

CERTIFICATION

November 16, 2015

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

STATE OF NEBRASKA
DEPARTMENT OF INSURANCE

NOV 16 2015

Financial Examination Report of

FILED

CAPITOL CASUALTY COMPANY

as of

December 31, 2014

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.



Bruce R. Ramage
DIRECTOR OF INSURANCE

CERTIFICATE OF ADOPTION

Take notice that the proposed report of the financial examination of

CAPITOL CASUALTY COMPANY

dated as of December 31, 2014, verified under oath by the examiner-in-charge on October 9, 2015, and received by the company on October 14, 2015, has been adopted without modification as the final report pursuant to Neb. Rev. Stat. § 44-5906(3)(a).

Dated this 3 day of November, 2015.

STATE OF NEBRASKA
DEPARTMENT OF INSURANCE


Justin Schrader
Chief Financial Examiner

STATE OF NEBRASKA

Department of Insurance

EXAMINATION REPORT

OF

CAPITOL CASUALTY COMPANY

as of

December 31, 2014



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Lincoln, Nebraska
September 3, 2015

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

Dear Sir:

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:

CAPITOL CASUALTY COMPANY
130 South 13th Street, Suite 200
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, 2014 by the State of Nebraska. The current financial condition examination covers the intervening period to, and including, the close of business on December 31, 2014, and includes such subsequent events and transactions as were considered pertinent to this report.

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 shareholders, 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, LLP, the Company's external auditors, during their audit of the Company's accounts for the year ended December 31, 2014. 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 March 23, 1987, as a capital stock property and casualty insurer and commenced business on March 27, 1987. The Company's Articles of Incorporation provide for the perpetual existence of the corporation. On December 29, 1987, the Company's sole shareholder, LRC, Inc., sold its interest in the Company to the current owners.

Under provisions of its amended charter and in conformity with Nebraska statutes, the Company is presently authorized to write those lines of business usual to a multiple line property and casualty insurance company.

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 2014 Annual Statement, is represented by the following (subsidiaries are denoted through the use of indentations, and unless otherwise indicated, all subsidiaries are 100% owned):

Grant Thomas Schumacher Irrevocable Trust
Capitol Casualty Company (35.09%)

Andrew Blake Schumacher Irrevocable Trust
Capitol Casualty Company (32.98%)

Duane and Phyllis Acklie
Capitol Casualty Company (28.10%)
Electronic Contracting Company
Farm & Home Insurance Agency (33.33%)
First National Bank Northeast
North Central Bancorp (49.63%)
BankFirst

Shareholders

The Company’s Articles of Incorporation state that, “the aggregate number of shares which the Company shall have the authority to issue is 10,000, consisting only of common stock, with a par value of \$100.00 per share.” At December 31, 2014, 5,000 shares were issued and outstanding as noted below:

<u>Name</u>	<u>Shares</u>
Grant Thomas Schumacher Irrevocable Trust	1,754.72
Andrew Blake Schumacher Irrevocable Trust	1,648.86
Duane William Acklie	752.49
Phyllis Ann Acklie	652.49
Laura Acklie Schumacher	61.22
Jeffrey Lee Schumacher	61.22
Andrew Blake Schumacher	34.50
Grant Thomas Schumacher	<u>34.50</u>
TOTAL	5,000.00

The Company's capital stock and paid in surplus accounts have been unchanged since the initial transaction on March 24, 1987, where \$500,000 of capital stock was issued and \$1,000,000 of paid in surplus was added. A dividend of \$500,000 was paid in 2012, which was the first dividend payment to shareholders since the organization of the Company.

The Company's By-Laws state that, "all annual meetings of the shareholders shall be held at the office of the Company in Lincoln, Nebraska, or at such other place as determined by the Board of Directors and stated in the notice to shareholders. Such annual meeting shall be held as declared by the Board of Directors and stated in the notice to shareholders but in no event shall the annual meeting of shareholders be held later than May 31st of each and every calendar year."

Board of Directors

The Company's By-Laws state that, "the property and business of this Company shall be managed by its Board of Directors of not less than five nor more than nine. At the first annual meeting of the shareholders and at each annual meeting thereafter, the shareholders shall elect Directors to hold office until the next succeeding meeting." The By-Laws also state that, "a

regular meeting of the Board of Directors shall be held without other notice than these By-Laws, immediately after an on the same date as the annual meeting of shareholders.”

The following persons were serving as Directors at December 31, 2014:

<u>Name and Residence</u>	<u>Principal Occupation</u>
Duane W. Acklie Lincoln, Nebraska	Chairman of the Board, Crete Carrier Corporation
Phyllis A. Acklie Lincoln, Nebraska	Vice President and Corporate Secretary, Crete Carrier Corporation
David L. Brown Lincoln, Nebraska	President, Transportation Claims, Inc.
Robert E. Caldwell, II Lincoln, Nebraska	Director of Corporate Development, NEBCO, Inc.
Arthel E. Crump Lincoln, Nebraska	Council, University of Nebraska Central Administration
Michael S. Dunlap Lincoln, Nebraska	Chairman and Chief Executive Officer, Nelnet
Clark D. Froehlich Norfolk, Nebraska	President and Chief Executive Officer, North Central Bancorp, Inc.
Jeffrey L. Schumacher Lincoln, Nebraska	President and Chief Executive Officer, Capitol Casualty Company
Christina L. Usher Lincoln, Nebraska	Attorney

Effective April 27, 1993, the Board of Directors authorized the payment of an annual fee for outside Directors of \$1,000, which is paid at the annual meeting.

Officers

The Company’s By-Laws state that,” the Officers of the Company shall be a Chairman of the Board; a President; one or more Vice Presidents, the number thereof to be determined by the Board of Directors; a Treasurer; and Secretary; or other Officers as may be elected or appointed by the Board of Directors.” The By-Laws also state that, “the Officers of the Company shall be

elected annually by the Board of Directors at the first meeting of the Board of Directors held after each annual meeting of shareholders or as soon thereafter as convenient and vacancies may be filled at any meeting of the Board of Directors.”

The following is a listing of Officers elected and serving the Company at December 31, 2014:

<u>Name</u>	<u>Office</u>
Jeffrey L. Schumacher	President and Chief Executive Officer
Curtis D. Ruwe	Secretary and General Counsel
Christina L. Usher	Treasurer
Timothy A. Aschoff	Assistant Secretary and Assistant General Counsel
Lynette J. Lewis	Controller and Assistant Secretary

Review of the Company’s Officers revealed areas of non-compliance with its By-Laws. Specifically, ”the Officers of the Company shall be a Chairman of the Board; a President; one or more Vice Presidents, the number thereof to be determined by the Board of Directors; a Treasurer; and Secretary; or other Officers as may be elected or appointed by the Board of Directors.” The Company does not elect or appoint a Chairman of the Board, and one or more Vice Presidents at its annual Board of Directors meeting.

It is recommended that the Company elect or appoint a Chairman of the Board and one or more Vice Presidents at its annual Board of Directors meeting and note this in its minutes in order to comply with its By-Laws.

Committees

The Company’s By-Laws state that, “the Board of Directors shall designate from their own number an executive committee and such other committee as in their sole discretion they shall deem necessary and appropriate.”

The following persons were serving on the Executive Committee at December 31, 2014:

Duane W. Acklie

Jeffrey L. Schumacher

The following persons were serving on the Investment Committee at December 31, 2014:

Jeffrey L. Schumacher, Chair

Duane W. Acklie

Michael S. Dunlap

TRANSACTIONS WITH RELATED PARTIES

Personnel and Claims Administration Agreement

The Company has a Personnel and Claims Administration Agreement with a related party, Crete Carrier Corporation (Crete), and its operating division, Transportation Claims, Inc. (TCI). Under the terms of the agreement, Crete agrees to provide sufficient personnel as required and directed by the Company to enable it to transact all business to further the purpose for which the Company was formed and to also provide claims administration services as required and directed by the Company in connection with property and casualty exposures insured or assumed by the Company. Such claims administration services shall include, but shall not necessarily be limited to, receiving, evaluation, investigation, processing, defending and settling claims; establishing and adjusting claims reserves; and providing legal representations (including retaining outside counsel) on behalf of the Company. In return, the Company shall pay Crete a monthly fee for its provision of personnel and claim administration services, which equals Crete's actual cost for the leased employees, including but not limited to the full cost of wages, payroll taxes, benefits, and administration.

This agreement became effective January 1, 2010 and shall continue in effect until terminated by either party upon thirty days prior written notice to the other party. This agreement supersedes and replaces any and all agreements between TCI and the Company regarding personnel and claims administration services.

Lease Agreement

The Company has a lease agreement with TCI, who in turn was absorbed by the Company's related party, Crete. The Company provides office space in the property owned and utilized by the Company as its home office. According to the terms signed in the agreement, the lease was effective January 1, 2009 and expired December 31, 2011. Upon absorption of TCI, the remaining entity, Crete and the Company have mutually agreed to continue the arrangement in perpetuity. The rental amount is \$4,800 per month and is payable on or before the 5th day of the following month. Crete is also responsible for 63% of all charges for utilities, maintenance, and other expenses to keep the property in a neat, clean and safe condition.

Participation Agreement and Certificate

The Company entered into a Participation Agreement and Certificate with its affiliate BankFirst, whereby the Company agreed to purchase \$2,000,000 of a loan which BankFirst had made to Watkins & Shepard Leasing, LLC (WSL). The Company would receive the same interest rate that the loan originator, BankFirst initially issued. In addition, BankFirst is not charging the Company a fee to service the loan. The loan is secured by collateral of forty-five 2015 Volvo tractors. On May 26, 2014, the Nebraska Department of Insurance, after completing its review of the Form D filing, did not disapprove this agreement.

On May 29, 2014, the Company purchased \$1,535,341.50 of a \$4,386,690 loan which BankFirst had made to WSL. The loan maturity date is June 1, 2017, and the interest rate is 4.25%. BankFirst and the Company have a security interest in thirty-five 2015 Volvo 670 tractors.

TERRITORY AND PLAN OF OPERATION

As evidenced by current or continuous Certificates of Authority, the Company is licensed to transact business in the States of Nebraska and Iowa.

The Company specializes in providing insurance coverages to the motor carrier industry. These coverages include Non-Trucking Use Liability and Physical Damage Insurance for owners of truck-tractors who are independent contractors and who are leasing to a motor carrier on an exclusive basis.

Substantially, all of the Company's business is derived through market leads provided by Crete and its affiliated companies. Physical damage and non-trucking use liability insurance is written for the independent contractors who are leasing with the affiliated companies. Non-trucking use is the period of time the truck-tractor is not being used to carry property in the motor carrier's or anyone else's business.

Crete and its affiliates self-insure or insure a portion of their bodily injury and property damage liability losses sustained as a result of their motor carrier operation.

REINSURANCE

The Company discontinued its Non-Trucking Use Liability reinsurance program with Great West Casualty Company, effective January 1, 2011.

BODY OF REPORT

GROWTH

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

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Bonds	\$ 2,702,724	\$ 3,009,418	\$ 2,404,944	\$ 2,305,110
Common stocks	13,224,393	13,154,795	16,352,588	18,511,274
Other invested assets	3,586,382	4,669,056	3,380,058	4,708,498
Admitted assets	20,640,915	22,044,426	24,818,400	27,317,088
Loss reserve	157,625	229,150	156,475	170,250
Total liabilities	1,428,375	2,334,940	2,690,707	3,265,130
Capital and surplus	19,212,540	19,709,486	22,127,693	24,051,958
Premium earned	462,069	414,476	389,115	389,557
Net investment income	672,689	747,405	670,390	675,460
Losses incurred	262,407	198,339	18,376	88,073
Net income	400,682	323,430	621,521	583,637

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the State of Nebraska Department of Insurance and present the financial condition of the Company for the period ending December 31, 2014. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements. A reconciliation of the capital and surplus account for the period under review is also included.

FINANCIAL STATEMENT
December 31, 2014

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 2,305,110		\$ 2,305,110
Common stocks	18,511,274		18,511,274
Real estate	503,328		503,328
Cash and short-term investments	1,136,013		1,136,013
Other invested assets	<u>4,708,498</u>		<u>4,708,498</u>
Subtotal, cash and invested assets	\$27,164,223		\$27,164,223
Investment income due and accrued	22,607		22,607
Premium in course of collection	33,631		33,631
Federal income tax recoverable	67,004		67,004
Guaranty funds on deposit	150		150
Furniture and equipment	9,087	\$9,087	
Accounts receivable	<u>29,473</u>	<u> </u>	<u>29,473</u>
Totals	<u>\$27,326,175</u>	<u>\$9,087</u>	<u>\$27,317,088</u>
 <u>Liabilities, Surplus, and Other Funds</u>			
Losses			\$ 170,250
Loss adjustment expense			750
Other expenses			6,252
Taxes, licenses and fees			17,846
Net deferred tax liability			<u>3,070,032</u>
Total liabilities			<u>\$ 3,265,130</u>
Common capital stock			\$ 500,000
Gross paid in and contributed surplus			1,000,000
Unassigned funds			<u>22,551,958</u>
Total capital and surplus			<u>\$24,051,958</u>
Totals			<u>\$27,317,088</u>

STATEMENT OF INCOME – 2014

Underwriting Income

Premiums earned	<u>\$ 389,557</u>
Losses incurred	\$ 88,073
Loss adjustment expenses incurred	4,611
Other underwriting expenses incurred	<u>399,324</u>
Total underwriting deductions	<u>\$ 492,008</u>
Net underwriting gain/(loss)	<u>\$(102,451)</u>

Investment Income

Net investment income earned	\$ 675,460
Net realized capital gain	<u>114,311</u>
Net investment gain	<u>\$ 789,771</u>
Net income before federal income taxes	\$ 687,320
Federal income taxes incurred	<u>103,683</u>
Net income	<u>\$ 583,637</u>

CAPITAL AND SURPLUS ACCOUNT

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Capital and surplus, beginning	<u>\$18,720,738</u>	<u>\$19,212,539</u>	<u>\$19,709,486</u>	<u>\$22,127,693</u>
Net income	\$ 400,682	\$ 323,430	\$ 621,521	\$ 583,637
Change in net unrealized capital gains	83,119	593,750	1,765,677	1,355,477
Change in net deferred income tax	(41,578)	77,136	29,041	(16,407)
Change in nonadmitted assets	21,094	2,631	1,968	1,557
Dividends to stockholders		(500,000)		
Income tax adjustment	<u>28,484</u>	<u> </u>	<u> </u>	<u> </u>
Net change for the year	<u>\$ 491,801</u>	<u>\$ 496,947</u>	<u>\$ 2,418,207</u>	<u>\$ 1,924,264</u>
Capital and surplus, ending	<u>\$19,212,539</u>	<u>\$19,709,486</u>	<u>\$22,127,693</u>	<u>\$24,051,957</u>

EXAMINATION CHANGES IN FINANCIAL STATEMENTS

Unassigned funds (surplus) in the amount of \$22,551,958, as reported in the Company's 2014 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:

Safekeeping Agreement – Review of the Company's Safekeeping Agreement revealed areas of non-compliance with Nebraska Regulation Title 210, Chapter 81. It is recommended that the Company amend its safekeeping agreement to comply with each of the provisions of Title 210, Chapter 81.

Action: The Company has complied with the prior examination listing of provisions to amend. The current examination identified an additional provision that should be included in this agreement.

COMMENTARY ON CURRENT EXAMINATION FINDINGS

Safekeeping Agreement

Review of the Company's Safekeeping Agreement revealed a provision of non-compliance with Nebraska Regulation Title 210, Chapter 81. It is recommended that the Company amend its safekeeping agreement to comply with the following provision of Title 210, Chapter 81:

(003.03(n)) In the event that the custodian gains entry in a clearing corporation through an agent, there shall be an agreement between the custodian and the agent under which the agent shall be subject to the same liability for loss of securities as the custodian. However, if the agent shall be subject to regulation under the laws of a jurisdiction that is different from the jurisdiction the laws of which regulate the custodian, the Commissioner or Director of Insurance of the state of domicile of the insurance company may accept a standard of liability applicable to the agent that is different from the standard of liability applicable to the custodian.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

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

Safekeeping Agreement– It is recommended that the Company amend its safekeeping agreement to include all provisions of Nebraska Regulation Title 210, Chapter 81.

Compliance with By-Laws – It is recommended that the Company elect or appoint a Chairman of the Board and one or more Vice Presidents at its annual Board of Directors meeting and note this in its minutes in order to comply with its By-Laws.

ACKNOWLEDGEMENT

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

In addition to the undersigned, Brian Davis and Ross Pedersen, Financial Examiners; and Linda Scholl, CFE, CISA, Information Systems Specialist; all with the Nebraska Department of Insurance, participated in this examination and assisted in the preparation of this report.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'Isaak Russell', with a long horizontal flourish extending to the right.

Isaak Russell, CFE
Supervisory Examiner
Department of Insurance
State of Nebraska

State of Nebraska,

County of Lancaster,

Isaak Russell, 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 Capitol Casualty 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 Capitol Casualty 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.


Examiner-in-Charge's Signature

Subscribed and sworn before me by FSAAK RUSSELL on this 9 day of OCTOBER, 2015.

(SEAL)


Notary Public

My commission expires Nov 8, 2015 [date].

