

REPORT ON EXAMINATION
OF
THE CINCINNATI SPECIALTY UNDERWRITERS
INSURANCE COMPANY
AS OF
December 31, 2009

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

I, Karen Weldin Stewart, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2009 of the

THE CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

Attest By: *Sonia C. Harris*

Date: 16 February 2011



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 16th day of February, 2011.

[Handwritten signature]

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT ON EXAMINATION
OF THE
THE CINCINNATI SPECIALTY UNDERWRITERS
INSURANCE COMPANY
AS OF
DECEMBER 31, 2009

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 black ink, appearing to read "Karen Weldin Stewart".

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 16th day of February, 2011

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May 18, 2010

SALUTATION

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Honorable Karen Weldin Stewart, CIR-ML
Commissioner
Delaware Department of Insurance
Rodney Building
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Dover, Delaware 19904

Dear Commissioners:

In accordance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 09.024, dated June 10, 2009, an examination has been conducted of the

THE CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY

The Cincinnati Specialty Underwriters Insurance Company

hereinafter referred to as “ the Company”, or CSUIC incorporated under the laws of the State of Delaware as a stock company with its registered office in the State of Delaware at 1807 North Market Street, Wilmington, Delaware 19802. The Company’s main administrative office is located at 6200 S. Gilmore Road, Fairfield Ohio 45014. This examination was conducted at the Company’s administrative office in Fairfield Ohio.

The report of such examination is respectfully submitted.

SCOPE OF EXAMINATION

The Department has performed a coordinated risk focused examination of The Cincinnati Specialty Underwriters Insurance Company. The previous examination was an organizational examination as of October 9, 2007. This examination covered the period from October 9, 2007 through December 31, 2009. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the NAIC *Financial Condition Examiners Handbook*. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company's control environment assessment and evaluation based upon the Company's Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company's independent public accountants when appropriate.

This examination is part of the coordinated examination of the Cincinnati Insurance Company Group being conducted by the Ohio Department of Insurance (ODOI). The examination was conducted in accordance with the proposed risk focused procedures and guidelines prescribed by the National Association of Insurance Commissioners. This examination, for common subject matter, will rely on ODOI to identify risk classifications and inherent risk of key functional activities. ODOI will also be responsible for preparation of matrices that identify controls and risk mitigation strategies. Finally ODOI will determine residual risk and prepare substantive test procedures where deemed necessary.

The Department examiners will be responsible for identifying those issues that are required by the Delaware Insurance Code. In addition, additional substantive procedures will be performed where Department examiners deem necessary.

ODOI has created a file that will contain all documents relating to the Group's business and all documents relating to subject matter common to all companies. There will be only one file. Documents relating specific to the Company will be segregated on this file. Individual states will be given a copy of the files upon completion of the examination.

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

SUMMARY OF SIGNIFICANT FINDINGS

There were no significant findings or material adjustments to the Company's financial statements that warranted disclosure in this examination report.

COMPANY HISTORY

The Cincinnati Specialty Underwriters Insurance Company (CSU or the Company) was formed in 2007. The company was capitalized with \$200 million from its parent company, The Cincinnati Insurance Company (CIC). CIC is a wholly owned subsidiary of the Cincinnati Financial Corporation (CFC) a publicly traded holding company.

CAPITALIZATION

The Company was incorporated on August 13, 2007, under the laws of the State of Delaware and authorized to issue ten thousand (10,000) shares of common stock with a par value of \$1500.00 per share. As of October 9, 2007, three thousand five hundred (3,500) shares of the Company were issued and outstanding to CIC an Ohio domestic insurer, on October 1, 2007. This provided the Company with common capital stock of \$5,250,000. An additional \$194,750,000 was contributed to the Company in the form of cash and intercompany receivables.

MANAGEMENT AND CONTROL

Shareholders

The annual meeting of the stockholders of the Company shall be held at the principal office of the Company, or at such other place and at such hour as shall be designated in the notice thereof, on the first Saturday of April in each calendar year provided that the Board may fix an alternate annual meeting date and time for any particular year.

Board of Directors

The Company's bylaws, adopted August 20, 2007, state that the business and property of the Company shall be managed by a Board of Directors. The number of Directors shall be not less than four or more than eighteen. Directors may or may not be shareholder and shall be elected annually. Regular meetings of the Board are to be held quarterly at the office of the Company in the State of Delaware or at such other place as the Chairman of the Board or President in his absence may direct.

Directors of the Company are as follows:

<u>Name</u>	<u>Affiliation</u>
William F. Bahl	Chairman, Bahl and Gaynor Investment Counsel Inc.
James E. Benoski	Vice Chairman, Cincinnati Financial Corporation
Gregory T. Bier	Vice Chairman, Cincinnati Financial Corporation
Donald J. Doyle	Senior Vice President, the Company
Martin F. Hollenbeck	Chief Investment Officer, Senior Vice President Assistant Secretary, Assistant Treasurer Cincinnati Financial
Stephen J. Johnston	Chief Financial Officer, Senior Vice President, Secretary and Treasurer Cincinnati Financial Corporation

The Cincinnati Specialty Underwriters Insurance Company

Thomas A. Joseph	Senior Vice President Cincinnati Insurance Company
William R. McMullen	President and Chief Operating Officer, The Kroger Company
Martin J. Mullen	Senior Vice President, Cincinnati Insurance Company
Charles P. Stoneburner	Senior Vice President, Cincinnati Insurance Company
Jacob F. Scherer	Executive Vice President, Cincinnati Insurance Company
John J. Schiff Jr.	Chairman Cincinnati Financial Corporation
Thomas R. Schiff	Chairman and Chief Executive Officer John J. & Thomas R. Schiff & Co.
Kenneth W. Stecher	President and Chief Executive Officer, Cincinnati Financial Corporation
John F. Steele	Chairman and Chief Executive Officer, Hilltop Basic Resources, Inc.
Timothy L. Timmel	Senior Vice President, Cincinnati Insurance Company
Larry R. Webb	President, Webb Insurance Agency Inc.
Earnest A. Woods	Chairman and Chief Executive Officer, SupportSource LLC

Committees of the Board of Directors

The Directors may by resolution regularly adopted, delegate not less than three or more than ten directors to constitute an executive committee. The executive committee shall possess all the powers of the full Board of Directors. The board of Directors may designate one or more committees in addition to the executive committee. Committees appointed as of December 31, 2009 are as follows:

Executive Committee

John J. Schiff Jr.

John F. Steele

James E. Benoski

Larry R. Webb

Kenneth W. Stecher

Investment Committee

John J. Schiff Jr.

Martin J. Mullen

William F. Bahl

Thomas R. Schiff

James E. Benoski

Earnest A. Woods

Gregory T. Bier

Officers

Officer of the Company shall be a President, Secretary, Treasurer, and if the Board so determines a Chairman of the Board, a Vice Chairman of the Board, a Chief Executive Officer and one or more Executive Vice Presidents, Senior Vice Presidents and Vice Presidents. Officers are elected by the Directors each year and shall hold office until his successor is chosen and qualified. Officers serving as of December 31, 2009 are as follows:

<u>Name</u>	<u>Office</u>
Kenneth W. Stecher	Chief Executive Officer, President
Steven J. Johnston	Chief Financial Officer, Secretary, Treasurer
Donald J. Doyle	Senior Vice President
Martin F. Hollenbeck	Senior Vice President
Stephen M. Spray	Secretary
Scott T. Hintze	Assistant Secretary
Marc J. Schambow	Assistant Secretary

The NAIC Biographical Affidavits of the Company's Officers and Directors were reviewed during this examination. In addition, both the Code of Conduct and Statement of Principles of the Company's ultimate parent Cincinnati Financial Corporation were reviewed and accepted without exception.

HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System. The ultimate controlling entity is the Cincinnati Financial Corporation. (CFC) CFC is a publicly traded

The Cincinnati Specialty Underwriters Insurance Company

company. No one person owns more than 10% of the outstanding shares of CFC. The organizational chart of CFC is as follows:

Cincinnati Financial Corporation

CSU Producer Resources, Inc.

CFC Investment Company

The Cincinnati Insurance Company

The Cincinnati Casualty Company

The Cincinnati Indemnity Company

The Cincinnati Life Insurance Company

The Cincinnati Specialty Underwriters Insurance Company

The Company's operations will be pursuant to the following Intercompany agreements.

Intercompany Benefits and Expense Allocation Agreement

The parties to this agreement are, Cincinnati Financial Corporation (CFC), and The Cincinnati Insurance Company (CIC), The Cincinnati Life Insurance Company (CLIC), The Cincinnati Specialty Underwriters Insurance Company (CSU), CFC Investment Company (CFC-I) and CSU Producers Resources, INC. (Companies)

During the term of this Agreement, CFC shall provide the employees of the Companies with stock compensation benefits based on actual grants as determined by the compensation committee of CFC's board of directors and pension benefits based on each eligible employee's pay, service and age.

The 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 books, accounts and records shall be so maintained as to clearly and accurately

The Cincinnati Specialty Underwriters Insurance Company

disclose the nature and details of the transactions including such accounting information as is necessary to support the expenses apportioned to the respective Company. The Companies reimburse CFC for such expenses, as well as for all other expenses incurred by CFC for providing services under this Agreement.

Intercompany Cost Sharing and Expense Allocation Agreement

The parties to this agreement are Cincinnati Financial Corporation (CFC), The Cincinnati Insurance Company (CIC), The Cincinnati Casualty Company (CCC), The Cincinnati Indemnity Company (CID), The Cincinnati Life Insurance Company (CLIC), and The Cincinnati Specialty Underwriters Insurance Company (CSU), CFC Investment Company (CFC-I) and CSU Producers Resources, INC. (CSUR) (individually referred to as a "Company" or collectively referred to as the "Companies").

Under this Agreement, CFC provides the named Companies with services including, but not limited to, office and storage space, utilities, cleaning, repair, maintenance and security services.

This Agreement also provides that CIC provide the Companies with services including, but not limited to, telephone services, mailroom services, accounting services, claims servicing, legal services, computer services, printing services, salaries, personnel services and routine office equipment and supplies.

In addition under this Agreement CLIC provides the Companies with services including, but not limited to, health and flexible spending account claims servicing.

Tax Sharing Agreement

The Tax Sharing Agreement has as parties to the agreement CFC and the following subsidiaries.

The Cincinnati Specialty Underwriters Insurance Company

The Cincinnati Insurance Company

The Cincinnati Life Insurance Company

The Cincinnati Casualty Company

The Cincinnati Indemnity Company

The Cincinnati Specialty Underwriters Insurance Company

CFC Investment Company

CSU Producer Resources, Inc

CFC and its subsidiaries file a U.S. consolidated federal income tax return for each tax period for which this agreement is in effect and for which the Company and subsidiaries are required or permitted to file a Consolidated Federal Tax Return.

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 for the following:

- 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.

FIDELITY BOND COVERAGES

The Company is included as a named participant in the CFC's Fidelity Bond along with other subsidiaries of the holding company. The bond provides a single loss limit of \$15,000,000 and an aggregate limit of \$30,000,000. There is a \$1,000,000 deductible on the single loss limit amount. Additionally, CFC and its subsidiaries maintain coverage for Commercial Property,

General Liability, Commercial Auto, Workers Compensation, Ohio Excess Workers Compensation, Umbrella and Directors & Officer Liability.

TERRITORY AND PLAN OF OPERATION

CSU began offering surplus lines insurance products in January 2008. It is licensed in the State of Delaware and approved as a surplus lines writer in all states except California, Florida and Rhode Island.

In 2009 the Company had direct premiums written in 35 states. The top ten states are as follows:

Total Direct Written Premium		\$41,627,976	
State	Active Status	Direct Premiums Written	
1 Ohio OH	E	5,405,445	
2 Indiana IN	E	4,910,835	
3 Illinois IL	E	3,840,404	
4 Georgia GA	E	3,088,382	
5 Michigan MI	E	2,154,623	
6 Missouri MO	E	2,041,025	
7 North Carolina NC	E	1,906,433	
8 Kentucky KY	E	1,495,244	
9 Wisconsin WI	E	1,490,236	
10 Minnesota MN	E	1,428,869	

The Direct Premium written by the five largest lines of business is as follows:

Line of Business	Direct Written Premium
Other liability-occurrence	\$19,258,837
Products liability-occurrence	12,378,971
Fire	5,902,652

Allied lines	2,695,173
Products Liability-claims made	1,181,682

The Company is structured to serve the surplus lines needs of the agencies representing the other standard lines writers within CFC. Agencies that need to place a portion or all of a client's insurance program on a surplus lines basis can now place all of the business within CFC.

Agencies access CSU through CSU Producer Resources (Resources) a wholly owned insurance brokerage subsidiary of CFC. Resources maintain appropriate agent and surplus line licenses to process non-admitted business. Dedicated surplus lines underwriters are utilized by Resources which has binding authority on all classes of business written through CSU. In addition Resources will remit surplus lines taxes and stamping fees and retain admitted markets affidavits where required.

CFC is one of the 25 largest property and casualty insurers in the nation. CFC identifies four reporting segments that are defined based on financial information CFC uses to evaluate performance and to determine the allocation of assets.

Commercial Lines Property and Casualty Insurance

Personal Lines Property and Casualty

Life Insurance

Investments

Commercial Lines segment provides coverage to businesses against third-party liability from accidents occurring on their premises or arising out of their operation. Personal Lines segment markets homeowners and personal automobile insurance products. Life Insurance Segment includes four lines of business, term insurance, whole life insurance, universal life

insurance and worksite products. In addition, it provides disability income insurance, deferred annuities and immediate annuities. Investments segment purchases and maintain medium-risk fixed-maturity and equity securities

Business is marketed through a select group of agencies in 35 states. Standard market commercial lines policies are available in all of those states, while personal lines policies are available in 27 and surplus commercial lines policies are available in 33 of the same 35 states.

There are no MGA's or TPA's.

REINSURANCE

Assumed

As of December 31, 2009, there were no reinsurance assumed agreements in effect.

Ceded

The Company's underlying reinsurance coverage is with Swiss Re. The treaty has two layers and covers both property and casualty risk.

Under the first layer The Company retains the first \$1,000,000 of loss and cedes the next \$1,000,000 of loss to Swiss Re.

The second layer provides that after the first \$2,000,000 of loss the Company cedes 100% of the next \$3,000,000 of loss to Swiss Re.

The Company then attaches to the covers maintained by CIC.

Property Excess Treaty

This treaty has two layers. Under the first layer after \$5,000,000 of loss the reinsurers will assume the next \$5,000,000 of loss.

The second layer attaches after \$10,000,000 of loss and provides for the reinsurers to assume the next \$15,000,000 of loss.

Facultative coverage is purchased on risk over \$25,000,000.

Property catastrophe layers attach after the Company has sustained \$45,000,000 of loss up to a maximum of \$400,000,000

For casualty risk CIC retention is \$6,000,000. There are four layers; the first two provide coverage up to \$25,000,000. There are two clash covers provide additional coverage.

FINANCIAL STATEMENTS

The following pages contain the financial statements of the Company as filed with the Delaware Department of Insurance. For each year since incorporation, the Certified Public Accounting (“CPA”) firm of Deloitte & Touche, LLP has provided an unqualified opinion based on statutory accounting principles. Relevant work performed by the CPA firm during its annual audit of the Company was reviewed during the examination and incorporated into the examination workpapers.

The ODOI property and casualty actuary reviewed the relevant work performed by the opining actuary to report on the adequacy of the carried reserves and to comment on any other statutory matters relating to reserves.

There were no financial adjustments to the Company’s financial statements as a result of this examination.

The Cincinnati Specialty Underwriters Insurance Company

ASSETS				
December 31, 2009				
		<u>Assets</u>	<u>Nonadmitted</u> <u>Assets</u>	<u>Net Admitted Assets</u>
Bonds		\$189,420,325	-	\$189,420,325
Cash		20,083,166		20,083,166
Subtotals cash and invested assets		209,503,491		209,503,491
Investment income due and accrued		3,115,764		3,115,764
Uncollected premiums and agents balances in course of collection		36,910		36,910
Net deferred tax asset		3,869,162	3,869,162	-
Receivable from parent subsidiaries and affiliates		<u>3,566,660</u>	-	<u>3,566,660</u>
Total		<u>\$220,091,987</u>	<u>\$ 3,869,162</u>	<u>\$216,222,825</u>
LIABILITIES, SURPLUS AND OTHER FUNDS				
Losses				\$15,166,052
Loss adjustment expenses				6,810,000
Commissions payable				803,900
Other expenses (excluding federal and foreign income taxes)				448,253
Current federal and foreign income taxes				994,757
Unearned premiums				21,853,017
Ceded reinsurance premiums payable				348,652
Payable to parent, subsidiaries and affiliates				<u>1,896,294</u>
Total liabilities				<u>\$48,320,925</u>
Common capital stock				\$5,250,000
Gross paid in and contributed surplus				194,750,000
Unassigned funds (surplus)				<u>(32,098,100)</u>
Surplus as regards policyholders				<u>\$167,901,900</u>
Total				<u>\$216,222,825</u>

STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned \$26,965,835

DEDUCTIONS

Losses incurred \$13,597,648
 Loss expenses incurred 6,556,697
 Other underwriting expenses incurred 21,513,051
 Aggregate write-ins for underwriting deductions 0
 Total underwriting deductions \$41,667,396
 Net underwriting gain (loss) (\$14,701,562)

INVESTMENT INCOME

Net Investment income earned 9,346,717
 Net realized capital gains (losses) less capital gains
 tax of \$0 (2,394,823)
 Net investment gain (loss) \$6,951,894

OTHER INCOME

Net gain (loss) from agents' or premium balances
 charged off (amount recovered \$0 amount charged
 off \$0) \$0.00
 Finance and service charges not included in
 premiums 0
 Aggregate write-ins for miscellaneous income 0
 Total other income \$0
 Net income before dividends to policyholders, after
 capital gains tax and before all other federal and
 foreign income taxes (\$7,749,668)
 Dividends to policyholders \$ 0
 Net income, after dividends to policyholders, after
 capital gains tax and before all other federal and
 foreign income taxes (7,749,668)
 Federal and foreign income taxes incurred (\$1,015,723)
 Net income (\$6,733,945)

CAPITAL AND SURPLUS ACCOUNT		
Surplus as regards policyholders, December 31 prior year		<u>\$174,307,823</u>
Net income		(\$6,733,945)
Change in net unrealized capital gains or (losses) less capital gains tax of \$325,290		604,110
Change in net deferred income tax		2,371,123
Change in non-admitted assets		(2,594,162)
Surplus adjustments paid in		<u>(53,049)</u>
Change in surplus as regards policyholders for the year		<u>(\$6,405,923)</u>
Surplus as regards policyholders, December 31 current year		<u>\$167,901,900</u>

PRIOR EXAMINATION RECOMMENDATIONS

The prior examination comment has been carried forward to this examination. The Company custodial agreement does not contain all the provision recommended by the NAIC. This will be included in the Surveillance Letter (Management Letter) issued as part of the coordinated examination by the Ohio Department of Insurance.

NOTES TO THE FINANCIAL STATEMENTS

Investments

The Company's investments were in compliance with 18 Del.C. § 1305.

Loss and Loss Adjustment Expense Reserves

The Company had an outside actuary, Susan R. Pino, ACAS, MAAA, ARM of Deloitte Consulting, LLP certify the total reserves for the years covered by the examination. The ODOI

The Cincinnati Specialty Underwriters Insurance Company

actuary, Mary D. Miller, FCAS, MAAA, reviewed the detailed calculations for the reserves of the major lines of business as of December 31, 2009.

On the basis of the above-mentioned analysis, it was determined that the loss and loss adjustment expense reserves were reasonable as of December 31, 2009.

SUMMARY OF RECOMMENDATIONS

The Company custodial agreement does not contain all the provision recommended by the NAIC. This will be included in the Surveillance Letter (Management Letter) issued as part of the coordinated examination by the Ohio Department of Insurance.

CONCLUSION

The balance sheet contained in this Report of Examination reflects the financial condition of the Company as of December 31, 2009, and is summarized as follows:

Total Admitted Assets	<u>\$216,222,826</u>
Liabilities	\$48,320,925
Surplus as Regards Policyholders	<u>167,901,900</u>
Total Liabilities and Surplus as Regards Policyholders	<u>\$216,222,826</u>

In addition to the undersigned various members of the Ohio Department of Insurance participated in this examination.

Respectfully Submitted,



Dennis J. McGovern, CFE
Examiner-In-Charge
Department of Insurance
State of Delaware