

Examination Warrant Number 16-1282-35114-A1

**Report of Examination of
NORCAL Specialty Insurance Company
Mechanicsburg, Pennsylvania**

As of December 31, 2016

For Informational Purposes Only

NORCAL Specialty Insurance Company

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Harrisburg, Pennsylvania
December 1, 2017

Honorable Joseph DiMemmo, CPA
Deputy Insurance Commissioner
Commonwealth of Pennsylvania
Insurance Department
Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 16-1282-35114-A1, dated June 3, 2016, an examination was made of

NORCAL Specialty Insurance Company, NAIC Code:35114

a Pennsylvania domiciled multi-state professional liability insurance company, hereinafter referred to as the "Company." The examination was conducted at the Company's home office, located at 1700 Bent Creek Boulevard, Mechanicsburg, Pennsylvania 17050-1865.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Pennsylvania Insurance Department ("Department") has performed an examination of the Company, which was last examined as of December 31, 2012. This examination covered the four-year period from January 1, 2013 through December 31, 2016.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance Department and 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 financial condition, assess corporate governance, identify current and prospective risks of the Company, evaluate system controls and procedures used to mitigate those risks, and review subsequent events. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with statutory accounting principles.

The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, in accordance with

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40 P.S. § 323.5(a), and general information about the Company and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

For each year from 2014 through 2016, the certified public accounting firm (“CPA”) of KPMG provided an unmodified audit opinion on the combined year-end financial statements of the following companies, based on statutory accounting principles. For the year-ending 2013, the CPA firm of EY provided an unmodified audit report on the year-end financial statements of the Company. Relevant work performed by KPMG, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

The following companies were examined at the same time during the above examination:

Company	NAIC Code
NORCAL Mutual Insurance Company (CA)	33200
Medicus Insurance Company (TX)	12754
FD Insurance Company (FL)	12441

HISTORY

The Company was incorporated on June 30, 1976, licensed by the Department on November 30, 1977, and commenced business on January 1, 1978.

Effective December 1, 2015, the Company changed its name from PMSLIC Insurance Company to its current name

The Company is currently authorized to transact those classes of insurance described in 40 P.S. § 382(c)(4), Other Liability.

MANAGEMENT AND CONTROL

CAPITALIZATION

As of the examination date, December 31, 2016, the Company’s total capital was \$44,059,636 consisting of 5,100,000 capital shares of issued and outstanding common stock with a par value of \$1.00 per share amounting to \$5,100,000; \$24,395,886 of paid-in and contributed surplus; and \$14,563,750 of unassigned funds (surplus).

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 \$750,000 in capital and \$375,000 in surplus. The Company has met all governing requirements throughout the examination period.

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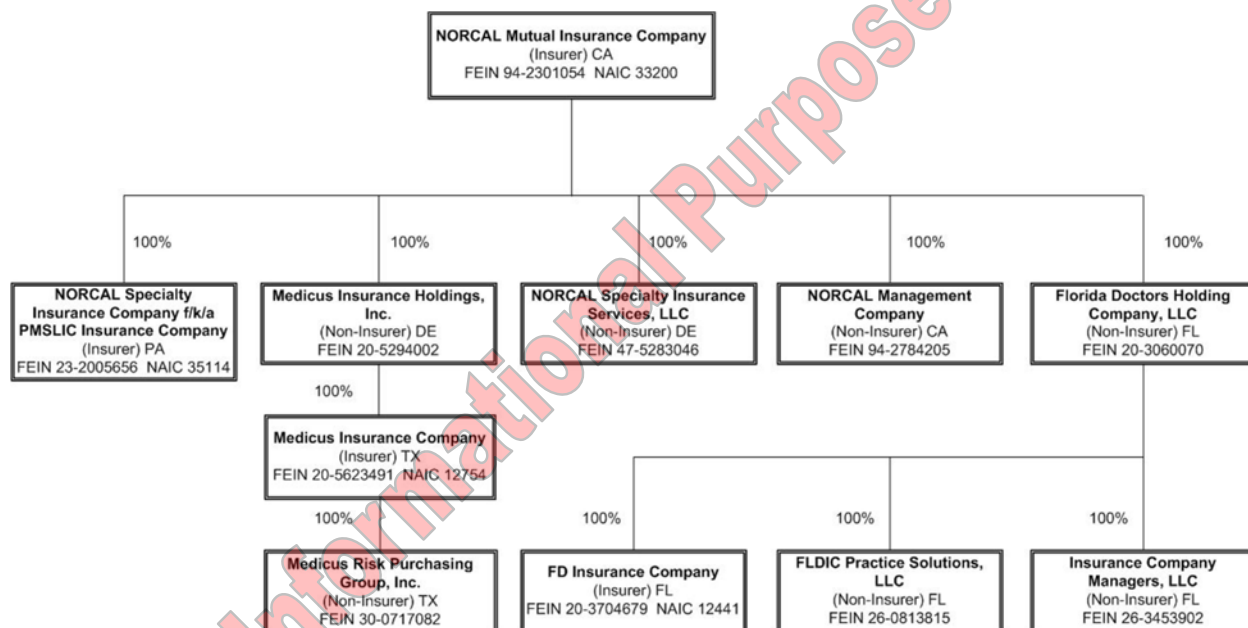
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STOCKHOLDER

NORCAL Mutual Insurance Company (“NORCAL”) owns 100% of the Company. On November 10, 2015, the Board approved an extraordinary dividend of \$205,000,000 payable to NORCAL, which was authorized by the Department on December 20, 2015, and payment thereof was completed by December 29, 2015.

INSURANCE HOLDING COMPANY SYSTEM

The Company meets the requirements for filing an insurance holding company system registration statement, in compliance with 40 P.S. § 991.1404 and an insurance company holding company system registration statement has been timely filed with the Department for each year during the examination period. The organization chart below depicts the insurance holding company structure.



NORCAL is named as the ultimate controlling person in the system. Members of the holding company system include the following entities briefly described below:

NORCAL Mutual Insurance Company

NORCAL is a California domestic professional liability mutual insurance company that was incorporated under the laws of California on September 18, 1975, and began transacting insurance business on November 11, 1975. As of December 31, 2016, NORCAL insured more than 27,000 physicians and other healthcare professionals in 48 states and the District of Columbia. As of December 31, 2016, NORCAL owned 100% of the Company, Medicus Insurance Holdings, Inc., NORCAL Specialty Insurance Services, LLC, NORCAL Management Company, and Florida Doctors Holding Company, LLC. On January 1, 2017, NORCAL

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acquired 100% of PPM Services, Inc. (PPM), a non-insurance holding company that controlled approximately \$36.5 million of premium written by Preferred Physicians Medical Risk Retention Group, Inc. (RRG) in 2016.

Medicus Insurance Holdings Inc.

Medicus Insurance Holdings Inc. operates as a holding company. The company, through its subsidiaries, provides medical professional liability insurance solutions to physicians, surgeons, and related medical service providers.

NORCAL Specialty Insurance Services LLC

NORCAL Specialty Insurance Services LLC is a Delaware company which was organized to provide a range of supplemental services to insurance companies.

NORCAL Management Company

NORCAL Management Company performs various management services to affiliates and others.

Florida Doctors Holding Company, LLC

Florida Doctors Holding Company, LLC operates as a holding company. The company, through its subsidiaries, provides property and casualty insurance services in Florida and Georgia.

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, 2016:

Name and Address	Principal Occupation
Theodore Scott Diener Greenbrae, California	President & CEO NORCAL Mutual Insurance Company
Julia Lynne Burns New Cumberland, Pennsylvania	Senior Vice President NORCAL Mutual Insurance Company
Timothy James Friers Mechanicsburg, Pennsylvania	Senior Vice President & COO NORCAL Specialty Insurance Company
Alice Hardy Gannon San Antonio, Texas	Member, Board of Directors NORCAL Specialty Insurance Company
Mark David Johnson Dripping Springs, Texas	Senior Vice President & CFO NORCAL Mutual Insurance Company
Ronald Carl Rumin Phoenix, Arizona	President & CEO NORCAL Specialty Insurance Company
Jaan Erik Sidorov, MD Harrisburg, Pennsylvania	Physician Sidorov Medical Solutions

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Article IV of the by-laws specifies that there shall be no less than 7 nor more than 15 directors elected at the annual shareholder meeting to serve for one year and to hold office until their successors are elected and qualified.

The Company's Conflict of Interest policy applies to all officers, Board members and employees, and they are required to complete an annual acknowledgement to that effect. The policy is also set forth in the employee handbook.

COMMITTEES

As of the examination date, December 31, 2016, the NORCAL committees were functioning as the Company's committees, as had been recommended by the Company's Governance Committee and approved by the Company's Board on December 2, 2011.

As of the examination date, December 31, 2016, the following committees were appointed by the NORCAL Board and serving in accordance with that company's by-laws:

Executive Committee

Jaan E. Sidorov, MD – Chair
Sandra L. Beretta, MD – Vice Chair
Rebecca J. Patchin, MD - Secretary
Scott C. Syphax

Audit Committee

Alice H. Gannon – Chair
Sandra L. Beretta, MD
Patricia A. Dailey, MD
M. Diane Koken
Rebecca J. Patchin

Compensation & Benefits Committee

Sandra L. Beretta, MD – Chair
Steven Packer, MD
Rebecca J. Patchin, Secretary
Scott C. Syphax
Jaan E. Sidorov, MD

Governance Committee

Fabiola Cobarrubias, MD – Chair
Steven Packer, MD
Rebecca J. Patchin, MD
Patricia A. Dailey, MD
Roger M. Hayashi, MD
Jaan E. Sidorov, MD

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Investment Committee

Steven Packer, MD – Chair
Roger M. Hayashi
Sandra L. Beretta, MD
Fabiola Cobarrubias, MD
M. Diane Koken
Scott C. Syphax
Jaan E. Sidorov, MD

OFFICERS

As of the examination date, December 31, 2016, the following officers were appointed and serving in accordance with the Company's by-laws:

Name	Title
Ronald C. Rumin	President & CEO
Mark D. Johnson	Senior Vice President Treasurer & Secretary
Timothy J. Friers	Senior Vice President & COO
Dennis A. Meisel	Vice President Finance & Controller
Theodore Scott Diener	Chair, Board of Directors
Jaan E. Sidorov, MD	Vice Chair, Board of Directors

CORPORATE RECORDS

MINUTES

The meeting minutes of the Board, the NORCAL committees, and the sole shareholder were all reviewed for the period under examination, through the date of this report, and any significant actions taken during each meeting were noted. In addition, a compliance review of corporate and other minutes revealed the following:

- The sole shareholder executed annual written consents which elected the directors in compliance with the by-laws.
- The shareholder ratified the actions of the Board, and the officers' powers are specified in the by-laws. Actions other than those specified are specifically approved by the shareholder or the Board.
- Officers are appointed at the first annual Board meeting and at later meetings to fill vacancies or new appointments.
- Quorums were present at all Board and committee meetings.
- NORCAL's Board approves the reinsurance contracts.
- All directors regularly attend Board meetings.

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ARTICLES OF INCORPORATION

The Articles of Incorporation were amended effective December 1, 2015, to change the Company's name from PMSLIC Insurance Company to NORCAL Specialty Insurance Company.

BY-LAWS

The by-laws of the Company were amended as of December 1, 2015, to conform them to those of the parent company. The changes were appropriately reported to the Department.

SERVICE AND OPERATING AGREEMENTS

INTERCOMPANY AFFILIATE SERVICE AGREEMENT

The Company, NORCAL, NORCAL Specialty Insurance Services, LLC, Medicus Insurance Holdings, Inc., Medicus Insurance Company, NORCAL Management Company, Medicus Risk Purchasing Group, Inc., Florida Doctors Holding Company, LLC, FD Insurance Company, Insurance Company Managers, LLC, and FDLC Practice Solutions, LLC (collectively, "the Group") participate in an amended and restated Intercompany Affiliate Service Agreement ("Agreement"). The Agreement was effective January 1, 2016 and was approved by the Department on March 15, 2016. This Agreement replaced earlier agreements effective January 1, 2009, July 23, 2011, and October 6, 2011, all of which added additional affiliated entities to the original parties of NORCAL and the Company.

Under the terms of this Agreement, all the companies may share in and use the services of personnel and facilities of the others in carrying out their business and that of the Group. The services rendered under this Agreement may include accounting, taxes, auditing, underwriting, claims, investment, and functional support services. Compensation for the services is based on actual cost, without a profit factor, but including indirect and shared expenses, all allocated in conformity with SSAP No. 70 – Allocation of Expenses. Settlements are due within 30 days of each quarter-end and delinquencies bear interest at 7% per annum.

TAX SHARING AGREEMENT

Effective January 1, 2016, the Company entered into a written Amended and Restated Tax-Sharing Agreement with NORCAL, NORCAL Specialty Insurance Services, LLC, Medicus Insurance Holdings, Inc., Medicus Insurance Company, NORCAL Management Company, Medicus Risk Purchasing Group, Inc., Florida Doctors Holding Company, LLC, FD Insurance Company, Insurance Company Managers, LLC, and FDLC Practice Solutions, LLC. The agreement was approved by the Company's Board and sets forth the manner in which the total combined federal income tax is allocated to each participating entity. The allocation is based upon separate return calculations, with current credit for net losses and or credits, where such items result in an actual reduction in the consolidated group's tax liability.

This agreement replaced earlier agreements effective January 1, 2010 and January 1, 2011, both of which added additional affiliated entities to the original parties of NORCAL and the Company.

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The examiner determined that the above agreements meet the fair and reasonable standards in 40 P.S. 991.1405(a)(1)(i) “Standards and management of an insurer within an insurance holding company system.”

The Company has no managing general agents.

REINSURANCE

CEDED and ASSUMED

INTERCOMPANY POOLING AGREEMENT

On January 1, 2007, the Company entered into an intercompany pooling agreement with NORCAL. Under the agreement, the Company ceded 100% of its business, net of unaffiliated reinsurance, to the pool and then assumed 27% of the combined business subject to the pool, while NORCAL retained the remainder. The net business subject to the pool included premiums, losses, loss adjustment expense, underwriting expenses, and policyholder dividends. The pool was covered by unaffiliated reinsurance for the excess exposure over the Company’s per occurrence retention.

Effective December 31, 2015, the Company and NORCAL entered into a Commutation and Release Agreement to terminate the 2007 pooling agreement and to extinguish any and all obligations and liabilities of both parties. The Company remitted \$193,247,000 to NORCAL in the first quarter of 2017 in settlement of the termination.

Effective December 31, 2015, the Company and NORCAL entered into a Loss Portfolio Transfer Agreement, whereby the Company transferred, and NORCAL accepted, all open, existing, and future claims under all insurance policies entered into on or prior to December 31, 2015. No gain or loss resulted from this transfer and assumption and both the Department and the California Department of Insurance approved the agreement.

QUOTA SHARE REINSURANCE AGREEMENT

Effective January 1, 2016, The Company entered into a 100% Quota Share Reinsurance Contract (“the Contract”) whereby the Company obligates itself to cede to NORCAL, and NORCAL obligates itself to accept for reinsurance of the Company a 100% quota share participation of the Company's Ultimate Net Loss. As premium for the reinsurance provided, the Company will cede to NORCAL all Net Written Premium and NORCAL shall allow the Company a ceding commission at a provisional rate of 33% on all premiums ceded under this Contract. The ceding commission is subject to adjustment on a quarterly basis during the term of the Contract based on actual expenses incurred.

TERRITORY AND PLAN OF OPERATION

The Company is licensed in the states of Delaware and Pennsylvania and is licensed to write surplus lines business in all other states and the District of Columbia.

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The Company is a surplus lines carrier, focusing on providing flexible medical professional liability coverage options that address the unique needs of complex accounts, such as facilities, staffing companies, multi-state groups, and more.

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Written Premium	Percentage of Total
December 31, 2016				
Medical malpractice - occurrence	\$ 7,919,566	\$ 7,919,566	\$ 0	0.0%
Medical malpractice - claims-made	7,498,979	9,992,389	(2,493,410)	100.0%
Totals	<u>\$ 15,418,545</u>	<u>\$ 17,911,955</u>	<u>\$ (2,493,410)</u>	<u>100.0%</u>

Prior to January 1, 2016, the Company was a direct writer of medical professional liability coverage on both a claims-made and occurrence basis. Subsequent to the Company's change to an excess and surplus lines carrier, its direct and assumed business was substantially reduced from its prior levels. This is demonstrated by a comparison to the four-year average data shown below.

SIGNIFICANT OPERATING RATIOS AND TRENDS

	Amount	Percentage
Premiums earned	\$ 224,957,111	100.0 %
Losses incurred	\$ 61,040,010	27.1 %
Loss expenses incurred	87,899,993	39.1 %
Other underwriting expenses incurred	86,840,730	38.6 %
Net underwriting gain or (loss)	(10,823,622)	(4.8)%
Totals	<u>\$ 224,957,111</u>	<u>100.0 %</u>

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

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

	2016	2015	2014	2013
Admitted assets	\$ 58,709,926	\$ 507,656,727	\$ 457,428,720	\$ 472,110,810
Liabilities	\$ 14,650,290	\$ 271,001,732	\$ 227,766,296	\$ 252,055,458
Surplus as regards policyholders	\$ 44,059,636	\$ 236,654,995	\$ 229,662,424	\$ 220,055,352
Gross premium written	\$ 15,418,545	\$ 51,119,703	\$ 124,623,379	\$ 131,081,112
Net premium written	\$ (2,493,410)	\$ (35,698,141)	\$ 76,862,231	\$ 78,524,841
Underwriting gain/(loss)	\$ 3,128	\$ (2,346,098)	\$ (7,213,632)	\$ (3,055,575)
Investment gain/(loss)	\$ 20,019,383	\$ 13,447,261	\$ 14,835,419	\$ 10,498,623
Other gain/(loss)	\$ (3,125)	\$ 18,633	\$ 35,662	\$ 6,923
Net income	\$ 18,126,870	\$ 14,821,885	\$ 8,452,638	\$ 3,533,060

PENDING LITIGATION

The Company was not involved in any pending litigation outside its normal business activities as of December 31, 2016.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2016, and the results of its operations for the four-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

*Note: Due to rounding errors some financials shown in this report may contain immaterial differences from those reported in the Company's filed Annual Statements.

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Comparative Statement of Assets, Liabilities, Surplus and Other Funds As of December 31, 2016

	2016	2015	2014	2013
Bonds	\$ 46,451,597	\$ 377,254,913	\$ 357,848,890	\$ 340,825,707
Preferred stocks	0	2,104,719	3,517,605	2,391,878
Common stocks	0	32,514,438	29,055,199	49,034,131
Cash, cash equivalents, and short term investments	7,987,171	8,857,875	17,839,807	29,061,885
Other invested assets	0	6,470,889	21,192,089	21,708,964
Subtotals, cash and invested assets	54,438,768	427,202,834	429,453,590	443,022,565
Investment income due and accrued	466,535	3,601,177	3,489,973	3,040,580
Premiums and agents' balances due	3,804,623	(29,281,241)	7,619,526	6,741,816
Amounts recoverable from reinsurers	0	96,608,378	8,615,954	7,725,137
Current federal and foreign income tax recoverable and interest thereon	0	2,992,498	785,173	1,872,336
Net deferred tax asset	0	209,888	4,726,131	6,879,157
Receivable from parent, subsidiaries and affiliates	0	6,323,193	2,738,373	2,829,219
Total assets excluding Separate Accounts, Segregated Accounts and Protected Cell Accounts	58,709,926	507,656,727	457,428,720	472,110,810
Separate Accounts, Segregated Accounts and Protected Cell Accounts	0	0	0	0
Total	\$ 58,709,926	\$ 507,656,727	\$ 457,428,720	\$ 472,110,810
Losses	\$ 0	\$ 0	\$ 113,838,027	\$ 116,395,006
Reinsurance payable on paid loss and loss adjustment expenses	0	183,231,319	13,533,794	16,020,000
Loss adjustment expenses	5,041,553	7,900,040	60,020,928	63,660,449
Commissions payable, contingent commissions and other similar charges	72,108	526,662	296,373	126,031
Other expenses	36,000	119,000	115,751	163,830
Taxes, licenses and fees	294,126	381,692	845,721	509,107
Current federal and foreign income taxes	2,198,123	0	0	0
Net deferred tax liability	2,914,186	0	0	0
Unearned premiums	0	2,493,410	36,075,898	33,604,801
Advance premium	0	442,769	88,752	11,309,617
Dividends declared and unpaid:				
Policyholders'	0	16,505	187,727	4,721,962
Ceded reinsurance premiums payable (net of ceding commissions)	3,545,134	75,613,958	1,108,206	2,748,903
Amounts withheld or retained by company for account of others	355	0	97	49,200
Remittances and items not allocated	214,796	123,410	537,053	352,907
Payable to parent, subsidiaries and affiliates	333,909	0	0	0
Payable for securities	0	152,967	22,809	0
Aggregate write-ins for liabilities	0	0	1,095,160	2,393,645
Total liabilities excluding protected cell liabilities	14,650,290	271,001,732	227,766,296	252,055,458
Protected cell liabilities	0	0	0	0
Total liabilities	14,650,290	271,001,732	227,766,296	252,055,458
Common capital stock	5,100,000	5,100,000	5,100,000	5,100,000
Gross paid in and contributed surplus	24,395,886	24,395,886	24,395,886	24,395,886
Unassigned funds (surplus)	14,563,750	207,159,109	200,166,538	190,559,466
Surplus as regards policyholders	44,059,636	236,654,995	229,662,424	220,055,352
Totals	\$ 58,709,926	\$ 507,656,727	\$ 457,428,720	\$ 472,110,810

**Comparative Statement of Income
For the Year Ended December 31, 2016**

	2016	2015	2014	2013
Underwriting Income				
Premiums earned	\$ 0	\$ (2,115,654)	\$ 74,391,134	\$ 78,080,482
Deductions:				
Losses incurred	0	(34,099,749)	30,180,635	34,573,618
Loss expenses incurred	499,515	11,241,822	25,554,401	27,378,069
Other underwriting expenses incurred	(502,643)	23,088,371	25,869,730	19,184,370
Total underwriting deductions	<u>(3,128)</u>	<u>230,444</u>	<u>81,604,766</u>	<u>81,136,057</u>
Net underwriting gain or (loss)	<u>3,128</u>	<u>(2,346,098)</u>	<u>(7,213,632)</u>	<u>(3,055,575)</u>
Investment Income				
Net investment income earned	8,632,515	11,808,356	11,832,771	11,261,109
Net realized capital gains or (losses)	11,386,868	1,638,905	3,002,648	(762,486)
Net investment gain or (loss)	<u>20,019,383</u>	<u>13,447,261</u>	<u>14,835,419</u>	<u>10,498,623</u>
Other Income				
Net gain or (loss) from agents' or premium balances charged off	(4,874)	(2,205)	(2,830)	3,992
Aggregate write-ins for miscellaneous income	1,749	20,838	38,492	2,931
Total other income	<u>(3,125)</u>	<u>18,633</u>	<u>35,662</u>	<u>6,923</u>
Net income before dividends to policyholders and before federal and foreign income taxes	20,019,386	11,119,796	7,657,449	7,449,971
Dividends to policyholders	(13,405)	0	(239,797)	4,488,171
Federal and foreign income taxes incurred	1,905,921	(3,702,089)	(555,392)	(571,260)
Net income	<u>\$ 18,126,870</u>	<u>\$ 14,821,885</u>	<u>\$ 8,452,638</u>	<u>\$ 3,533,060</u>

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**Comparative Statement of Capital and Surplus
For the Year Ended December 31, 2016**

	2016	2015	2014	2013
Surplus as regards policyholders, December 31, previous year	\$ 236,654,995	\$ 229,662,424	\$ 220,055,352	\$ 220,837,603
Net income	18,126,870	14,821,885	8,452,638	3,533,060
Net unrealized capital gains or (losses)	(1,816,714)	(2,111,451)	2,476,018	(1,344,988)
Change in net deferred income tax	(4,109,449)	(5,599,448)	(1,406,161)	(810,416)
Change in nonadmitted assets	203,934	(118,415)	418,817	(504,987)
Dividends to stockholders	(205,000,000)	0	0	0
Aggregate write-ins for gains and losses in surplus	0	0	(334,240)	(1,654,920)
Change in surplus as regards policyholder for the year	(192,595,359)	6,992,571	9,607,072	(782,251)
Surplus as regards policyholders, December 31, current year	\$ 44,059,636	\$ 236,654,995	\$ 229,662,424	\$ 220,055,352

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**Comparative Statement of Cash Flow
For the Year Ended December 31, 2016**

	2016	2015	2014	2013
Cash from Operations				
Premiums collected net of reinsurance	\$ (1,266,235)	\$ 75,938,685	\$ 63,004,074	\$ 78,487,354
Net investment income	13,344,472	14,034,224	14,045,015	13,689,748
Miscellaneous income	(3,128)	18,634	35,662	6,923
Total income	12,075,109	89,991,543	77,084,751	92,184,025
Benefit and loss related payments	6,384,151	30,476,966	34,853,328	28,489,314
Commissions, expenses paid and aggregate write-ins for deductions	7,956,849	54,232,399	55,860,353	48,203,261
Dividends to policyholders	3,100	171,222	4,294,438	5,171,951
Federal and foreign income taxes paid (recovered)	(2,955,994)	222,594	(28,827)	4,400,000
Total deductions	11,388,106	85,103,181	94,979,292	86,264,526
Net cash from operations	687,003	4,888,362	(17,894,541)	5,919,499
Cash from Investments				
Proceeds from investments sold, matured or repaid:				
Bonds	23,320,886	91,100,144	136,181,422	234,128,443
Stocks	0	1,357,902	40,269,295	7,694,143
Other invested assets	6,223,456	13,581,463	385,748	9,185,292
Net gain or (loss) on cash and short-term investments	5,559	22,823	(13)	425,697
Miscellaneous proceeds	(152,967)	130,158	22,809	0
Total investment proceeds	29,396,934	106,192,490	176,859,261	251,433,575
Cost of investments acquired (long-term only):				
Bonds	28,773,250	110,419,884	150,646,676	234,603,796
Stocks	8,291,599	4,630,188	18,182,185	12,776,988
Other invested assets	0	0	0	7,000,000
Miscellaneous applications	0	0	2	576,284
Total investments acquired	37,064,849	115,050,072	168,828,863	254,957,068
Net increase (or decrease) in policy loans and premium notes	0	0	0	0
Net cash from investments	(7,667,915)	(8,857,582)	8,030,398	(3,523,493)
Cash from Financing and Miscellaneous Services				
Other cash provided (applied):				
Dividends to stockholders (paid)	638,724	0	0	0
Other cash provided or (applied)	6,748,932	(5,012,712)	(1,357,935)	(3,832,850)
Net cash from financing and miscellaneous sources	6,110,208	(5,012,712)	(1,357,935)	(3,832,850)
Reconciliation of cash and short-term investments:				
Net change in cash and short-term investments	(870,704)	(8,981,932)	(11,222,078)	(1,436,844)
Cash and short-term investments:				
Beginning of the year	8,857,875	17,839,807	29,061,885	30,498,729
End of the year	\$ 7,987,171	\$ 8,857,875	\$ 17,839,807	\$ 29,061,885

NORCAL Specialty Insurance Company

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SUMMARY OF EXAMINATION CHANGES

There were no examination changes to the preceding financial statements as filed with regulatory authorities over the review period.

NOTES TO FINANCIAL STATEMENTS

ASSETS

INVESTMENTS

As of December 31, 2016, the Company's invested assets were distributed as follows:

	Amount	Percentage
Bonds	\$ 46,451,597	85.3 %
Cash	865,784	1.6 %
Short-term investments	7,121,387	13.1 %
Totals	<u>\$ 54,438,768</u>	<u>100.0 %</u>

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

NAIC Designation	Amount	Percentage
1 - highest quality	\$ 52,811,106	98.6 %
2 - high quality	761,878	1.4 %
Totals	<u>\$ 53,572,984</u>	<u>100.0 %</u>

The Company's portfolio is generally comprised of the highest quality bonds, cash and short-term investments, ninety percent of which matures within ten years.

The Company has a written investment policy as required by 40 P.S. § 653b(b). The investment policy is reviewed and approved on an annual basis by the Board of Directors. The Company was following its investment policy at December 31, 2016.

The Company entered into a custodial agreement with Bank of New York Mellon Trust Company, effective March 19, 2010. The custodial agreement complies with the standards for custodial agreements required by 31 Pa. Code § 148a.3.

LIABILITIES

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company reported net reserves in the amount of \$0 for losses and \$5,041,553 for loss adjustment expenses (“LAE”) on the December 31, 2016 Annual Statement. These amounts are being accepted for the purposes of this examination.

Bryan G. Young, FCAS, MAAA, of Willis Towers Watson, has been the Company’s appointed actuary (“AA”) for all the years in the examination period. For each year in the examination period, the AA provided a Statement of Actuarial Opinion (“Opinion”) stating that the loss and LAE reserve amounts, “make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements, including the reserve for yet-to-be issued DD&R extended reporting coverage.”

Giovanni Muzzarelli, FCAS, CERA, MAAA, a casualty actuary of the California Department of Insurance provided examination assistance to the Pennsylvania examiners, by reviewing the reserve liabilities for the Group. Mr. Muzzarelli reviewed the loss reserve analyses and underlying support from the Company’s actuarial reports and concurred that the loss, LAE, and premium DD&R reserves of the Company are reasonably stated as of December 31, 2016.

Based on the procedures performed and the results obtained, the examination team accepts the work provided by the California casualty actuary that all reserves are reasonably stated as of December 31, 2016.

SUBSEQUENT EVENTS

Tim Friers, NORCAL’s former SVP & Chief Operating Officer, left the Company in January 2017.

On January 1, 2017, NORCAL purchased 100% of PPM Services, Inc. (“PPM”). PPM was a non-insurance holding company that controlled approximately \$36.5 million of premium written by Preferred Physicians Medical Risk Retention Group, Inc. (RRG) in 2016. Effective January 1, 2017, NORCAL entered into a Loss Portfolio Transfer Agreement and a Quota Share Reinsurance Contract with RRG.

RECOMMENDATIONS

PRIOR EXAMINATION

The prior examination report contained no recommendations.

CURRENT EXAMINATION

As a result of the current examination, no recommendations are being made.

CONCLUSION

As a result of this examination, the financial condition of NORCAL Specialty Insurance Company, as of December 31, 2016, was determined to be as follows:

	Amount	Percentage
Admitted assets	\$ 58,709,926	100.0 %
Liabilities	\$ 14,650,290	25.0 %
Surplus as regards policyholders	44,059,636	75.0 %
Total liabilities and surplus	\$ 58,709,926	100.0 %

Since the previous examination, made as of December 31, 2012, the Company's assets decreased by \$417,674,005, its liabilities decreased by \$240,896,038, and its surplus decreased by \$176,777,967.

This examination was conducted by John Gaynard, CFE.

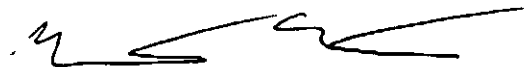
Respectfully,



Melissa L. Greiner

Director

Bureau of Financial Examinations



Matthew C. Milford, CFE

Examination Manager



John Gaynard, CFE

Examiner-in-Charge