

REPORT ON EXAMINATION
OF
THE CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY
AS OF
DECEMBER 31, 2019

Office of the
Commissioner



Delaware
Department of Insurance

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The above-captioned report was completed by examiners of the Delaware Department of Insurance.

Consideration has been duly given to the comments, conclusions and recommendations of the examiners regarding the status of the company as reflected in the report.

This report is hereby accepted, adopted and filed as an official record of this Department.

A handwritten signature in blue ink that reads "Trinidad Navarro".

Trinidad Navarro
Insurance Commissioner

Dated this 7 day of June, 2021

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May 27, 2021

Honorable Trinidad Navarro
Commissioner of Insurance
Delaware Department of Insurance
1351 West North Street
Suite 101
Dover, Delaware 19904-2465

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Examination Authority No. 20.031, dated March 26, 2020, an examination has been made of the affairs, financial condition and management of

THE CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY hereinafter referred to as the Company or CSU. CSU was incorporated under the laws of Delaware as a stock company with its registered office located at 1807 North Market Street, Wilmington, Delaware 19802. The Company's administrative office is located at 6200 South Gilmore Road, Fairfield, Ohio 45014. The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

We have performed our multi-state examination of CSU. The last examination was conducted as of December 31, 2014 by the Delaware Department of Insurance (Department). This examination covered the period of January 1, 2015 through December 31, 2019. Our examination was performed as part of the multi-state coordinated examination of the Cincinnati Financial Corporation (CFC) group of regulated entities wherein Ohio is the lead state. The examination

was conducted concurrently with that of Ohio's domiciled affiliate companies, The Cincinnati Insurance Company (CIC), The Cincinnati Casualty Company (CCC), The Cincinnati Indemnity Company (CID) and The Cincinnati Life Insurance Company (CLIC). To the fullest extent, the efforts, resources, project material and findings were coordinated and made available to all examination participants.

We conducted our examination in accordance with the *National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook* (Handbook) and generally accepted statutory insurance examination standards consistent with the Insurance Code and Regulations of the State of Delaware. The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company, and evaluate system controls and procedures used to mitigate those risks. 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, pursuant to the General Corporation Law of the State of Delaware as required by 18 *Del. C.* §321, along with general information about the insurer and its financial condition. There may be other items identified

during the examination that, due to their nature, are not included within the examination report but separately communicated to other regulators and/or the Company.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, Deloitte & Touche LLP (Deloitte). Certain auditor work papers of the 2019 audit of the Company have been incorporated into the work papers of the examiners and have been utilized in determining the scope, areas of emphasis in conducting the examination, and in the area of risk mitigation and substantive testing.

SUMMARY OF SIGNIFICANT FINDINGS

There were no significant findings or material changes in financial statements as a result of this examination.

COMPANY HISTORY

CSU was incorporated on August 13, 2007, under the laws of the State of Delaware and commenced business on November 2, 2007. The Company was established to offer excess and surplus lines insurance products, which provides insurance unavailable in the standard market, due to market conditions or specific characteristics of the persons or organizations needing insurance.

Capitalization

The Company was initially capitalized on October 1, 2007, by a cash contribution of \$20,000,000 from its direct parent, CIC. CIC made additional cash and common stock contributions of \$200,000,000 after the initial capitalization date, which included paid-in capital stock of \$5,250,000 (3,500 common shares at \$1,500 par value each) and \$194,750,000 of additional paid-in surplus. As of December 31, 2019, the Company reported policyholder surplus of \$526,081,536.

Dividends

During the examination period, the Department approved the following three (3) ordinary dividends for payment by the Company:

Year	Amount	Declared	Paid
2017	\$10,000,000	January 27, 2017	February 17, 2017
2018	\$20,000,000	January 26, 2018	February 16, 2018
2019	\$55,000,000	February 1, 2019	February 18, 2019

MANAGEMENT AND CONTROL

Directors

Pursuant to the general Corporation Laws of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, the property and affairs of the Company must be managed by or under the direction of its Board of Directors (Board). The bylaws provide that the number of Directors that constitutes the whole Board may change by resolution of the shareholder at the annual meeting of shareholders.

Each Director shall be elected for a term of one year and serve until such Director's successor is elected and qualified. As of December 31, 2019, CSU's Board was comprised of the following nineteen (19) Directors:

The Cincinnati Specialty Underwriters Insurance Company

<u>Name</u>	<u>Title</u>
Kenneth W. Stecher	Chairman of the Board
Gregory T. Bier	Retired, Deloitte & Touche LLP
Teresa C. Cracas	Chief Risk Officer and Senior Vice President
Donald J. Doyle, Jr.	Senior Vice President, Excess and Surplus Lines
Martin F. Hollenbeck	Chief Investment Officer and Senior Vice President
Steven J. Johnston	Chief Executive Officer and President
John S. Kellington	Chief Information Officer and Senior Vice President
Lisa A. Love	Senior Vice President, General Counsel and Corporate Secretary
W. Rodney McMullen	Chairman and Chief Executive Officer, The Kroger Company
Martin J. Mullen	Chief Claims Officer and Senior Vice President
David P. Osborn	President, Osborn Williams & Donohoe, LLC
Thomas R. Schiff	Chairman and Chief Executive Officer, John J. & Thomas R. Schiff & Co., Inc.
Michael J. Sewell	Chief Financial Officer, Senior Vice President and Treasurer
Stephen M. Spray	Chief Insurance Officer and Senior Vice President
William F. Bahl	Chairman, Bahl & Gaynor Investment Counsel, Inc.
William H. Van Den Heuvel *	Senior Vice President, Personal Lines
Sean M. Givler **	Senior Vice President, Sales and Marketing
Larry R. Webb	President, Webb Insurance Agency, Inc.
John F. Steele, Jr.	Chairman and Chief Executive Officer, Hilltop Basic Resources, Inc.

* as of January 30, 2015

** as of January 27, 2017

Officers

Officers were elected by the Board in accordance with the bylaws during the period under examination. The following Officers were elected and served as of December 31, 2019:

<u>Name</u>	<u>Title</u>
Steven J. Johnston	Chief Executive Officer and President
Michael J. Sewell	Chief Financial Officer, Senior Vice President and Treasurer
Theresa A. Hoffer *	Senior Vice President

* as of January 29, 2016

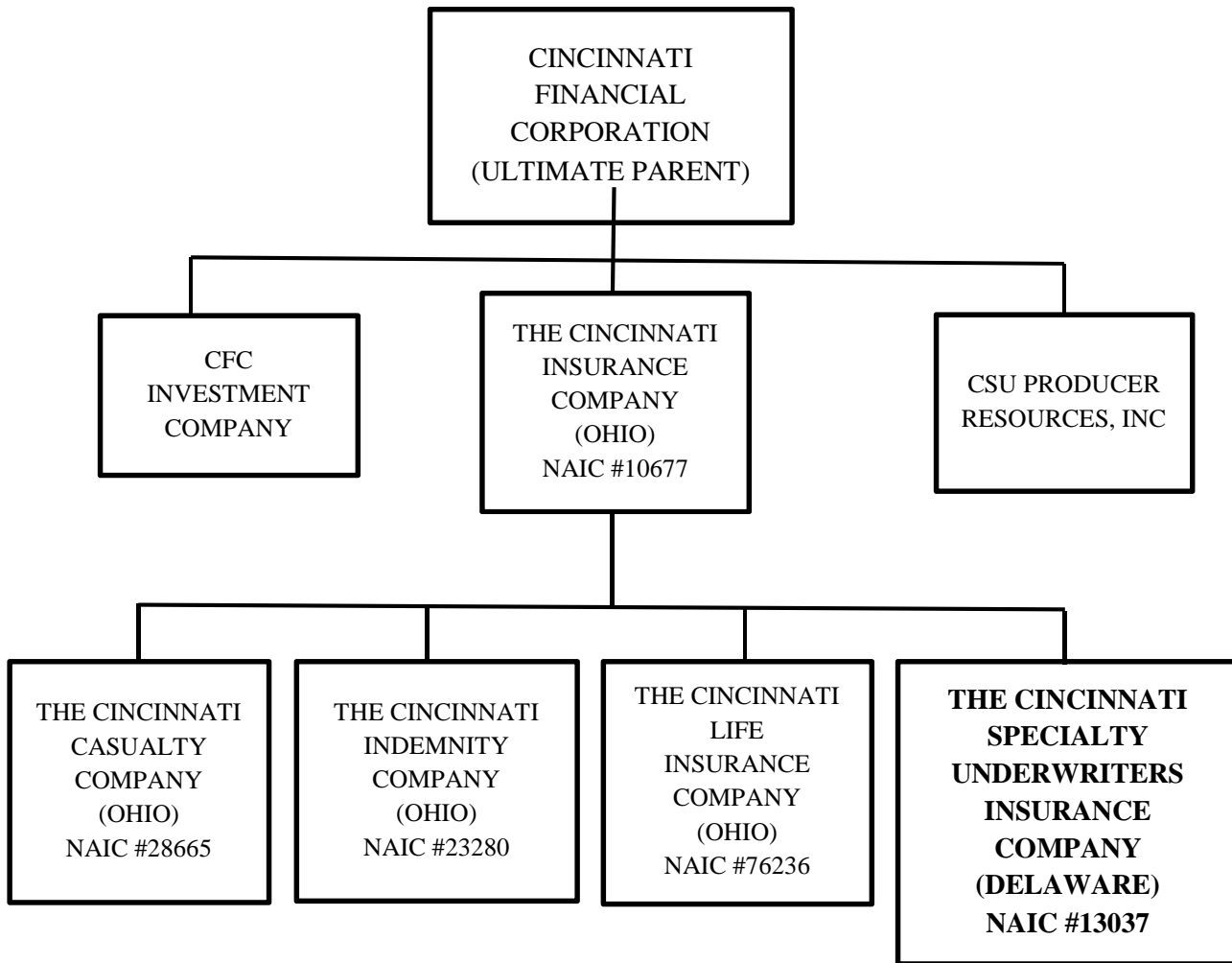
Corporate Records

The recorded minutes of the shareholders and Board were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events including approval of investment transactions in accordance with 18 *Del. C.* §1304. In addition, review of Company files indicated that written correspondence was submitted to the Department with regards to the changes in officers and directors during the period under examination in compliance with 18 *Del. C.* §4919.

Insurance Holding Company System

CSU is a member of an insurance holding company system as defined under 18 *Del. C.* §5001 of the Delaware Insurance Code. The Company is a wholly owned subsidiary of CIC, which is wholly owned by CFC, the ultimate parent within the insurance holding company system. CIC also wholly owns the Ohio domiciled affiliate insurance companies, CCC, CID and CLIC.

The following abbreviated organizational chart depicts the Company's relationship within the holding company system as of December 31, 2019:



Agreements with Affiliates

The following affiliated agreements within CSU’s organizational structure were identified and in effect as of December 31, 2019:

Intercompany Cost Sharing and Expense Allocation Agreement

Effective December 31, 2019, and superseding all prior agreements, the Company entered into an Intercompany Cost Sharing and Expense Allocation Agreement. The agreement sets forth the cost allocation methods and procedures allowing CFC to provide certain subsidiary companies with services including, but not limited to, office and storage space, utilities, cleaning, repair, maintenance and security services. CFC may further provide capital necessary to meet regulatory

capital requirements. This may include, but may not be limited to cash, securities, and access to letters of credit or collateral pledge facilities supported by the credit strength of CFC. Under the agreement, CIC shall provide subsidiary or affiliate companies with services including, but not limited to, telephone services, mailroom services, accounting services, claims servicing, legal services, computer and technology-related services, printing services, salaries, personnel services and routine office equipment and supplies. Also, under the agreement, CLIC shall provide certain subsidiary or affiliate companies with services including, but not limited to, health and flexible spending account claims servicing. For services provided, the companies pay all ordinary and necessary expenses. Expenses are apportioned in accordance with SSAP No. 70 - Allocation of Expenses.

Intercompany Benefits and Expense Allocation Agreement

Effective December 31, 2019, and superseding all prior agreements, the Company entered into an Intercompany Benefits and Expense Allocation Agreement. The agreement sets forth the cost allocation methods and procedures allowing CFC to provide employees of certain subsidiary companies with stock compensation benefits based on actual grants as determined by the compensation committee of CFC's Board and retirement benefits based on each eligible employee's pay, service and age. Subsidiary companies pay all ordinary and necessary expenses that are associated with the benefits provided. Expenses are apportioned in accordance with SSAP No. 70 - Allocation of Expenses. The Company reimburses CFC for such expenses, as well as all other expenses incurred by CFC for providing services under the agreement.

Broker Agreement

Effective January 1, 2012, the Company entered into a Broker Agreement with CSU Producer Resources, Inc. (CSUPR). Under terms of the agreement, CSUPR provides broker

services as authorized by Company, to include but not limited to, accepting applications from eligible insurance producers for new and renewal policies and negotiating terms, conditions, price, renewals and commission for said policies. CSUPR is responsible for assuring compliance with all applicable laws related to the surplus lines and licensing laws of the state(s) involved.

For services rendered, the Company pays CSUPR a commission that is a percentage rate of the premium on each policy written at a minimum rate of 17% and a maximum rate of 30%. CSUPR pays the Company a return commission at the same rate on any return premiums, including return premiums on cancellations ordered or made by Company. CSUPR agrees to pay the Company, within 30 days, all insurance charges and premiums due to Company, whether or not collected by CSUPR, and hold such premiums in a fiduciary capacity as trustee for the Company. All moneys received by CSUPR on behalf of Company shall be promptly deposited in a bank account approved by Company.

Tax Sharing Agreement

Effective January 1, 2012, the Company entered into a Tax Sharing Agreement with other members of the consolidated group. The agreement provides that the allocation of the consolidated federal income tax liability is to be based upon each party's relative contribution to such liability. The agreement also provides an allocation for a particular tax year to each party that reflects their share of consolidated federal income tax liability after adjustments for tax audits or otherwise. The method of allocation among affiliates is based on separate return calculations with current credit for net losses to the extent the losses provide a benefit in the consolidated tax return.

TERRITORY AND PLAN OF OPERATION

CSU is authorized as a domestic surplus lines' writer in the state of Delaware and is eligible or approved to write surplus lines insurance in the other 49 states and the District of

Columbia. The Company offers various products through non-insurance affiliate, CSUPR as its exclusive broker. CSUPR was created solely to provide non-admitted products to independent agents and has binding authority on all the classes of business written through CSU.

The Company writes a balanced book of business within the following industry segments: Construction, Miscellaneous Manufacturing, Retail and Wholesale services, Real Estate related, Amusement and Special Events, Bars and Taverns, Fire Suppression Contractors, Habitation (apartments), Janitorial Services and non-auto Transportation companies such as tire re-treaders and truck service repair.

CSU does not write business with asbestos and environmental exposures. The Company's formal risk guidelines avoid several classes of business, to include medical malpractice, invasive medical devices, pharmaceuticals, nutraceuticals, workers' compensation, auto (including long-haul trucking), directors and officers, engineers, architects, aircraft products liability or catastrophe exposed property.

The Company targets small to mid-sized risks and many of their policyholders also have standard market insurance with other CFC subsidiaries. The average excess and surplus lines policy size is approximately \$7,000 in annual premiums and the majority has coverage limits of \$1,000,000 or less. All policies are written for a maximum term of one year and all renewal policies and policy endorsements are subject to underwriter review. Approximately ninety percent (90%) of CSU's 2019 earned premiums provided commercial casualty coverages and about ten percent (10%) provided commercial property coverages.

The commercial casualty business covers businesses for third-party liability from accidents occurring on their premises or arising out of their operations, including injuries sustained from products. Other coverages available include miscellaneous errors and

omissions, professional liability and excess liability. Typical businesses covered include contractors, manufacturers, real estate owners and managers, retail, consultants and bars or taverns. Policies covering liability at special events are also available.

The commercial property business covers buildings, inventory, equipment and business income from loss or damage due to causes such as fire, wind, hail, water, theft and vandalism. Examples of property coverages include temporarily vacant buildings, habitational, restaurants and relatively higher-hazard manufacturing classes.

REINSURANCE

The Company reported net premiums written of \$303,164,509 for the year ended December 31, 2019. The distribution of premiums written for the years ended December 31, 2019, and the prior examination date of December 31, 2014, are as follows:

	<u>2019</u>	<u>2014</u>
Direct Premiums Written	\$ 319,248,539	\$ 162,412,129
Plus: Assumed Premiums		
Less: Ceded Premiums		
Affiliate	13,367,577	8,268,105
Non-Affiliate	<u>2,716,453</u>	<u>882,835</u>
Net Premiums Written	<u>\$ 303,164,509</u>	<u>\$ 153,261,189</u>

Assumed Reinsurance

As of December 31, 2019, the Company had no assumed business.

Ceded Reinsurance (Affiliated)

Casualty Excess of Loss Reinsurance Agreement

Effective January 1, 2011, the casualty excess of loss (XOL) reinsurance agreement between CIC and CSU renews annually with substantially similar renewal terms. The casualty treaty is written on an excess of loss basis and provides limits up to \$6,000,000. A second treaty layer of \$5,000,000 in excess of \$6,000,000 is written to provide coverage for extra contractual

obligations or clash exposures. The maximum retention for any one casualty loss is \$1,000,000. Losses between \$1,000,000 and \$6,000,000 are reinsured 100% by CIC.

Property Per Risk Excess of Loss Reinsurance Agreement

Effective January 1, 2011, the property per risk XOL reinsurance agreement between CIC and CSU renews annually with substantially similar renewal terms. The property treaty provides limits up to \$5,000,000 and includes protection for extra-contractual liability coverage losses. CSU retains the first \$1,000,000 of any policy loss. Losses between \$1,000,000 and \$5,000,000 are reinsured 100% by CIC.

As part of the property treaty, CSU is also provided basket retention in the event of a loss involving a combination of the property business subject to the agreement and with casualty business subject to the casualty treaty. Under the basket retention, CSU retains the first \$1,000,000 of the combined property and casualty ultimate net loss, provided only one property risk is combined in the same loss occurrence.

Ceded Reinsurance (Non-Affiliated)

The Company has a small amount of ceded business to third parties. For property risks with limits exceeding \$5,000,000 or casualty risks with limits exceeding \$6,000,000, underwriters place facultative reinsurance coverage on an individual certificate basis to companies rated A+ or better by A.M. Best.

FINANCIAL STATEMENTS

The following financial statements, as reported and filed by the Company with the Department, are reflected in the following:

- Statement of Assets as of December 31, 2019
- Statement of Liabilities and Surplus as of December 31, 2019
- Statement of Income for the year ended December 31, 2019
- Reconciliation of Capital and Surplus for the Period from the Prior Examination as of December 31, 2014 to December 31, 2019

**Statement of Assets
As of December 31, 2019**

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$ 701,023,010	\$ -	\$ 701,023,010
Common stocks	183,504,036		183,504,036
Cash	96,935,052		96,935,052
Subtotals, cash and invested assets	<u>\$ 981,462,098</u>	<u>\$ -</u>	<u>\$ 981,462,098</u>
Investment income due and accrued	7,793,258		7,793,258
Deferred premiums and agents' balances and installments booked but deferred and not yet due	12,486,705	1,247,156	11,239,549
Amounts recoverable from reinsurers	741,450		741,450
Electronic data processing equipment and software	4,452,931	4,452,931	
Receivable from parent, subsidiaries and affiliates	47,492,781		47,492,781
Aggregate write-ins for other than invested assets:			
Prepaid expenses	6,791	6,791	
Totals	<u>\$ 1,054,436,012</u>	<u>\$ 5,706,878</u>	<u>\$ 1,048,729,134</u>

**Statement of Liabilities and Surplus
As of December 31, 2019**

		<u>Notes</u>
Losses	\$ 242,330,926	1
Loss adjustment expenses	100,311,222	1
Commissions payable, contingent commissions and other similar charges	13,343,847	
Other expenses	1,128,387	
Taxes, licenses and fees	215,311	
Current federal and foreign income taxes	2,330,589	
Net deferred tax liability	7,918,680	
Unearned premiums	144,488,173	
Ceded reinsurance premiums payable	1,771,924	
Amounts withheld or retained by company for account of others	10,409	
Payable to parent, subsidiaries and affiliates	8,784,022	
Aggregate write-ins for liabilities:		
Accounts payable other	<u>14,105</u>	
Total liabilities	<u>\$ 522,647,597</u>	
Common capital stock	5,250,000	
Gross paid in and contributed surplus	194,750,000	
Unassigned funds (surplus)	<u>326,081,536</u>	
Surplus as regards policyholders	<u>\$ 526,081,536</u>	
Totals	<u>\$ 1,048,729,134</u>	

Statement of Income
For the Year Ended December 31, 2019

Premiums earned	\$ 278,190,099
Losses incurred	\$ 93,626,844
Loss adjustment expenses incurred	48,520,172
Other underwriting expenses incurred	87,643,945
Total underwriting deductions	<u>\$ 229,790,962</u>
Net underwriting gain (loss)	\$ 48,399,137
Net investment income earned	30,142,349
Net realized capital gains or (losses)	356,766
Net investment gain (loss)	<u>\$ 30,499,115</u>
Net income before dividends to policyholders	<u>\$ 78,898,252</u>
Dividends to policyholders	<u>-</u>
Net income, after dividends to policyholders	\$ 78,898,252
Federal and foreign income taxes incurred	<u>16,816,571</u>
Net income	<u><u>\$ 62,081,681</u></u>

**Reconciliation of Capital and Surplus
For the Period from the Prior Examination
As of December 31, 2014 to December 31, 2019**

	<u>Common Capital Stock</u>	<u>Gross Paid-in Surplus</u>	<u>Dividends to Stockholders</u>	<u>Unassigned Surplus</u>	<u>Total</u>
12/31/14	\$ 5,250,000	\$ 194,750,000	\$ -	\$ 65,555,671	\$ 265,555,671
12/31/15				40,914,546	40,914,546
12/31/16 (1)				65,631,353	65,631,353
12/31/17 (1)				73,858,481	73,858,481
12/31/17			(10,000,000)		(10,000,000)
12/31/18 (1)				62,790,241	62,790,241
12/31/18			(20,000,000)		(20,000,000)
12/31/19 (1)				102,331,245	102,331,245
12/31/19			(55,000,000)		(55,000,000)
	<u>\$ 5,250,000</u>	<u>\$ 194,750,000</u>	<u>\$ (85,000,000)</u>	<u>\$ 411,081,536</u>	<u>\$ 526,081,536</u>

(1) Represents net income, change in net unrealized capital gains or (losses), change in net deferred income tax, and change in nonadmitted assets.

**ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE
EXAMINATION**

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

COMMENTS ON FINANCIAL STATEMENT ITEMS

Note 1:

Losses	\$ 242,330,926
Loss Adjustment Expenses	\$ 100,311,222

The examination liability for the aforementioned captioned items of \$242,330,926 and \$100,311,222 are the same as reported by the Company as of December 31, 2019. The examination analysis of Loss and Loss Adjustment Expense reserves was conducted in accordance with Generally Accepted Actuarial Principles and Statutory Accounting Principles, including NAIC *Accounting Practices and Procedures Manual*, Statement of Statutory Accounting Principle No. 55 (SSAP No. 55).

SUBSEQUENT EVENTS

On February 19, 2020, the Company paid an ordinary dividend to its direct parent, CIC, in the amount of \$67,000,000. The dividend was approved by the Department on February 11, 2020.

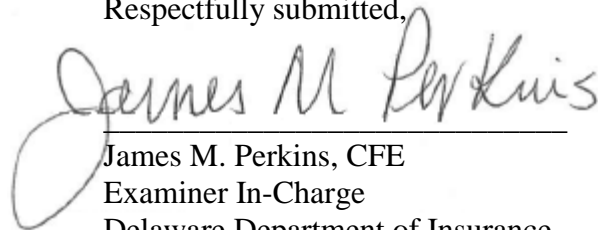
Effective January 1, 2020, the Company entered into a High Net Worth Homeowners Quota Share Reinsurance Contract with CIC. Under terms of the contract, CSU cedes 100% share of all high net worth homeowners business reinsured by CIC. CIC will pay CSU's quota share of losses under the policies, loss adjustment expense, extra contractual obligations, and loss in excess of policy limits covered under contract.

SUMMARY OF RECOMMENDATIONS


There were no recommendations as a result of this examination.

The assistance and cooperation of the Company's independent audit firm, Deloitte, examination representatives from lead state Ohio, the consulting actuarial firm, INS Consultants, Inc., and the Company's management and staff was appreciated and is acknowledged.

Respectfully submitted,

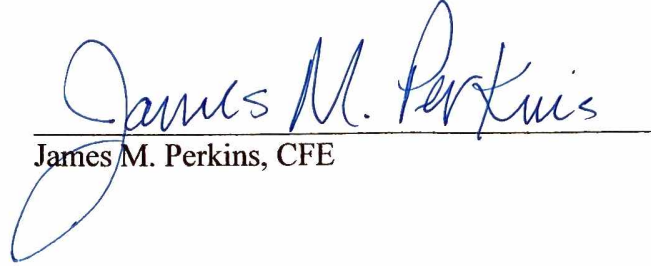


James M. Perkins, CFE
Examiner In-Charge
Delaware Department of Insurance



James Call, CFE, CPA
Supervising Examiner
Delaware Department of Insurance

I, James M. Perkins, hereby verify and attest, under penalty of perjury, that the above is a true and correct copy of the examination report and findings submitted to the Delaware Department of Insurance pursuant to examination authority 20.031.


James M. Perkins, CFE