CERTIFICATION

December 30, 2014

I, Bruce R. Ramge, Director of Insurance of the State of Nebraska, do hereby certify that the attached is a full and correct copy of the

Financial Examination Report of

UNIVERSAL SURETY COMPANY

as of

December 31, 2013

The report is now on file and forming a part of the records of this Department.

I hereto subscribe my name under the seal of my office at Lincoln, Nebraska.

STATE OF NEBRSKA
DEPARTMENT OF INSURANCE
DEC 30 2014
FILED

GREAT SEAL OF THE STATE OF NEBRASKA
MARCH 1ST 1867

Bruce R. Ramge

DIRECTOR OF INSURANCE

CERTIFICATE OF ADOPTION

Take notice that the proposed report of the financial examination of

UNIVERSAL SURETY COMPANY

dated as of December 31, 2013, verified under oath by the examiner-in-charge on November 7, 2014, and received by the company on December 9, 2014, has been adopted without modification as the final report pursuant to Neb. Rev. Stat. § 44-5906(3)(a).

Dated this 23 day of December, 2014.

STATE OF NEBRASKA
DEPARTMENT OF INSURANCE

Justin Schrader
Chief Financial Examiner

STATE OF NEBRASKA

Department of Insurance

EXAMINATION REPORT

OF

UNIVERSAL SURETY COMPANY

as of

December 31, 2013

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Lincoln, Nebraska
November 6, 2014

Honorable Joseph Torti, III
Chairman, Financial Condition (E) Committee, NAIC
Deputy Director and Superintendent of Insurance
Rhode Island Division of Insurance
1511 Pontiac Avenue, Bldg #69-2
Cranston, Rhode Island 02920

Honorable John M. Huff
Chair, Midwestern Zone, NAIC
Director of Insurance
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Honorable Bruce R. Ramge
Director of Insurance
Nebraska Department of Insurance
941 "O" Street, Suite 400
Lincoln, Nebraska 68508

Dear Sirs:

Pursuant to your instruction and authorizations, and in accordance with statutory requirements, an examination has been conducted of the financial condition and business affairs of:

UNIVERSAL SURETY COMPANY
601 South 12th Street, Suite 100
Lincoln, Nebraska 68508

(hereinafter also referred to as the "Company") and the report of such examination is respectfully presented herein.

INTRODUCTION

The Company was last examined as of December 31, 2009 by the State of Nebraska. The current financial condition examination covers the intervening period to, and including, the close of business on December 31, 2013, and includes such subsequent events and transactions as were considered pertinent to this report. The State of Nebraska participated in this examination and assisted in the preparation of this report.

The same examination staff conducted a concurrent financial condition examination of the Company's affiliate, Inland Insurance Company.

SCOPE OF EXAMINATION

This examination was conducted pursuant to and in accordance with both the NAIC Financial Condition Examiners Handbook (Handbook) and Section §44-5904(1) of the Nebraska Insurance Statutes. The Handbook requires that examiners plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including, but not limited to: corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and Annual Statement Instructions, when applicable to domestic state regulations.

A general review was made of the Company's operations and the manner in which its business has been conducted in order to determine compliance with statutory and charter provisions. The Company's history was traced and has been set out in this report under the caption "Description of Company". All items pertaining to management and control were reviewed, including provisions for disclosure of conflicts of interest to the Board of Directors and the departmental organization of the Company. The Articles of Incorporation and By-Laws were reviewed, including appropriate filings of any changes or amendments thereto. The minutes of the meetings of the stockholders, Board of Directors and committees, held during the examination period, were read and noted. Attendance at meetings, proxy information, election of Directors and Officers, approval of investment transactions and authorizations of salaries were also noted.

The fidelity bond and other insurance coverages protecting the Company's property and interests were reviewed, as were plans for employee welfare and pension. Certificates of Authority to conduct the business of insurance in the various states were inspected and a survey was made of the Company's general plan of operation.

Data reflecting the Company's growth during the period under review, as developed from the Company's filed annual statements, is reflected in the financial section of this report under the caption "Body of Report".

The Company's reinsurance facilities were ascertained and noted, and have been commented upon in this report under the caption "Reinsurance". Accounting records and procedures were tested to the extent deemed necessary through the risk-focused examination process. The Company's method of claims handling and procedures pertaining to the adjustment and payment of incurred losses were also noted.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This included a review of workpapers prepared by McGladrey, the Company's external auditors, during their audit of the Company's accounts for the year ended December 31, 2012. Portions of the auditor's workpapers have been incorporated into the workpapers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination. This utilization was performed pursuant to Title 210 (Rules of the Nebraska Department of Insurance), Chapter 56, Section 013.

Any failure of items to add to the totals shown in schedules and exhibits appearing throughout this report is due to rounding.

DESCRIPTION OF COMPANY

HISTORY

The Company was incorporated under the laws of the State of Nebraska on May 1, 1947, as a capital stock casualty insurance company. At the date of incorporation, the nature of its business was the guaranteeing of the fidelity of persons holding places of public or private trust, guaranteeing the performance of contracts other than insurance policies and guaranteeing and executing all bonds, undertakings and contracts of suretyship. By appropriate amendments to its Articles of Incorporation in 1949 and 1952, the Company extended the nature of its business to include the writing of additional kinds of fire and casualty insurance. Under provisions of its amended charter and in conformity with Nebraska Statutes, the Company was authorized to write as of December 31, 2013, the kinds of insurance prescribed by sub-sections 5, 7, 8, 9, 10, 11, 12, 13, 14, 16, 18, and 20 of Section 44-201 of the Nebraska Insurance Code.

MANAGEMENT AND CONTROL

Holding Company

The Company is a member of an insurance holding company system as defined by Nebraska Statute. An organizational listing flowing from the 'Ultimate Controlling Person", as reported in the 2013 Annual Statement, is represented by the following (subsidiaries are denoted through the use of indentations, and unless otherwise indicated, all subsidiaries are 100% owned):

NEBCO, Inc.
    Inland Insurance Company
    Universal Surety Company

NEBCO, Inc. owns 100% of the common stock of Inland Insurance Company, an affiliate of Universal Surety Company. Stockholders of NEBCO, Inc. also own a controlling interest in Universal Surety Company and 100% of Universal's preferred stock is owned by Inland Insurance Company.

Shareholders

As of December 31, 2013, Company records indicated that 31,796 shares of its $100 par value common stock and 5,000 shares of its $100 par value non-voting cumulative preferred stock were issued and outstanding.

No dividends have been paid to common stockholders during the period covered by this examination. Dividends in the amount of $32,500 were paid to the preferred stockholder, Inland Insurance Company, in each of the years covered by this examination.

Article II of the Company's Amended By-Laws states, "the annual meeting of the shareholders shall be held at such time as the Board of Directors may select, during the months of April or May of each year, at the principal office of the corporation, for the purpose of electing Directors and for the transaction of such other business as may come before the meeting." Per Section 4 of Article II of the Company's Amended By-Laws, "a majority of the outstanding shares of the corporation entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of shareholders."

Board of Directors

Per the Company's Amended By-Laws, "the business and affairs of the corporation shall be managed by its Board of Directors. The number of Directors of the corporation shall be not less than five nor more than nine. Each Director shall hold office until next annual meeting of shareholders and until his successor shall have been elected and qualified. Directors need not be residents of the State of Nebraska or shareholders of the corporation. A regular meeting of the Board of Directors shall be held without other notice than this By-Law immediately after, and at the same place as, the annual meeting of shareholders."

The following persons were serving as Directors at December 31, 2013:

Name and Residence	Principal Occupation
James P. Abel Lincoln, Nebraska	Executive of NEBCO, Inc.
Michael S. Dunlap Lincoln, Nebraska	Chief Executive Officer of Nelnet, Inc.
Curtis L. Hartter Lincoln, Nebraska	President of the Company and Inland Insurance Company
William W. Lester Lincoln, Nebraska	Senior Vice President and Corporate Treasurer at Ameritas Life Insurance Corporation
Robert E. Miller Lincoln, Nebraska	Vice President of NEBCO, Inc.
Thomas A. Tallman Lincoln, Nebraska	Consultant for the Company and Inland Insurance Company

The two outside Directors, Michael S. Dunlap and William W. Lester, are paid $2,500 for each meeting plus a retainer fee of $10,000 or $20,000 a year. No reimbursement fees are paid.

Officers

The Company's Amended By-Laws states, "the Officers of the corporation shall be a President, one or more Vice-Presidents (the number thereof to be determined by the Board of Directors), a Secretary, and a Treasurer, each of whom shall be elected by the Board of Directors. Such other Officers and Assistant Officers as may be deemed necessary may be elected or appointed by the Board of Directors. Any two or more offices may be held by the same person, except the offices of President and Vice-President, or President and Secretary."

The following is a listing of Officers elected and serving the Company at December 31, 2013:

Name and Residence	**Office**
Curtis L. Hartter	President
Leon J. Harre	Secretary and Treasurer
Phillip C. Abel	Chief Investment Officer
Shannon L. Doering	Vice President and General Counsel

The Officers of the Company are the same as those of its affiliate, Inland Insurance Company, and a portion of their salaries are allocated to the Company through the allocation of joint operating expenses.

Committees

Per the Company's Amended By-Laws, "the Directors shall have the power to appoint an Executive Committee to transact business for the company between meetings of the Board of Directors, and such other committees as are deemed necessary, and to provide for the membership and functioning of said committees by resolution." The Company has an Executive Committee, Audit Committee, and Investment Committee.

The following persons were serving on the Executive Committee at December 31, 2013:

James P. Abel	Shannon L. Doering
Curtis L. Hartter	

The following persons were serving on the Audit Committee at December 31, 2013:

Curtis L. Hartter	Leon J. Harre
Thomas A. Tallman	

The following persons were serving on the Investment Committee at December 31, 2013:

James P. Abel	Phil C. Abel
William W. Lester	Robert E. Miller
Thomas A. Tallman	

TRANSACTIONS WITH AFFILIATES

General Reinsurance Agreement

The Company and its affiliate, Inland Insurance Company, have in effect between them, a general reinsurance agreement whereby risks may be assumed/ceded on a facultative basis. This agreement is commented upon later in this report under the caption, "Reinsurance".

Service Agreement

Through a service agreement, NEBCO, Inc. provides the Company with legal and management services, computer services, tax preparation services, and building maintenance and lawn services. A portion of the cost of these services is charged to Inland Insurance Company through the allocation of joint operating expenses.

Agreement for Allocation of Operating Expenses

The Company and its affiliate, Inland Insurance Company, share Home Office space, utilize the services of much of the same personnel and together incur other costs for goods and services. These joint expenses are subject to an agreement for allocation of operating expenses. The allocation formulas used are derived from three sources. These sources are direct written premiums, a salary/premium combination and special studies. The salary/premium formula is the principal method used.

Rental Agreement

A rental agreement was entered into by Universal Surety Company and its affiliate, Inland Insurance Company, in 1980. Since Inland Insurance Company owns the home office building at 12^{th} and J streets in Lincoln, Nebraska, and the Company jointly occupies the office building with Inland Insurance Company, it was agreed that the Company would pay Inland Insurance Company $2,500 per month. The amount was increased in 1981 to $3,000 a month.

TERRITORY AND PLAN OF OPERATION

As evidenced by current or continuous Certificates of Authority, the Company is licensed to transact business in Arizona, Arkansas, Colorado, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nebraska, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, Wisconsin, and Wyoming.

The Company's primary business is fidelity and surety for which it is licensed in all of the above states. Certain states listed above allow the Company to write various other lines of property and casualty business.

Business is produced on the agency plan by independent agents. Production is under the supervision of the Company's President. Three field representatives are responsible for agency activity within designated geographical areas. They also have limited underwriting authority, subject to Home Office approval. At year-end 2013, approximately 268 agencies were authorized Company representatives. In most instances, agents are appointed with both the Company as well as with Inland Insurance Company, and agents may place business with either of the companies. Underwriting requirements and rate differentials vary by Company so that generally the type of risk dictates which Company will write a specific policy.

The Company is on the approved bond writers' list of the United States Treasury Department.

REINSURANCE

Assumed

The Company's affiliate, Inland Insurance Company, had undertaken a small percentage of numerous reinsurance contracts, pools and syndicates, both foreign and domestic dating from the late sixties through 1991. These treaties are principally of the excess of loss type with limited exposure covering mostly property damage catastrophes but do include minimal exposure to asbestosis, pollution and mass tort claim liability. All such contracts are on a run-off basis. The Company participated in this business through a quota share reciprocal agreement with its affiliate, Inland Insurance Company. The percentage of retrocessions varied with the applicable contract's date of coverage.

The Company and its affiliate, Inland Insurance Company, under terms of a general reinsurance agreement, cede and assume fidelity and surety business on a facultative basis.

Ceded

Under the terms of three automatic reinsurance treaties with authorized reinsurers, the Company cedes, on a surplus share basis, fidelity, forgery and surety business in excess of its retention. All lines are ceded under each treaty. The Company's retention and the reinsurers liability apply to the Company and its affiliate, Inland Insurance Company, as a group and not separately. This also applies to any other benefits accruing to the companies under the terms of the treaties. The following schedule shows the Company's retention and the reinsurers' limits by bond type:

Class of Business	Retention	Amount Ceded to Reinsurers
Construction and Supply Bonds:		
Contract Price		
0 To $250,000	All	Nil
Exceeding $250,000 to $1,500,000	$250,000 or 45% whichever is greater	100% of remainder
Exceeding $1,500,000 to $3,000,000	$675,000 or 33 1/3% whichever is greater	100% of remainder
Exceeding $3,000,000 to $12,000,000	$1,000,000 or 25% whichever is greater	Remainder to a maximum of the $9,000,000
All Other Surety, Fidelity Except Multiple Penalty Fidelity, Forgery, and Burglary:		
Bond Amount		
0 to $20,000	All	Nil
Exceeding $20,000 to $250,000	$20,000 or 50% whichever is greater	100% of remainder
Exceeding $250,000 to $1,200,000	$125,000 or 33 1/3% whichever is greater	100% of remainder to a maximum of $800,000
Multiple Penalty Fidelity:		
Bond Amount		
0 to $10,000	All	Nil
Exceeding $10,000 to $160,000	At least $10,000 each risk subject to maximum of 50% of each risk	100% of remainder not to exceed twice the Company's retention nor $80,000

Each agreement provides for specific commissions by type of bond ranging from 32.5% to 42.5% and a contingent commission based on the underwriting profits of the covered business of 50% in 1998 and subsequent accounting periods.

General

All contracts reviewed contained standard insolvency, arbitration, errors and omissions, and termination clauses where applicable. All contracts contained the clauses necessary to assure reinsurance credits could be taken.

BODY OF REPORT

GROWTH

The following comparative data reflects the growth of the Company during the period covered by this examination:

	2010	2011	2012	2013
Common stocks	$102,000,291	$ 98,240,401	$113,963,347	$140,950,772
Admitted assets	116,690,751	113,748,855	133,374,113	169,027,000
Loss reserves	5,385,364	5,518,834	5,447,592	5,944,236
Total liabilities	33,034,177	30,949,114	36,092,471	47,282,229
Capital and surplus	83,656,574	82,799,741	97,281,643	121,744,771
Premiums earned	2,718,827	2,707,255	2,755,611	2,888,300
Losses incurred	(32,697)	170,577	34,543	634,862
Net investment income	1,853,748	2,482,650	3,516,019	8,187,567
Net income	2,508,021	2,765,794	3,610,206	7,304,605

FINANCIAL STATEMENTS

The following statement of admitted assets and liabilities, together with the accompanying summary of operations, reflects the financial condition of the Company at December 31, 2013 and its transactions during the year 2013 as determined through this examination. A reconciliation of the capital and surplus account for the period under review is also included.

FINANCIAL STATEMENT
December 31, 2013

Assets	**Assets**	**Assets Not Admitted**	**Net Admitted Assets**
Bonds	$ 16,055,801		$ 16,055,801
Common stocks	140,950,772		140,950,772
Real estate	109,932		109,932
Cash and cash equivalents	3,919,198		3,919,198
Other invested assets	7,328,668		7,328,668
Subtotal, cash and invested assets	$168,364,371		$168,364,371
Investment income due and accrued	356,653		356,653
Agents' balances in course of collection	307,731	1,583	306,148
Amounts recoverable from reinsurers	(372)		(372)
Guaranty funds receivable or on deposit	200		200
Furniture and equipment	58,468	58,468	
Non-qualified plan	60,950	60,950	
Totals	$169,148,001	$121,001	$169,027,000

Liabilities, Surplus, and Other Funds

Losses	$ 5,944,236
Loss adjustment expenses	295,270
Commissions payable	(143,787)
Other expenses	1,493
Taxes, licenses and fees	26,291
Current federal income taxes	655,837
Net deferred tax liability	36,739,430
Unearned premiums	3,317,591
Funds held by company under reinsurance treaties	275,138
Amounts withheld or retained by company	61,050
Drafts outstanding	248
Payable to parent, subsidiaries and affiliates	4,117
Derivatives	105,430
Rounding	(115)
Total liabilities	$ 47,282,229
Common capital stock	$ 3,179,600
Preferred capital stock	500,000
Unassigned funds (surplus)	118,065,171
Total capital and surplus	$121,744,771
Totals	$169,027,000

STATEMENT OF INCOME – 2013

Underwriting Income

Premiums earned	$2,888,300
Losses incurred	$ 634,862
Loss adjustment expenses incurred	103,141
Other underwriting expenses incurred	1,709,427
Total underwriting deductions	$2,447,430
Net underwriting gain	$ 440,870

Investment Income

Net investment income earned	$5,360,910
Net realized capital gain	2,826,657
Net investment gain	$8,187,567

Other Income

Rounding	$ (7)
Miscellaneous income	$ 155
Total other income	$ 148
Net income before federal income taxes	$8,628,585
Federal income taxes incurred	1,323,980
Net income	$7,304,605

CAPITAL AND SURPLUS ACCOUNT

	2010	2011	2012	2013
Capital and surplus, beginning	$ 73,746,374	$83,656,574	$82,799,741	$ 97,281,643
Net income	$ 2,508,021	$ 2,765,794	$ 3,610,206	$ 7,304,605
Change in net unrealized capital gains	7,614,958	(3,618,981)	10,927,152	27,397,767
Change in net deferred income tax	(182,728)	28,818	(6,957)	(10,208,155)
Change in nonadmitted assets	2,449	36	(15,999)	1,411
Dividends to stockholders	(32,500)	(32,500)	(32,500)	(32,500)
Net change for the year	$ 9,910,200	$ (856,833)	$14,481,902	$ 24,463,128
Capital and surplus, ending	$ 83,656,574	$82,799,741	$97,281,643	$121,744,771

EXAMINATION CHANGES IN FINANCIAL STATEMENTS

Unassigned funds (surplus) in the amount of $118,065,171, as reported in the Company's 2013 Annual Statement, has been accepted for examination purposes. Examination findings, in the aggregate, were considered to have no material effect on the Company's financial condition.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

The recommendations appearing in the previous report of examination are reflected below together with the remedial actions taken by the Company to comply therewith:

> **Capital Stock** – It is recommended that the Company fully disclose the nature and dollar amount of all holding company transactions in a timely and appropriate manner in accordance with the Nebraska Holding Company Act, the Nebraska rules and regulations Title 210, Chapter 24 Holding Company, and Chapter 8, Reports of Directors, Officers and Principal Stockholders.
>
> **Action:** The Company has complied with this recommendation.

COMMENTARY ON CURRENT EXAMINATION FINDINGS

Custodial Agreement

The Company's investments are handled through its broker, Ameritas Investment Corp. In August 2013, Ameritas changed its custodian to National Financial Services (NFS) from

Pershing, LLC. A custodial agreement was in place with Pershing, LLC, but it was noted during the review of the Company's safeguarding of investments, that a new custodial agreement was never executed with NFS. This appears to be a violation of Title 210, Chapter 81, Section 3 of the Nebraska Department of Insurance Rules and Regulations. It is recommended that the Company execute a custodial agreement with NFS in accordance with Title 210, Chapter 81, Section 3 of the Nebraska Department of Insurance Rules and Regulations.

Fidelity Bond Coverage

The Company, along with its affiliate, Inland Insurance Company, has a fidelity bond providing protection against forgery or alteration and loss of securities. The Single Loss Limit of Liability is $800,000 and the Single Loss Deductible is $2,500.

Based on the examination of the Company's fidelity bond and using the NAIC Financial Condition Examiners' Handbook, the suggested minimum fidelity bond amount was calculated to be $900,000. The Company currently has an $800,000 bond and it will be recommended that the Company review the adequacy of its current coverage.

Reporting of Bond Values

During the review of investments, and utilizing work performed by the Nebraska Department of Insurance analysts, it was found that the Company is incorrectly reporting the value of bonds at cost rather than amortized cost value. This is out of accordance with the NAIC's Annual Statement Instructions for Schedule D – Part 1. It is recommended that the Company corrects the reporting of bonds at amortized cost value on Schedule D – Part 1.

Actuarial Report

The Appointed Actuary did not include a formal reconciliation for Schedule P to reserving data, which is required per NAIC Annual Statement Instructions. It is recommended that the Appointed Actuary includes a formal Schedule P reconciliation in the Actuarial Reports as required by the NAIC Annual Statement Instructions.

Schedule P

In the course of the actuarial review, inconsistencies were observed between the Calendar Years (columns) in Schedule P Part 2. It is recommended that the Company complete Schedule P in accordance with the NAIC Annual Statement Instructions, which should produce consistency from year-to-year and between the summaries and by-line components.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following comments and recommendations have been made as a result of this examination:

Custodial Agreement – It is recommended that the Company execute a custodial agreement with National Financial Services in accordance with Title 210, Chapter 81, Section 3 of the Nebraska Department of Insurance Rules and Regulations.

Fidelity Bond Coverage – It is recommended that the Company reviews the adequacy of its current coverage.

Reporting of Bond Values - It is recommended that the Company corrects the reporting of bonds at amortized cost value on Schedule D – Part 1.

Actuarial Report - It is recommended that the Appointed Actuary includes a formal Schedule P reconciliation in the Actuarial Reports as required by the NAIC Annual Statement Instructions.

Schedule P - It is recommended that the Company complete Schedule P in accordance with the NAIC Annual Statement Instructions, which should produce consistency from year-to-year and between the summaries and by-line components.

ACKNOWLEDGMENT

The courteous cooperation extended by the Officers and employees of the Company during this examination is hereby acknowledged.

In addition to the undersigned, Elizabeth Hofker, CFE, and Joe Hofmeister, CFE, Financial Examiners; Linda Scholl, CFE, Information Systems Specialist and Gordon Hay, FCAS, MAAA, CPCU, Senior P&C Actuarial Examiner; all with the Nebraska Department of Insurance, participated in this examination and assisted in the preparation of this report.

Respectfully submitted,

Andrea Johnson

Andrea Johnson, CFE
Examiner-in-Charge
Department of Insurance
State of Nebraska

State of Nebraska,

County of Lancaster,

Andrea Johnson, being duly sworn, states as follows:

1. I have authority to represent the Department of Insurance of the State of Nebraska in the examination of Universal Surety Company.

2. The Department of Insurance of the State of Nebraska is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination work papers and examination report, and the examination of Universal Surety Company was performed in a manner consistent with the standards and procedures required by the Department of Insurance of the State of Nebraska.

The affiant says nothing further.

Andrea Johnson
Examiner-in-Charge's Signature

Subscribed and sworn before me by Andrea Johnson on this 7th day of November, 2014.

(SEAL) GENERAL NOTARY - State of Nebraska
SUSAN D. WILLIAMS
My Comm. Exp. September 16, 2017

Susan D. Williams
Notary Public

My commission expires 9/16/2017 [date].