. Read, Richard J. Collins, and Richard J. Taylor each acquired 73,519 shares of common stock representing thirteen and four-tenths percent (13.4 %) ownership each in the corporation.

Simultaneous to the acquisition of the above common stock, all existing shareholders formed an insurance holding company under the name "The Allegheny Group, Inc." ("TheGroup"). All shareholders contributed their common stock to The Group in exchange for the same pro rata ownership of The Group as each had held previously in the Company. Also at this time, Paul C. Read, Richard J. Collins, and Richard J. Taylor purchased an additional 60,606 shares each in The Group for an aggregate price of \$300,000. Richard J. Collins retired in 2003 and the majority of his shares were acquired by Paul C. Read and Richard J. Taylor. As of the examination date, Paul C. Read and Richard J. Taylor, directly or indirectly, control 64.2% of the Group and no other shareholders own ten percent (10%) or more of the outstanding voting stock of The Group.

The Company is currently authorized to transact those classes of insurance described in 40 P.S. § 382 (c) (1), Fidelity and Surety.

MANAGEMENT AND CONTROL

CAPITALIZATION

As of the examination date, December 31, 2011, the Company's total capitalization was \$2,947,475, consisting of five hundred fifty thousand (550,000) shares of issued and outstanding common stock with a par value of one dollar thirty-seven cents (\$1.37) per share amounting to \$753,500; \$575,001 in gross paid in and contributed surplus and \$1,618,974 in unassigned funds (surplus).

The Company's minimum capital and surplus requirements for the types of business for which it is licensed, pursuant to 40 P. S. § 386, is \$250,000 in capital and \$125,000 in surplus. The Company has met all governing requirements throughout the examination period.

STOCKHOLDER

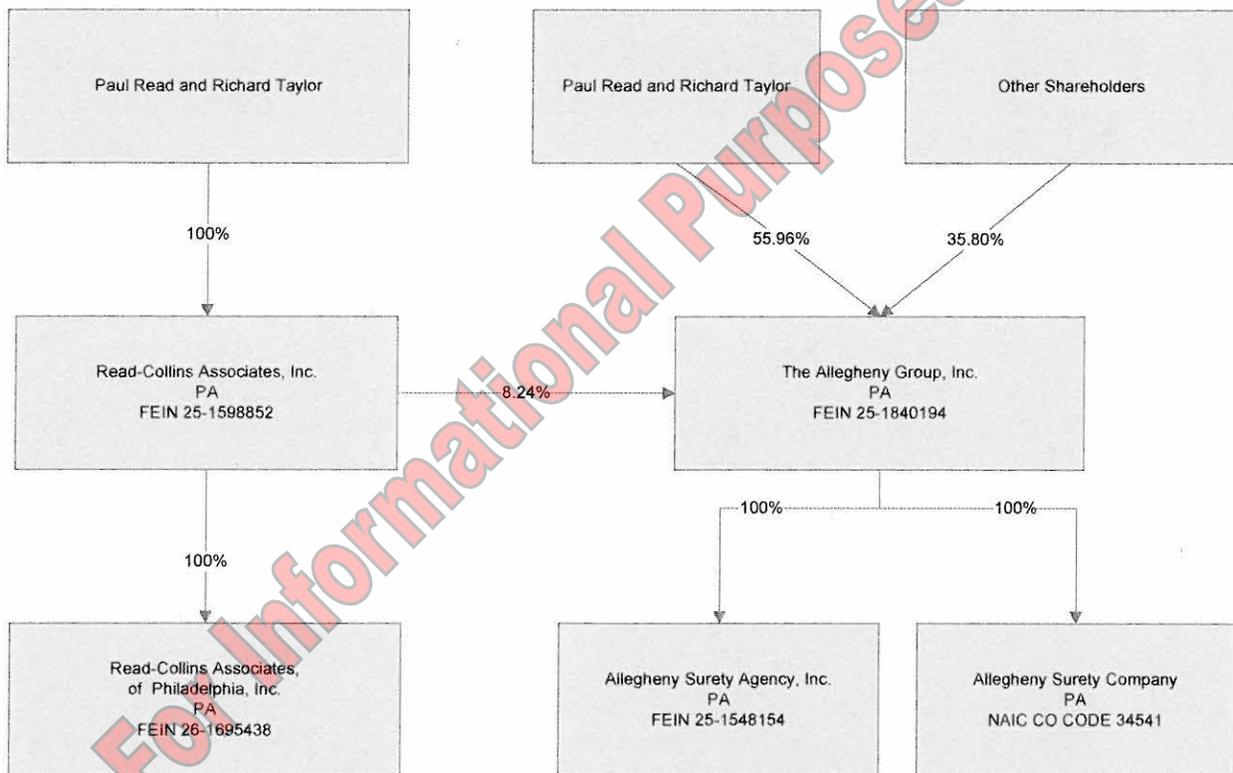
The Group is the Company's sole shareholder and owns 100% of the Company's common stock. The Company did not pay any dividends to its shareholder during the examination period.

INSURANCE HOLDING COMPANY SYSTEM

The Company is an entity within an insurance holding company system and is subject to the requirements of 40 P.S. §§ 991.1401 – 1413, and therefore, is required to file insurance holding company system registration statements. The required filings for the examination period have been filed with the Department. As of December 31, 2011, the Company was one hundred percent (100%) owned by The Group. As of the examination date, December 31, 2011, the following individuals own ten percent (10%) or more of the outstanding voting stock of The Group:

Paul C. Read	27.98%
Richard J. Taylor	27.98%

The following represents the Company’s organization chart as of December 31, 2011.



Due to their stock ownership, either directly or indirectly, Paul C. Read and Richard J. Taylor control sixty four point two percent (64.2%) of the stock of The Group; therefore, they are the ultimate controlling persons of the Insurance Holding Company System. The Group owns two companies that are briefly described below:

Allegheny Surety Agency, Inc. (“ASA”) has a general agent agreement with the Company that provides the Company with executive, managerial, administrative, other personnel, and data processing services as well as the use of facilities, supplies and communications.

Allegheny Surety Company

Allegheny Surety Company is a property and casualty insurance company that provides surety bonds for construction companies.

BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of the examination date, December 31, 2011:

Name and Address	Principal Occupation
Paul C. Read McKees Rocks, Pennsylvania	President The Allegheny Group, Inc.
Richard J. Taylor Venetia, Pennsylvania	Treasurer The Allegheny Group, Inc.
Wallace L. Cunningham New Castle, Pennsylvania	Retired
Christopher Ruck Plymouth Meeting, Pennsylvania	Regional Manager Read-Collins Associates
James Carlins McKees Rocks, Pennsylvania	Surety Manager The Allegheny Group, Inc.
Anthony Lekse Pittsburgh, Pennsylvania	Vice-President The Allegheny Group, Inc.
Thomas McConnell New Castle, Pennsylvania	Retired

The examination team documented that Directors complete a Conflict of Interest Questionnaire and Acceptance of Trust Statement annually.

COMMITTEES

The Company has an Investment Committee, a Compensation, an Actuary, an Accounting, a Nominations and Salary ("CAANS") Committee and an Audit Committee.

The Directors and/or Officers were assigned to serve on the following Committees as listed below as of the examination date:

Investment Committee

Richard J. Taylor
Anthony Lekse
Wallace L. Cunningham

CAANS Committee

Wallace L. Cunningham

Audit Committee

Christopher Ruck

Anthony Lekse

40 P.S. § 991.1405 (c) (3) Standards of transactions between insurer and affiliate (within the holding company system) states, in part, that “not less than one-third of the directors of any 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 at any meeting of the board of directors or any committee thereof”.

Additionally, 40 P.S. § 991.1405 (c) (4) Standards of transactions between affiliates (within the holding company system), further states that “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 candidates 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 is not in compliance with 40 P.S. § 991.1405 (c) 3 and (c) 4.

It is recommended that the Company comply with 40 P.S. § 991.1405 (c) 3 and (c) 4.

OFFICERS

As of the examination date, December 31, 2011, the following officers were appointed and serving in accordance with the Company’s By-Laws:

Name	Title
Paul C. Read	President
Richard J. Taylor	Treasurer
Jane E. Matczak	Secretary

CORPORATE RECORDS

MINUTES

A review of the minutes disclosed that the Company has complied with its By-Laws and has held the Company's Annual Shareholders meetings in accordance with its By-Laws. The Company's Directors were elected in accordance with its By-Laws and the Sole Shareholder approved the actions of the Company's directors and officers.

A review of the minutes of the meetings of the Company's Board of Directors during the examination period indicated that a quorum was achieved at all scheduled meetings. The Board of Directors approved all of the Company's investment transactions.

ARTICLES OF AGREEMENT

There were no changes or amendments to the Company's Articles of Agreement since the last examination.

BY-LAWS

There were no changes or amendments to the Company's By-Laws since the last examination.

SERVICE AND OPERATING AGREEMENTS

General Agent Agreement

The Company entered into a General Agent Agreement, effective January 1, 2008, with ASA. This agreement with ASA provides the Company with executive, managerial, administrative, other personnel, and data processing services as well as the use of facilities, supplies and communications. ASA is a wholly-owned subsidiary of The Allegheny Group, Inc. The actual fees paid by the Company to ASA under this agreement amounted to \$599,000 for yearended December 31, 2011.

REINSURANCE

CEDED

The Company terminated a ceded reinsurance contract with Odyssey America Reinsurance Company on July 1, 2007. No ceded reinsurance was reported by the Company from July 1, 2007 through December 31, 2011.

ASSUMED

The following summarizes the primary reinsurance contract that was in effect from August 1, 2007 through December 31, 2011:

Type of contract: Variable Quota Share
 Reinsured: Hudson Insurance Company
 Intermediary: None
 Effective date: August 1, 2007
 Term: Until terminated
 Business covered: Property & Casualty
 Limits and retention: The Company shall have maximum assumption of \$180,000 based on an assumption schedule. The Company will assume 20% of a \$900,000 bond and decreases their participation to 1.80% of a \$10,000,000 bond.

The contract contains the necessary arbitration and insolvency clauses. This contract appears to transfer risk from the reinsured to the reinsurer.

TERRITORY AND PLAN OF OPERATION

The Company is licensed only in Pennsylvania and is only authorized to write Fidelity and Surety Insurance. The Company writes business through a network of independent agents. The following is the distribution of the Company's lines of business by percentage of total net written premium for the year ended December 31, 2011:

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written Premium	Percentage of Total
December 31, 2011				
Surety	\$ 1,610,385	\$ 0	\$ 1,610,385	100.0%
Totals	\$ 1,610,385	\$ 0	\$ 1,610,385	100.0%

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	\$ 7,096,276	100.0 %
Losses incurred	\$ (215,536)	(3.0)%
Loss expenses incurred	34,379	0.5 %
Other underwriting expenses incurred	6,286,239	88.6 %
Net underwriting gain or (loss)	991,194	13.9 %
Totals	\$ 7,096,276	100.0 %

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

	2011	2010	2009	2008	2007
Admitted assets	\$ 4,406,133	\$ 4,287,827	\$ 4,149,504	\$ 3,416,366	\$ 3,631,330
Liabilities	\$ 1,458,658	\$ 1,454,521	\$ 1,428,746	\$ 1,335,169	\$ 1,591,769
Surplus as regards policyholders	\$ 2,947,475	\$ 2,833,306	\$ 2,720,758	\$ 2,081,197	\$ 2,039,561
Gross premium written	\$ 1,610,385	\$ 1,524,791	\$ 1,276,733	\$ 1,068,001	\$ 1,976,057
Net premium written	\$ 1,610,385	\$ 1,527,690	\$ 1,270,298	\$ 1,067,082	\$ 1,796,435
Underwriting gain/(loss)	\$ 97,030	\$ 129,041	\$ 514,885	\$ 98,992	\$ 151,246
Investment gain/(loss)	\$ 59,562	\$ 67,877	\$ 58,008	\$ 38,681	\$ 131,712
Other gain/(loss)	\$ 0	\$ 10,759	\$ 35,267	\$ 0	\$ 318
Net income	\$ 120,708	\$ 142,974	\$ 491,944	\$ 86,842	\$ 226,004

ACCOUNTS AND RECORDS

The Company's accounting, investment, policy, and claim records are all kept, maintained and available at the Company's home office.

PENDING LITIGATION

The Company was not involved in any litigation whose outcome could have a material effect on its financial condition as of the date of this examination report.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2011, and the results of its operations for the five-year period under examination as reported by the Company in its Annual Statements filed with the Department, 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,**

	2011	2010	2009	2008	2007
Bonds	\$ 1,710,283	\$ 1,699,505	\$ 1,646,099	\$ 1,604,466	\$ 1,355,701
Common stocks	249,709	307,707	272,146	234,549	603,327
Cash, cash equivalents, and short term investments	809,435	625,776	1,154,633	673,454	987,220
Subtotals, cash and invested assets	2,769,427	2,632,988	3,072,878	2,512,469	2,946,248
Investment income due and accrued	22,636	24,060	21,323	22,288	16,174
Premiums and agents' balances due	120,588	231,141	20,655	17,771	71,217
Funds held by or deposited with reinsured companies	1,076,020	989,313	817,308	513,014	220,000
Other amounts receivable under reinsurance contracts	148,551	167,802	26,379	145,898	238,486
Current federal and foreign income tax recoverable and interest thereon	27,176	50,920	0	16,846	51,266
Net deferred tax asset	121,865	107,062	181,771	136,770	72,174
Electronic data processing equipment and software	36,975	0	371	2,446	7,339
Receivable from parent, subsidiaries and affiliates	80,000	80,086	0	37,269	7,005
Aggregate write-ins for other than invested assets	2,895	4,455	8,819	11,595	1,421
Total	\$ 4,406,133	\$ 4,287,827	\$ 4,149,504	\$ 3,416,366	\$ 3,631,330
Losses	\$ 225,016	\$ 225,016	\$ 225,016	\$ 450,016	\$ 450,016
Other expenses	53,874	67,931	13,146	1,342	34,022
Current federal and foreign income taxes	3,456	3,464	48,536	10,412	0
Net deferred tax liability	0	0	126	832	2,495
Unearned premiums	548,392	468,375	398,731	390,586	449,566
Ceded reinsurance premiums payable (net of ceding commissions)	0	0	2,899	7,222	6,304
Amounts withheld or retained by company for account of others	502,920	564,937	580,081	265,215	589,151
Payable to parent, subsidiaries and affiliates	125,000	124,798	160,211	209,544	60,215
Total liabilities	1,458,658	1,454,521	1,428,746	1,335,169	1,591,769
Common capital stock	753,500	753,500	753,500	753,500	753,500
Gross paid in and contributed surplus	575,001	575,001	575,001	575,001	575,001
Unassigned funds (surplus)	1,618,974	1,504,805	1,392,257	752,696	711,060
Surplus as regards policyholders	2,947,475	2,833,306	2,720,758	2,081,197	2,039,561
Totals	\$ 4,406,133	\$ 4,287,827	\$ 4,149,504	\$ 3,416,366	\$ 3,631,330

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**Comparative Statement of Income
For the Year Ended December 31,**

	2011	2010	2009	2008	2007
Underwriting Income					
Premiums earned	\$ 1,530,368	\$ 1,458,045	\$ 1,262,153	\$ 1,126,063	\$ 1,719,647
Deductions:					
Losses incurred	0	9,464	(225,000)	0	0
Loss expenses incurred	764	31,214	0	1,244	1,157
Other underwriting expenses incurred	1,432,574	1,288,326	972,268	1,025,827	1,567,244
Total underwriting deductions	1,433,338	1,329,004	747,268	1,027,071	1,568,401
Net underwriting gain or (loss)	97,030	129,041	514,885	98,992	151,246
Investment Income					
Net investment income earned	56,572	65,365	70,124	81,875	108,055
Net realized capital gains or (losses)	2,990	2,512	(12,116)	(43,194)	23,657
Net investment gain or (loss)	59,562	67,877	58,008	38,681	131,712
Other Income					
Aggregate write-ins for miscellaneous income	0	10,759	35,267	0	318
Total other income	0	10,759	35,267	0	318
Net income before dividends to policyholders and before federal and foreign income taxes	156,592	207,678	608,160	137,673	283,276
Federal and foreign income taxes incurred	35,884	64,704	116,216	50,831	57,272
Net income	\$ 120,708	\$ 142,974	\$ 491,944	\$ 86,842	\$ 226,004

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

	2011	2010	2009	2008	2007
Surplus as regards policyholders,					
December 31, previous year	\$ 2,833,306	\$ 2,720,758	\$ 2,081,197	\$ 2,039,561	\$ 1,851,200
Net income	120,708	142,974	491,944	86,842	226,004
Net unrealized capital gains or (losses)	(21,342)	44,157	101,910	(111,465)	(47,969)
Change in net deferred income tax	14,803	(74,583)	45,707	66,259	(1,634)
Change in nonadmitted assets	0	0	0	0	11,960
Change in surplus as regards policyholder for the year	114,169	112,548	639,561	41,636	188,361
Surplus as regards policyholders,					
December 31, current year	\$ 2,947,475	\$ 2,833,306	\$ 2,720,758	\$ 2,081,197	\$ 2,039,561

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

	2011	2010	2009	2008	2007
Cash from Operations					
Premiums collected net of reinsurance	\$ 1,720,937	\$ 1,314,303	\$ 1,263,093	\$ 1,121,447	\$ 1,749,897
Net investment income	78,713	79,957	85,420	90,617	123,452
Miscellaneous income	0	10,759	35,267	(1)	317
Total income	1,799,650	1,405,019	1,383,780	1,212,063	1,873,666
Benefit and loss related payments	67,458	322,892	184,775	200,426	171,613
Commissions, expenses paid and aggregate write-ins for deductions	1,322,393	1,264,755	960,212	1,059,750	1,593,087
Federal and foreign income taxes paid (recovered)	12,148	160,696	61,246	5,999	143,953
Total deductions	1,401,999	1,748,343	1,206,233	1,266,175	1,908,653
Net cash from operations	397,651	(343,324)	177,547	(54,112)	(34,987)
Cash from Investments					
Proceeds from investments sold, matured or repaid:					
Bonds	50,000	303,203	332,904	55,000	597,233
Stocks	182,897	90,775	125,246	353,774	205,253
Total investment proceeds	232,897	393,978	458,150	408,774	802,486
Cost of investments acquired (long-term only):					
Bonds	81,496	362,010	381,944	318,621	505,792
Stocks	143,249	91,593	80,227	139,655	354,154
Total investments acquired	224,745	453,603	462,171	458,276	859,946
Net cash from investments	8,152	(59,625)	(4,021)	(49,502)	(57,460)
Cash from Financing and Miscellaneous Services					
Other cash provided (applied):					
Other cash provided or (applied)	(222,144)	(125,908)	307,653	(210,152)	78,544
Net cash from financing and miscellaneous sources	(222,144)	(125,908)	307,653	(210,152)	78,544
Reconciliation of cash and short-term investments:					
Net change in cash and short-term investments	183,659	(528,857)	481,179	(313,766)	(13,903)
Cash and short-term investments:					
Beginning of the year	625,776	1,154,633	673,454	987,220	1,001,123
End of the year	\$ 809,435	\$ 625,776	\$ 1,154,633	\$ 673,454	\$ 987,220

SUMMARY OF EXAMINATION CHANGES

As a result of this examination, the following changes have been made to the Company's financial statements as reported by the Company in its Annual Statements filed with the Department during the examination period:

	Balance Reported by Company	Balance After Exam Adjustment	Increase/(Decrease) to Surplus
Assets			
Funds held by or deposited with reinsured companies	1,076,020	509,931	(566,089)
Electronic data processing equipment and software	36,975	32,625	(4,350)
Net increase/(decrease) to surplus			(570,439)
Total surplus, December 31, 2011, per Company			2,947,475
Total surplus, December 31, 2011, per Examination			<u>\$ 2,377,036</u>

NOTES TO FINANCIAL STATEMENTS

ASSETS

INVESTMENTS

As of December 31, 2011, the Company's invested assets were distributed as follows:

	Amount	Percentage
Bonds	\$ 1,710,283	61.8 %
Common stocks	249,709	9.0 %
Cash	809,435	29.2 %
Totals	<u>\$ 2,769,427</u>	<u>100.0 %</u>

The Company's bond portfolio had the following quality and maturity profiles:

NAIC Designation	Amount	Percentage
1 - highest quality	\$ 1,710,283	100.0 %
Totals	<u>\$ 1,710,283</u>	<u>100.0 %</u>

Years to Maturity	Amount	Percentage
2 to 5 years	1,315,202	76.9 %
6 to 10 years	176,422	10.3 %
11 to 20 years	218,658	12.8 %
Totals	<u>\$ 1,710,283</u>	<u>100.0 %</u>

The Company has sixty-one and eight-tenths percent (61.8%) of its cash and invested assets invested in municipal bonds. All bonds held by the Company have the rating of one ("1") or highest quality by the NAIC. Eighty-seven and two-tenths percent (87.2%) of all bonds have a maturity of between two and ten years. Another nine percent (9.0%) of invested assets are in common stocks and twenty-nine and two-tenths percent (29.2%) is held in cash. The Company was not able to provide a written copy of its investment policy. According to 40 P.S. § 653b (b)

which states; "A domestic company is required to have a formal investment plan, updated on an annual basis, as authorized by the board of directors. The investment plan shall include, at a minimum, a description of the investment strategy of the company designed to provide for liquidity and diversity of the investment portfolio. The investment plan shall be made available to the Insurance Department during the course of a financial condition examination."

It is recommended that the Company develop a formal written investment policy to comply with the requirements of 40 P.S. § 653b (b) and that it is reviewed and approved by the Board on an annual basis.

As of December 31, 2011 all certificated assets were held by the Company's investment advisor, Morgan Stanley. The Company was not able to provide an executed custodial agreement with Morgan Stanley, an investment broker, as required by 31 Pa. Code §148.4 (a) which states; "The underlying agreement between an insurer and a custodian shall be available. Such custodial agreements shall provide: a standard of responsibility on the part of the custodian which shall not be less than the responsibility of a bailee for hire or a fiduciary under statutory or case law of the custodian's state of domicile, that securities held by the custodian are subject to instructions of the insurer, and that the securities may be withdrawn immediately upon demand of the insurer."

On February 21, 2013, the Company executed a contract with Comerica Bank to provide custodial services for the Company's invested assets. The agreement was reviewed and is in compliance with 31 Pa. Code § 148a3. The Company's invested assets are now held by Comerica Bank.

FUNDS HELD BY OR DEPOSITED WITH REINSURED COMPANIES \$509,931

The Company reported \$1,076,020 as Funds held by or deposited with reinsured companies in its 2011 Annual Statement. A review of the quarterly statement obtained from Hudson Insurance Company ("Hudson") reflected that the amounts held by the reinsured exceeded the liabilities that were secured. SSAP No. 62R, paragraph 21, states "Funds held or deposited with reinsured companies, whether premiums withheld as security for unearned premium and outstanding loss reserves or advances for loss payments, are admitted assets provided they do not exceed the liabilities they secure and provided the reinsured is solvent. Those funds which are in excess of the liabilities, and any funds held by an insolvent reinsured, shall be non-admitted." As a result of this examination, the proper amount of Funds held by or deposited with reinsured companies as of December 31, 2011 has been determined to be \$509,931, a decrease of \$566,089. This examination adjustment reduces the Company's assets and reported surplus by \$566,089.

It is recommended that the Company properly record Funds held or deposited with reinsured companies in compliance with SSAP No. 62R, paragraph 21.

ELECTRONIC DATA PROCESSING EQUIPMENT AND SOFTWARE \$32,625

The Company reported an amount of \$36,975 for Electronic data processing equipment and software in its 2011 Annual Statement. A review of the depreciation schedule obtained from the Company's CPA firm disclosed that certain assets were incorrectly depreciated over a five-year period. SSAP No. 16 states that "EDP equipment and software shall be depreciated for a period not to exceed three years." As a result of this examination, the proper amount of Electronic data processing equipment and software as of December 31, 2011 has been determined to be \$32,625, a decrease of \$4,350. This examination adjustment reduces the Company's assets and reported surplus by \$4,350.

It is recommended that the Company properly record Electronic Data Processing Equipment and Software in compliance with SSAP No. 16.

LIABILITIES

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company reported losses and loss adjustment expenses of \$225,016 and \$0 respectively, on the December 31, 2011 Annual Statement. These amounts were accepted for the purposes of this examination.

Ronald T. Kuehn, FCAS, MAAA, CPCU, FCA of Huggins Actuarial Services, Inc., was the Company's appointed actuary providing the Statements of Actuarial Opinion for the Company. For each year during the examination period, Mr. Kuehn concluded that the amounts carried in the balance sheet

- A. "Meet the requirements of the insurance laws of Pennsylvania;
- B. Are consistent with reserves computed with accepted loss reserving standards and principles; and
- C. Make a reasonable provision in the aggregate for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements."

The CAANS Committee appointed the actuary each year. During our review of the minutes of the Company's Board and Committee meetings held during the examination period, we found no evidence in the minutes documenting that the Actuarial Report and Opinion were presented or were made available to the Board of Directors as required by the NAIC 2011 Annual Statement Instructions. The 2011 NAIC Annual Statement Instructions, property/ casualty, actuarial opinion, Page 25, Section 1, states as follows: "The Appointed Actuary must report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the Appointed Actuary has presented such information to the Board of Directors or the Audit Committee and that the Actuarial Opinion and the Actuarial Report were made available."

It is recommended that the Company document within board minutes that the Actuarial Opinion and Actuarial Report have been reported to the Board of Directors, as required by the NAIC Annual Statement Instructions.

SUBSEQUENT EVENTS

Other than the exam adjustments noted previously in this report, there were no other material events noted through the date of this report that would have a material impact on the financial condition of the Company.

RECOMMENDATIONS

PRIOR EXAMINATION

The prior examination report contained the following recommendations:

1. It was recommended that the Company comply with 40 P.S. § 322.3 and amend its MGA agreement with Read-Collins so that all funds are remitted to the Company not less than monthly.
This recommendation is no longer valid as the company has entered into a new Management and Cost Sharing agreement with its affiliated company, ASA.

CURRENT EXAMINATION

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

1. It is recommended that the Company comply with 40 P.S. § 991.1405 (c) 3 and (c) 4. (See "Committees", page 5)
2. It is recommended that the Company develop a formal written investment policy to comply with the requirements of 40 P.S. § 653b (b) and that it is reviewed and approved by the Board on an annual basis. (See "Investments", page 14)
3. It is recommended that the Company properly record Funds held or deposited with reinsured companies in compliance with SSAP No. 62R, paragraph 21. (See "Notes to Financial Statements – Assets", page 14)
4. It is recommended that the Company properly record Electronic Data Processing Equipment and Software in compliance with SSAP No. 16. See "Notes to Financial Statements – Assets", page 15)
5. It is recommended that the Company document within board minutes that the Actuarial Opinion and Actuarial Report have been reported to the Board of Directors, as required by the NAIC Annual Statement Instructions. (See "Loss and Loss Adjustment Expense Reserves", page 15)

CONCLUSION

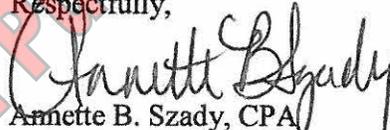
As a result of this examination, the financial condition of Allegheny Surety Company, as of December 31, 2011, was determined to be as follows:

	Amount	Percentage
Admitted assets	\$ 3,835,694	100.0 %
Liabilities	\$ 1,458,658	38.0 %
Surplus as regards policyholders	2,377,036	62.0 %
Total liabilities and surplus	\$ 3,835,694	100.0 %

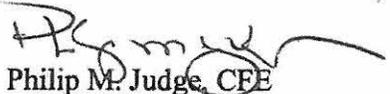
Since the previous examination, made as of December 31, 2006, the Company's assets increased by \$451,805, its liabilities decreased by \$74,031, and its surplus increased by \$526,279.

This examination was conducted by Kevin R. Prescott, CFE, CISA, and Robert W. Smith, CFE with the latter in charge.

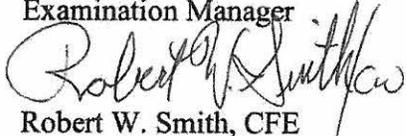
Respectfully,



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



Philip M. Judge, CFE
Examination Manager



Robert W. Smith, CFE
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