

REPORT ON EXAMINATION
OF
THE CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY
AS OF
DECEMBER 31, 2014

NAIC CODE 13037

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 OF EXAMINATION, made as of December 31, 2014 of the

THE CINCINNATI SPECIALITY UNDERWRITERS INSURANCE COMPANY

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

Attest By:

Date: May 10, 2016



In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 10th day of May, 2016.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner



Delaware Department of Insurance

REPORT OF EXAMINATION
OF THE
THE CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY
AS OF
DECEMBER 31, 2014

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 10th day of May, 2016

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March 15, 2016

Honorable Karen Weldin Stewart
Commissioner
Delaware Department of Insurance
Rodney Building
841 Silver Lake Blvd.
Dover, Delaware 19904

Dear Commissioner:

In accordance with instructions and pursuant to statutory provisions contained in Certification Number 15.039, dated April 24, 2015, a financial examination has been made of the affairs, financial condition and management of

THE CINCINNATI SPECIALTY UNDERWRITERS INSURANCE COMPANY

hereinafter referred to as (Company or CSU) 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 this examination is respectfully submitted.

SCOPE OF EXAMINATION

The Delaware Department of Insurance has performed a multi-state coordinated risk-focused financial examination of The Cincinnati Specialty Underwriters Insurance Company. The last examination was conducted as of December 31, 2009. This examination covered the period of January 1, 2010 through December 31, 2014, and encompasses a general review of

transactions during the period, the Company's business policies and practices, as well as management and relevant corporate matters, with a determination of the financial condition of the Company at December 31, 2014. Transactions subsequent to the examination date were reviewed where deemed necessary.

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 States of Delaware and Ohio. The 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. Certain auditor work papers of their 2014 audit 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. The examination of the Company was conducted concurrently with the examination of the Company's direct parent company, The Cincinnati Insurance Company (CIC), along with affiliate companies: The Cincinnati Casualty Company (CCC), The Cincinnati Indemnity Company (CID) and The Cincinnati Life Insurance Company (CLIC), all Ohio domiciled insurance companies.

SUMMARY OF SIGNIFICANT FINDINGS OF FACT

This examination had no material adverse findings, significant non-compliance findings, material changes in financial statements, or updates on other significant regulatory information disclosed in the previous examination.

COMPANY HISTORY

The Company was incorporated on August 13, 2007, under the laws of the State of Delaware and commenced business on November 2, 2007. Initial capitalization of \$200,000,000 as of December 31, 2007 included paid-in capital stock of \$5,250,000 consisting of 3,500 common shares outstanding at \$1,500 par value each and \$194,750,000 of paid-in surplus. Assets transferred totaled \$212,400,000, which included a deferred tax liability of \$12,400,000. There are 10,000 common shares authorized. All shares are Class A shares and there is no preferred stock. The Company was initially capitalized on October 1, 2007, by a cash

contribution of \$20,000,000 from CIC. CIC made additional cash and common stock contributions of more than \$200,000,000 subsequent to the initial capitalization date in 2007.

MANAGEMENT AND CONTROL

Directors

Pursuant to the General Corporation Law of the State of Delaware as required by 18 Del. C. §4903, and implemented by the Company's Certificate of Incorporation and bylaws, all corporate powers and its business property and affairs are managed by, or under direction of, its Board of Directors (Board). The bylaws provide that the number of directors that constitutes the whole Board shall not be less than four members or more than eighteen. Each director shall be elected for a term of one year and serve until such director's successor is elected and qualified. The directors duly elected in accordance with the Company's bylaws and serving at December 31, 2014, including their Primary Business Affiliation, were as follows:

<u>Name</u>	<u>Primary Business Affiliation</u>
William F. Bahl	Chairman Bahl & Gaynor Investment Counsel, Inc.
Gregory T. Bier	Retired Deloitte & Touche LLP
Teresa C. Cracas	Senior Vice President and Chief Risk Officer The Cincinnati Insurance Companies
Donald J. Doyle, Jr.	Senior Vice President The Cincinnati Insurance Companies
Martin F. Hollenbeck	Senior Vice President and Chief Investment Officer The Cincinnati Insurance Companies
Steven J. Johnston	President and Chief Executive Officer The Cincinnati Insurance Companies
John S. Kellington	Senior Vice President and Chief Information Officer The Cincinnati Insurance Companies

The Cincinnati Specialty Underwriters Insurance Company

Lisa A. Love	Senior Vice President and Secretary The Cincinnati Insurance Companies
W. Rodney McMullen	Chairman and Chief Executive Officer The Kroger Co.
Martin J. Mullen	Senior Vice President The Cincinnati Insurance Companies
David P. Osborn*	President Osborn Rohs Williams & Donohoe, LLC
Jacob F. Scherer	Executive Vice President The Cincinnati Insurance Companies
John J. Schiff, Jr.	Former Chairman and Chief Executive Officer The Cincinnati Insurance Companies
Thomas R. Schiff	Chairman and Chief Executive Officer John J. & Thomas R. Schiff & Co., Inc.
Michael J. Sewell	Senior Vice President and Chief Financial Officer The Cincinnati Insurance Companies
Stephen M. Spray	Senior Vice President The Cincinnati Insurance Companies
Kenneth W. Stecher	Chairman The Cincinnati Insurance Companies
John F. Steele, Jr.	Chairman and Chief Executive Officer Hilltop Basic Resources, Inc.
Charles P. Stoneburner II	Senior Vice President The Cincinnati Insurance Companies
Timothy L. Timmel	Senior Vice President The Cincinnati Insurance Companies
Larry R. Webb	President Webb Insurance Agency, Inc.

* New director in 2014

Officers

The bylaws state that the officers of the corporation shall consist of a President, a Secretary, a Treasurer, and may, at the discretion of the Board, include a Chairman and one or more Vice Chairmen and one or more Vice Presidents (including Executive Vice Presidents and Senior Vice Presidents). The following individuals were elected as officers of the Company and were serving in that capacity at December 31, 2014:

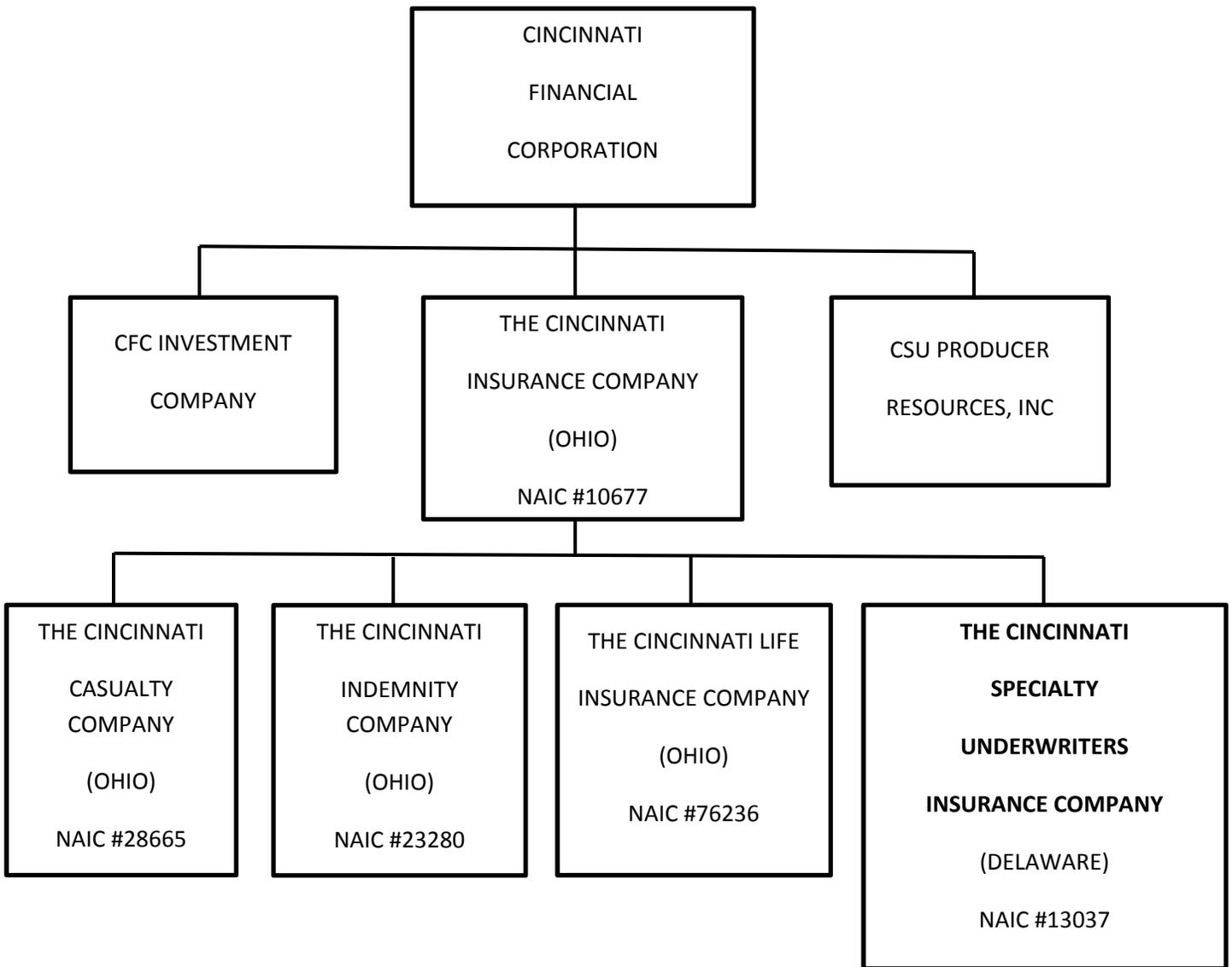
<u>Name</u>	<u>Title</u>
Kenneth W. Stecher	Chairman
Steven J. Johnston	President and Chief Executive Officer
Michael J. Sewell	Senior Vice President and Chief Financial Officer
Jacob F. Scherer	Executive Vice President
Lisa A. Love	Senior Vice President and Corporate Secretary
Teresa C. Cracas	Senior Vice President
Donald J. Doyle, Jr.	Senior Vice President
Martin F. Hollenbeck	Senior Vice President
John S. Kellington	Senior Vice President
Eric N. Mathews*	Senior Vice President
Martin J. Mullen*	Senior Vice President
Timothy L. Timmel*	Senior Vice President

* New officer in 2014

Holding Company System

The Company is a member of an insurance holding company system as defined under Chapter 50, “Insurance Holding Companies” of the Delaware Insurance Code. The Company is a wholly-owned subsidiary of CIC, which is wholly-owned by Cincinnati Financial Corporation (CFC), the ultimate parent within the holding company system. CIC also wholly-owns the following three Ohio domiciled affiliate companies, CCC, CID and CLIC. The following

organizational chart depicts the Company's relationship within the holding company system at December 31, 2014.



Affiliated Agreements

The following agreements, approved by the Delaware Department of Insurance, were in effect between the Company and its parent, affiliates, and subsidiaries as of December 31, 2014:

Intercompany Reinsurance Agreements

The Company is party to an intercompany Property Per Risk Excess of Loss Reinsurance Agreement and an intercompany Casualty Excess of Loss Reinsurance Agreement, both of which are discussed in the “Reinsurance” section of this report.

Intercompany Service Agreements

Effective August 15, 2007, the Company became party to an Intercompany Cost Sharing and Expense Allocation Agreement. Under this agreement, the Company’s ultimate parent, CFC, provides its subsidiary companies with services including, but not limited to, office and storage space, utilities, cleaning, repair, maintenance and security services. In addition, the Company’s direct parent, CIC, provides its subsidiary 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. Finally, CLIC provides affiliate companies with services including, but not limited to, health and flexible spending account claims servicing.

Effective August 15, 2007, the Company became party to an Intercompany Benefits and Expense Allocation Agreement. Under this agreement, the Company’s ultimate parent, CFC, provides employees of its subsidiary companies with stock compensation benefits based on actual grants as determined by the Compensation Committee of CFC's Board, along with pension 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 books, accounts and records are maintained as to clearly and accurately disclose the nature and details of the transactions including such accounting information as necessary to support the expenses

apportioned to the respective subsidiary company. The Company reimburses CFC for such expenses, as well as all other expenses incurred by CFC for providing services under the agreement.

Tax Sharing Agreement

Effective January 1, 2012, the Company became party to a Tax Sharing Agreement (Agreement) with other members of the consolidated group. This 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

Territory

The Company is an excess and surplus lines carrier offering an array of products through affiliate, CSU Producer Resources, Inc. (CSUPR), which was created solely to provide non-admitted products to CIC agents written through the Company. As of December 31, 2014, CIC and its wholly owned standard market subsidiaries actively marketed admitted products in 39 states through independent agencies.

Plan of Operation

The Company writes a balanced book of business, both geographically, as well as by class of business with no more than 25% of written premium represented by any particular class of business. The Company primarily writes within the following industry segments:

The Cincinnati Specialty Underwriters Insurance Company

Construction, Miscellaneous Manufacturing, Miscellaneous 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.

The Company is not a market for asbestos and environmental exposures. Formal risk guidelines avoid a number of classes of business including: medical malpractice, invasive medical devices, pharmaceuticals, nutraceuticals, workers' compensation, auto (including long-haul trucking), Directors and Officers, engineers, architects, aircraft products liability, or CAT exposed property.

REINSURANCE

Assumed Reinsurance

As of December 31, 2014, the Company did not assume any business. Therefore, there were no reinsurance assumed agreements in effect during the examination period.

Ceded Reinsurance

Intercompany Reinsurance Agreements

Effective January 1, 2014, the Company became party to an amended and restated Property Per Risk Excess of Loss Reinsurance Agreement with its direct parent, CIC. The agreement provides limits up to \$5,000,000 and includes protection for extra-contractual liability coverage losses. The Company retains the first \$500,000 of any policy loss. Losses between \$500,000 and \$5,000,000 are reinsured at 100 percent by CIC. The Company also has “basket retention” coverage in the event of a loss involving a combination of the property business subject to this agreement and/or the casualty business subject to its Casualty Excess of Loss

agreement (see below). The Company purchased coverage to limit retention to \$1,000,000 in the event that the same occurrence results in both a property and a casualty loss.

Effective January 1, 2014, the Company became party to an amended and restated Casualty Excess of Loss Reinsurance Agreement with its direct parent, CIC. The casualty agreement is written on an excess of loss basis and provides limits up to \$6,000,000. A second layer of \$5,000,000 excess of \$6,000,000 is written to provide coverage for extra contractual obligations or clash exposures. The maximum retention by the Company for any one casualty loss is \$1,000,000. Losses between \$1,000,000 and \$11,000,000 are reinsured at 100 percent by CIC.

Third Party Reinsurance Agreements

As a subsidiary of CIC, the Company was added as a named insured under the corporate Property Catastrophe Excess of Loss Treaty and for the collateralized reinsurance funded through the issuance of catastrophe bonds. All terms and conditions of the reinsurance coverage apply to policies underwritten by the Company. The coverage is in 5 layers as follows:

- 1st Layer – 95% of \$75.0 million excess of \$25.0 million
- 2nd Layer – 95% of \$100.0 million excess of \$100.0 million
- 3rd Layer – 95% of \$ 100.0 million excess of \$200.0 million
- 4th Layer – 95% of \$ 100.0 million excess of \$ 300.0 million
- 5th Layer – 95% of \$ 200.0 million excess of \$ 400.0 million

Effective November 1, 2009, the Company became party to a Casualty Quota Share Reinsurance Agreement with Swiss Reinsurance America Corporation (Swiss Re). Under terms of the agreement for certain underlying policies, the Company cedes 100% of its ultimate net liability for new and renewal excess policies, subject to a maximum cession limit of \$5,000,000

each policy. For other certain underlying policies, the Company cedes 80% of its ultimate net liability for new and renewal excess policies, subject to a maximum cession limit of \$4,000,000 each policy (80% share of ultimate net liability of \$5,000,000).

For property risks with limits exceeding \$5,000,000 and/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. In 2014, underwriters placed a small amount of property facultative reinsurance with Arch Reinsurance Company (Arch Re).

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Delaware 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.

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Reconciliation of Surplus Account

The narrative on the reserve related balances is presented in the “Comments on Financial Statements” section of this report.

The Cincinnati Specialty Underwriters Insurance Company

Assets
December 31, 2014

	<u>Assets</u>	Nonadmitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$ 420,410,547	\$ -0-	\$ 420,410,547
Common stocks	85,180,620		85,180,620
Cash and short-term investments	15,635,429		15,635,429
Investment income due and accrued	5,040,371		5,040,371
Deferred premiums, agents' balances and installments booked but deferred	6,021,721	561,509	5,460,212
Amounts recoverable from reinsurers	3,856,302		3,856,302
Current federal and foreign income tax recoverable and interest thereon	488,053		488,053
Electronic data processing equipment and software	3,263,675	3,256,242	7,433
Furniture and equipment	1,565	1,565	
Receivables from parent, subsidiaries and affiliates	9,747,826		9,747,826
Total Assets	<u>\$ 549,646,109</u>	<u>\$ 3,819,316</u>	<u>\$ 545,826,793</u>

Liabilities, Surplus and Other Funds
December 31, 2014

		<u>Comments</u>
Losses	\$ 148,068,216	1
Loss adjustment expenses	45,866,185	1
Commissions payable, contingent commissions and other similar charges	5,371,274	
Other expenses	682,518	
Taxes, licenses and fees	225,300	
Net deferred tax liability	754,230	
Unearned premiums	73,540,398	
Ceded reinsurance premiums payable	762,259	
Amounts withheld or retained by company for account of others	17,891	
Payable to parent; subsidiaries and affiliates	4,974,415	
Aggregate write-ins for liabilities:		
Accounts Payable Other	8,436	
Total liabilities	<u>\$ 280,271,122</u>	
Common capital stock	\$ 5,250,000	
Gross paid in and contributed surplus	194,750,000	
Unassigned funds (surplus)	<u>65,555,671</u>	
Surplus as regards policyholders	<u>\$ 265,555,671</u>	
Totals	<u><u>\$ 545,826,793</u></u>	

Statement of Income
December 31, 2014

Surplus as regards policyholders, December 31, 2013	<u>\$ 364,034,083</u>
GAINS AND (LOSSES) IN SURPLUS	
Net income	32,301,470
Change in net unrealized capital gains or losses less capital gains tax of (\$183,817)	997,001
Change in net unrealized foreign exchange capital gain	(2,065,378)
Change in net deferred income tax	1,514,443
Change in non-admitted assets	18,653,826
Change in provision for reinsurance	(315,386)
Surplus adjustments:	
Paid in	<u>1,305,786</u>
Change in surplus as regards policyholders for the year	52,391,762
Surplus as regards policyholder, December 31, 2014	<u><u>\$ 416,425,845</u></u>

Reconciliation of Surplus Account
December 31, 2009 to December 31, 2014

Surplus as regards policyholders, December 31, 2009	<u>\$ 167,901,900</u>
Net income	67,964,050
Change in net unrealized capital gains or (losses)	22,271,123
Change in net deferred income tax	6,440,865
Change in non-admitted assets	49,846
Cumulative effect of changes in accounting principles	<u>927,887</u>
Surplus as regards policyholders, December 31, 2014	<u><u>\$ 265,555,671</u></u>

COMMENTS ON FINANCIAL STATEMENTS

(Note 1) Losses	\$ 148,068,216
Loss adjustment expenses	\$ 45,866,185

The Delaware Department of Insurance contracted INS Consultants, Inc. (INS), to conduct an independent review of the Company's loss and LAE reserves as of December 31, 2014. The Consulting Actuary's analysis was performed using a risk-focused approach according to the guidelines contained in the Handbook. The conclusions set forth in the Consulting Actuary's report were based on information provided by the Company, including the 2014 Annual Statement. The Statement of Actuarial Opinion and the Actuarial Report for the Company were signed by Rita M. Zona, ACAS, MAAA, associated with the outside firm Deloitte Consulting, LLP.

Based on work performed, the Consulting Actuary found the Company's carried net and gross loss and LAE reserves, as of December 31, 2014, to be reasonably stated. No financial adjustment to Company reserves was required for examination purposes.

SUBSEQUENT EVENTS

There were no significant events that occurred subsequent to the examination date that would have an impact on the Company's financial statements.

SUMMARY OF RECOMMENDATIONS

No examination report recommendations were noted as a result of this examination.

CONCLUSION

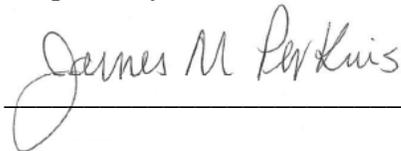
The following schedule reflects the results of this examination and the results of the prior examination with changes between the examination periods:

<u>Description</u>	<u>December 31, 2009</u>	<u>December 31, 2014</u>	<u>Increase (Decrease)</u>
Assets	\$216,222,826	\$545,826,793	\$329,603,967
Liabilities	48,320,925	280,271,122	231,950,197
Common capital stock	5,250,000	5,250,000	
Gross paid in and contributed surplus	194,750,000	194,750,000	
Unassigned funds (surplus)	<u>(32,098,100)</u>	<u>65,555,671</u>	<u>97,653,771</u>
Surplus as regards policyholders	<u>167,901,900</u>	<u>265,555,671</u>	<u>97,653,771</u>
Total liabilities, capital and surplus	<u>\$216,222,826</u>	<u>\$545,826,793</u>	<u>\$329,603,967</u>

The Cincinnati Specialty Underwriters Insurance Company

The assistance and cooperation of examiners representing the state of Ohio is acknowledged. In addition, the assistance of Delaware's consulting actuarial firm, INS Consultants, Inc., the Company's outside audit firm, Deloitte & Touche, and the Company's management and staff was appreciated and is acknowledged.

Respectfully submitted,

A handwritten signature in cursive script that reads "James M. Perkins". The signature is written in dark ink and is positioned above a horizontal line.

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