REPORT ON EXAMINATION

OF THE

UNITED SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

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, 2010 of the

UNITED SPECIALTY INSURANCE COMPANY

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

Attest By:

Date: 18 Jun 2012

Insurance Commissioner of the State of Delaware

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 18th day of June, 2012.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

REPORT ON EXAMINATION

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UNITED SPECIALTY INSURANCE COMPANY

AS OF

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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.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Dated this 18th day of June, 2012

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March 14, 2012

SALUTATION

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

Dear Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 11.030, an Association examination has been made of the affairs, financial condition and management of the

UNITED SPECIALTY INSURANCE COMPANY

hereinafter referred to as "Company" or "USIC", incorporated under the laws of the State of Delaware as a stock company. The Company's statutory home address is 160 Greentree Drive, Suite 101, Dover, Delaware. The examination was conducted at the administrative office of the Company located at 1900 L. Don Dodson Drive, Bedford, Texas 76021.

The report of this examination is submitted herewith.

SCOPE OF EXAMINATION

This examination was a multistate coordinated examination of State National Insurance Company, Inc. (TX) (SNIC), National Specialty Insurance Company (TX) (NSIC) and USIC which collectively make up the State National Pool members and all are controlled by ultimate parent, State National Companies, Inc. (SNC), a Delaware holding company.

These concurrent examinations were conducted in accordance with the Association Plan of Examination guidelines established by the National Association of Insurance Commissioners (NAIC). Examiners representing the states of Delaware and Texas participated in these concurrent examinations, and Reports of Examination for each of the three U.S. domestic companies were filed separately. The last examination was an organization examination as of November 14, 2005. This examination is a comprehensive risk-focused examination which covers the five year period from January 1, 2006 to December 31, 2010, and encompassed a general review of the Company's business policies and practices, as well as management and relevant corporate matters, with a determination of financial condition at December 31, 2010. Transactions and operations 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). The NAIC Handbook requires that we plan and perform the examination to assess financial condition and identify prospective risks by evaluating Company information including operations, corporate governance, identifying and assessing material inherent risks to which the Company is considered exposed and evaluating processes, systems, controls and other procedures used to mitigate those risks. The examination also included assessing principles used and significant estimates made by management, as well as evaluating overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, Ernst and Young, LLC. Certain auditor work papers of their 2010 audit have been incorporated into the work papers of this examination and have been utilized principally in the area of tests of controls, risk mitigation and substantive tests of account balances.

In addition to items hereinafter incorporated as a part of this report, the following were reviewed without material exception and made part of the work papers of this examination.

- Dividends
- Corporate Records
- Conflict of Interest
- Pensions, Stock Ownership and Insurance Plans
- NAIC Ratios
- Legal Actions
- Regulatory Agency Correspondence
- Compliance with Prior Report Examination
- All other Assets and Liabilities not mentioned

SUMMARY OF SIGNIFICANT FINDINGS

In accordance with Amended Articles of Incorporation and Board approval, the Company did not cancel the initial capital stock certificate and issue another stock certificate in the amount of 100,000 shares.

Addendum 5 to the Management Service Agreement with immediate parent, T.B.A. Insurance Group, Ltd. (TBA) was not filed with the Department for approval. Although not specifically stated, the Company paid debt service to TBA via the management service agreement which may be considered a dividend per SSAP 25, and not filed with the Department for review and/or approval.

Addendum 3 to the Agency Agreement with TBA was not filed with the Department for review or approval.

The Company did not file a Financial Guaranty Agreement with its immediate parent, SNIC and the State of Maine, for review and approval with the Department.

The Custodial Agreement with Frost Bank did not contain necessary and required safeguards protecting the Company's investments in accordance with the NAIC Examiners Handbook guidelines.

The Company did not provide/obtain nonresident licenses for those program managers that meet the definition of MGAs and required statute provisions.

The Company's fidelity bond coverage did not adequately cover itself to the minimum suggested levels according to the NAIC Examiners' Handbook guidelines.

SUBSEQUENT EVENTS

The following events occurred subsequent to the examination date:

Management and Control

On January 1, 2011, the Company made changes to its Board of Directors by the addition of Company officers and two (2) new members. The Board was expanded to seven (7) members with the addition of the following:

Name	Principal Affiliation
Wyatt Douglas Blackburn	EVP, COO and Secretary
David Donaldson Hale	EVP, CFO and Treasurer
Lonnie Kossuth Ledbetter III	SVP, Services
Anita Kay Guadin	Director, T.B.A. Ins. Grp. Ltd.
Ferdinand "Fred" Herbert Reichelt	Independent, Retired

On January 2, 2011, The Board appointed an Audit Committee that comprised of the following:

Name	Principal Affiliation
David Donaldson Hale	EVP, CFO and Treasurer
Ferdinand ("Fred") Herbert Reichelt	Independent, Retired

Reinsurance

On December 27, 2011, the Department approved a Form D filing that amended the reinsurance pooling agreement with parent, SNIC, and affiliate, NSIC, by Addendum 3.

Addendum 3 revised the pooling percentages to more accurately reflect each Company's percentage of SNIC's total surplus and eliminates the "Other investment income and expense" provision from the original agreement. The pooling percentages changed from 65/25/10 to 45/35/20 for SNIC, USIC and NSIC respectively.

As part of the filing, USIC notified the Department of a capital contribution in the amount of $15,000,000 from immediate parent, SNIC. The transfer of securities was made on January 27, 2012.

Common Capital Stock

On March 8, 2012, the Company canceled the initial 1,500 shares of common capital stock and issued 100,000 shares to SNIC in accordance with its 2006 Board of Director minutes and 2007 filed Amended Articles of Incorporation.

COMPANY HISTORY

The Company was incorporated on July 8, 2005, under the laws of the State of Delaware. A Certificate of Authority, issued by the Insurance Commissioner on July 11, 2005 authorizes the Company to transact the business of property and casualty.

The Company became part of an insurance holding company system at the time of incorporation as a wholly owned subsidiary of State National Insurance Company, Inc (SNIC). One hundred percent (100%) of the Company's stock is held by SNIC, a Texas domiciled insurer, which in turn is a wholly owned subsidiary of TBA, which in turn is a wholly owned subsidiary of SNC, a Delaware corporation, which is the "ultimate controlling person" of the Company.

COMMON CAPITAL STOCK AND PAID-IN SURPLUS

As of December 31, 2010, the Company had 1,500 issued and outstanding shares of common stock with no par value per share, for common capital stock totaling $200,000 according to its capital stock book. All of the common stock of the Company is issued to SNIC.

The Company had taken appropriate action via its Board of Director's minutes and filed Amended Articles of Incorporation to increase the authorized shares from 1,500 shares to 200,000 shares with a par value of $35.00 a share on December 29, 2006 and March 27, 2007 respectively. However, during the examination period and subsequent thereto, the Company failed to cancel the initial shares and issue 100,000 shares to SNIC.

It is recommended that the Company cancel and execute new stock issuance to be consistent with its Articles as amended and as approved by the Board of Directors.

RECONCILIATION OF CAPITAL AND SURPLUS

The following reconciliation of capital and surplus for the period as of December 31, 2006 to December 31, 2010, was extracted from the Company's filed Annual Statements:

	Common Stock	Gross Paid-In Surplus	Unassigned Surplus	Total
Balance at January 1, 2006	$ -	$ -	$ -	$ -
Operations			1,672,703	1,672,703
Capital Paid In	3,500,000			3,500,000
Surplus Paid In		16,500,000		16,500,000
Balance at December 31, 2006	$ 3,500,000	$ 16,500,000	$ 1,672,703	$ 21,672,703
Net Income			3,111,200	3,111,200
Change in net unrealized capital gains			0	0
Change in net deferred taxes			(192,640)	(192,640)
Change in nonadmitted assets			37,988	37,988
Balance at December 31, 2007	$ 3,500,000	$ 16,500,000	$ 4,629,251	$ 24,629,251
Net Income			1,811,032	1,811,032
Change in net unrealized capital gains			(79,632)	(79,632)
Change in net deferred taxes			(151,059)	(151,059)
Change in nonadmitted assets			(30,917)	(30,917)
Balance at December 31, 2008	$ 3,500,000	$ 16,500,000	$ 6,178,675	$ 26,178,675
Net Income			2,814,126	2,814,126
Change in net unrealized capital gains			(78,424)	(78,424)
Change in net deferred taxes			(143,819)	(143,819)
Change in nonadmitted assets			(6,090)	(6,090)
Balance at December 31, 2009	$ 3,500,000	$ 16,500,000	$ 8,764,468	$ 28,764,468
Net Income			2,359,772	2,359,772
Change in net unrealized capital gains			138,113	138,113
Change in net deferred taxes			220	220
Change in nonadmitted assets			72,549	72,549
Balance at December 31, 2010	$ 3,500,000	$ 16,500,000	$ 11,335,122	$ 31,335,122

MANAGEMENT AND CONTROL

Board of Directors

The Company's bylaws as amended to date, state that the business, property, and affairs of the Company shall be conducted and managed by its Board of Directors. Directors are elected at the annual meeting of the stockholder and each director serves until his successor shall have been elected and qualified or until he shall die or resign, or shall have been removed.

The Board of Directors regular meetings shall be held without notice at the registered office of the Company or at such other time and place as shall be determined by the Board. Special meetings of the Board of Directors may be held as designated by the President.

The minutes of the meetings of the stockholder and the Board of Directors which were held during the period of examination were reviewed. Attendance at meetings, election of directors and officers, approval of investment transactions and approval of investment consultant were noted.

Directors serving at December 31, 2010 were as follows:

Name	Principal Occupation
Terry Lee Ledbetter	President
Lonnie Kossuth Ledbetter	Chairman, CEO

Officers

The Company's bylaws state that the officers of the Company shall be appointed by the Board of Directors and shall be a President, one or more Vice Presidents, a Secretary and a Treasurer. Any two or more offices may be held by the same person.

The following officers had been elected by the Board of Directors and were serving at December 31, 2010:

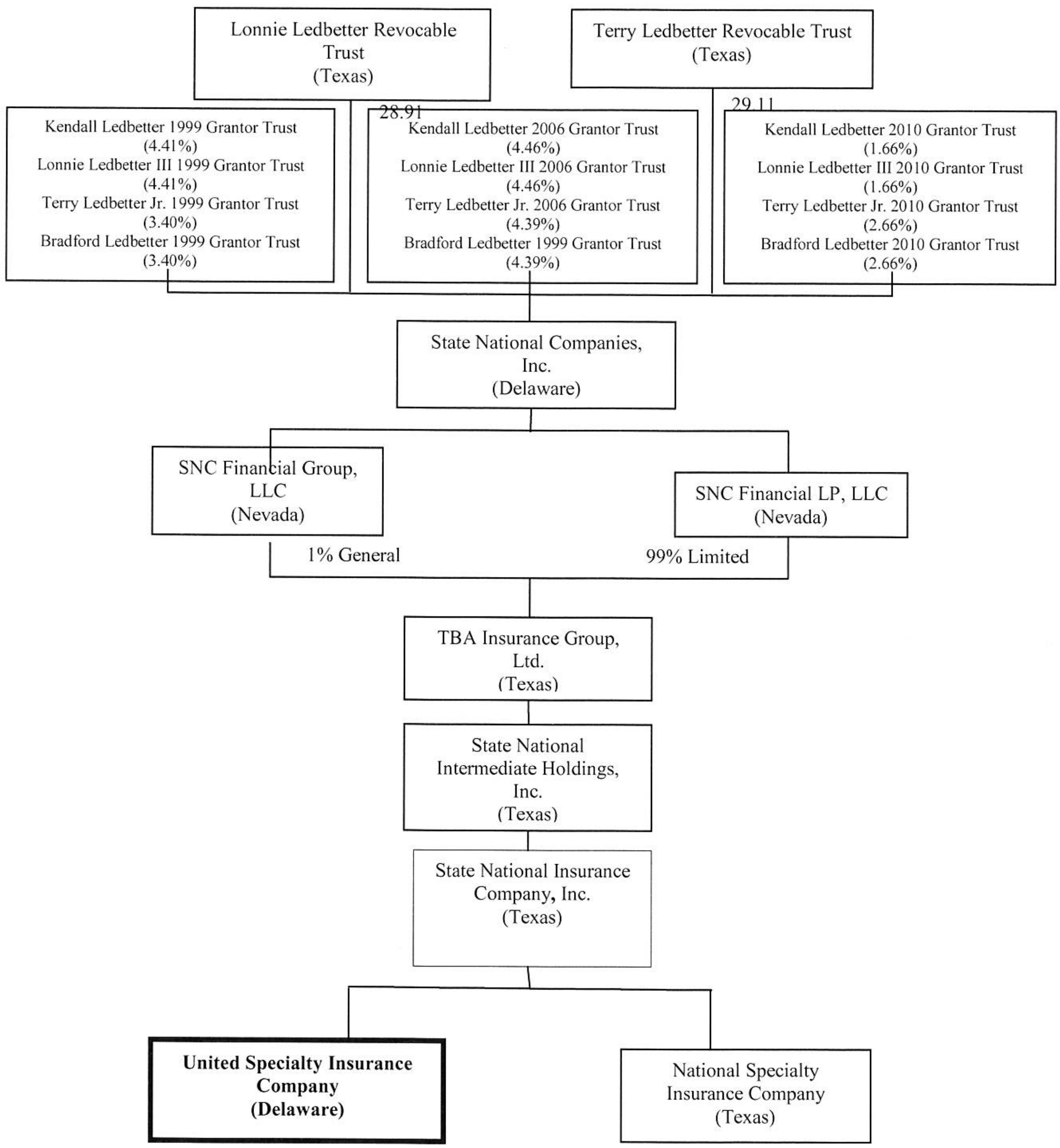
Name	Title
Terry Lee. Ledbetter	President
Lonnie Kossuth Ledbetter	Chairman, CEO
David Donald Hale	EVP, CFO and Treasurer
Wyatt Douglas Blackburn	EVP, COO and Secretary
Lonnie Kossuth Ledbetter III	SVP, Services
David Martin Cleff	SVP, General Counsel and Assistant Secretary

HOLDING COMPANY SYSTEM

The Company is a wholly owned subsidiary of SNIC. SNIC is a wholly owned subsidiary of State National Intermediate Holdings, Inc. (SNIH) and is ultimately owned by SNC. SNC is ultimately controlled by a Revocable Trust for which Lonnie Ledbetter and Terry Ledbetter are majority Trust Grantors with other family members as minority Trust Grantors.

State National Companies currently write over $600 million in premium and employs a staff of over 350 at its headquarters in Bedford, Texas, with additional staff located throughout the country.

The following chart reflects ownership of USIC and other affiliates by its ultimate parent:


Lonnie Ledbetter Revocable Trust (Texas)
Terry Ledbetter Revocable Trust (Texas)
28.91
29.11
Kendall Ledbetter 1999 Grantor Trust (4.41%)
Lonnie Ledbetter III 1999 Grantor Trust (4.41%)
Terry Ledbetter Jr. 1999 Grantor Trust (3.40%)
Bradford Ledbetter 1999 Grantor Trust (3.40%)
Kendall Ledbetter 2006 Grantor Trust (4.46%)
Lonnie Ledbetter III 2006 Grantor Trust (4.46%)
Terry Ledbetter Jr. 2006 Grantor Trust (4.39%)
Bradford Ledbetter 1999 Grantor Trust (4.39%)
Kendall Ledbetter 2010 Grantor Trust (1.66%)
Lonnie Ledbetter III 2010 Grantor Trust (1.66%)
Terry Ledbetter Jr. 2010 Grantor Trust (2.66%)
Bradford Ledbetter 2010 Grantor Trust (2.66%)
State National Companies, Inc. (Delaware)
SNC Financial Group, LLC (Nevada)
SNC Financial LP, LLC (Nevada)
1% General
99% Limited
TBA Insurance Group, Ltd. (Texas)
State National Intermediate Holdings, Inc. (Texas)
State National Insurance Company, Inc. (Texas)
United Specialty Insurance Company (Delaware)
National Specialty Insurance Company (Texas)

A review of the Insurance Holding Company Annual Registration Statement filings (Form B and Form C) made by the Company for all years under examination revealed that the Company had complied with the requirements of 18 Del. Admin. Code 1801 § 20.0 and § 21.0.

AGREEMENTS

Affiliated Agreements

The Company was a party to numerous intercompany agreements, which were disclosed by the Company in its Form B Registration Statement filings with the Delaware Department of Insurance. The agreements of significance are summarized as follows:

Agreement for Management Services

Effective April 1, 2006, by Addendum 4, the Company entered into an existing agreement (dated December 29, 1999) and addendums for management services with its upstream parent, TBA that included SNIC and NSIC. TBA provides management services to all of the insurance companies for the oversight of the Companies' underwriting operations.

Addendum 5 changed the termination date provision to the original agreement. The addendum, with a stated effective date of December 31, 2004, was approved by the Texas Department on November 14, 2006. However, this addendum was not filed with the Department in accordance with 18 Del. C. § 5005(a)(2)d.

Fees incurred by the Company for such services were approximately $4,606,597 and $6,406,985 for 2010 and 2009 respectfully. For the other years of examination, it was noted that the fees were in the same range. The examiner reviewed the amount of fees charged in consideration of SSAP No. 25. It was ascertained that all of the insurance subsidiaries' pay TBA to cover its debt service. The management and service agreement does not specifically address any provision for payment of debt service to immediate parent, TBA, and thus could be considered a dividend under SSAP No. 25 guidelines and in violation of 18 Del. C. § 5005(b).

It is recommended that USIC submit, via Form D, Addendum 5 for approval with the Department in accordance with 18 Del. C. § 5005(a)(2)d.

It is recommended that the Company assure compliance with SSAP 25 and 18 Del. C. § 5005(b) with regard to amounts paid to upstream parents.

Agency Agreement

Effective April 1, 2006, by Addendum 1, the Company entered into an existing agreement (dated January 1, 2003) and prior addendums with its upstream parent, TBA, that included SNIC and NSIC. Addendum 1 was approved by the Department on May 25, 2006. Managing general agent services included: soliciting lender services business or collateral protection insurance (CPI), mortgage protection insurance (MPI) and GAP insurance for financial institution borrowers; underwriting and payment of claims.

Addendum 2, with an effective date of September 1, 2007, changed the provision related to payment and remitting of funds to USIC, SNIC and NSIC within 90 days. This addendum was approved by the Texas Department of Insurance on November 16, 2007 but was not submitted to the Department for review and approval and is in violation of 18 Del. C. § 5005(a)(2)d.

It is recommended that USIC submit, via Form D, Agency Agreement Addendum 2 for approval with the Department.

Tax Allocation Agreement

Effective by the approval of the Department on July 19, 2007, the Company entered into an existing agreement (dated March 30, 1999) with its upstream parent, State National Intermediate Holdings, Inc., that included SNIC and NSIC. Per this agreement, the Company files consolidated federal income tax returns under its name for the consolidated group for each taxable year and for any subsequent taxable period for which the group is permitted to file a consolidated return. Each affiliate shall determine its tax liability consistent with the calculation of tax as shown in the affiliate pro-forma tax return, taking into consideration the separate tax attributes of the affiliate. Tax balances are settled as soon as practicable after these amounts have been determined.

Financial Guaranty

Effective April 1, 2007, United Specialty entered into a Financial Guaranty Agreement with SNIC and the Maine Bureau of Insurance. In order to grant surplus lines eligibility to the Company, the Bureau required SNIC to agree to maintain the Company's capital and surplus at a level no less than the regulatory action level for risk based capital or the minimum requirements for capital or surplus in Maine, which are each $500,000.

This agreement was not submitted nor approved by the Department and such non-action by USIC is a violation of 18 Del C § 5005(a)(2)d.

It is recommended that the Company, via Form D, submit this agreement to the Department for approval in accordance with 18 Del C § 5005(a)(2)d.

External Agreements

In addition to the above intercompany agreements, the Company had the following external agreements in effect at December 31, 2010:

Custodial

The Company is party to a custodial agreement with Frost Bank, NA for the purpose of safekeeping invested assets. A review of the agreement showed it did not contain necessary and required safeguards protecting the Company's investments being held by the custodian according to the guidelines of the NAIC Financial Condition Examiners' Handbook ("Handbook").

It is recommended that the Company take steps to update the current Custodial Agreement with Frost Bank to the guidelines required by the "Handbook."

Managing General Agents

The Company utilized program managers by agreement to solicit, underwrite and pay claims for its direct written business which is ceded 90% to 100% to external reinsurers.

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2010, USIC was licensed to transact multiple lines of insurance business only in the state of Delaware. The Company was eligible to write in 46 states and in the District of Columbia on a surplus lines basis.

Plan of Operation

For the year ending 2010, approximately 65.0% or $41,794,167 of the Company's direct written premium was written in 5 states: California (32.5%), Florida (14.5%), Colorado (7.44%), Texas (6.4%) and Arizona (4.0%). Direct premium written in all other states amounted to $22,590,861. The Company was required by the State of California to retain 10% of the business written. The State of California removed the 10% retention requirement in 2011. The Company did not write any business in Delaware. On a surplus lines basis, the Company wrote the following business: general liability, commercial automobile, excess liability, personal liability, professional liability and inland marine. The Company markets its products through program managers and/or managing general agents (MGAs).

Program Manager/MGA Agreements

At year end 2010, the Company had agreements with at least 17 program managers/MGAs that wrote the business, collected premiums and settled claims. The program managers provided settlement statements to the Company and reinsurers per the covenant conditions noted within the contracts. The Company utilizes an external CPA, Sutton Frost Cary, LLP, to perform audits of the program managers/MGAs on a semi-annual basis.

Under 18 Del. C. § 1803(b), it states: "No person, firm, association or corporation shall act in the capacity of an MGA representing an insurer domiciled in this State with respect to risks located outside this State unless such person is licensed as a producer in this State (such license may be a nonresident license) pursuant to this chapter."

At least 10 of the 17 program managers meet the MGA definition and 5% of surplus threshold according to said statute. These program managers performed operational services on behalf of the Company such as underwriting, soliciting of business, collection of premium, settlement and payment of claims. The Company did not provide/obtain licenses or nonresident licenses for those program managers/general agents in compliance with said statute.

Additionally, under 18 Del. C. § 1805(e) and (f), the statutes note specific duties of domiciled insurers in regard to those determined MGA's for which compliance is required under the statute.

It is recommended that the Company take the necessary steps to assure compliance with 18 Del. C. § 1805(e) and (f).

Best's Rating

Based on A.M. Best's current opinion of the consolidated financial condition and operating performance of the property and casualty members of SNC, the Company was assigned a Best's rating of A (Excellent) for the year ended 2010.

GROWTH OF THE COMPANY

The following information was extracted from the Company's filed Annual Statements and covers the five (5) years since the inception of operations that began in 2006 through this examination, December 31, 2010:

Year	Net Written Premiums	Net Admitted Assets	Liabilities	Surplus as Regards Policyholders	Net Income (Loss)
2010	$ 23,052,393	$ 54,108,609	$ 22,773,486	$ 31,335,123	$ 2,359,772
2009	21,538,950	49,235,361	20,470,894	28,764,468	2,814,126
2008	22,033,270	48,241,332	22,062,657	26,178,675	1,811,032
2007	25,808,490	49,497,264	24,868,012	24,629,251	3,111,200
2006	33,963,757	49,153,228	27,480,527	21,672,703	(459,218)

The changes from 2006 to 2010 in the examination period are as follows:

- A 32.13 % decrease in Net Written Premiums
- A 10.08 % increase in Net Admitted Assets
- A 17.13 % decrease in Liabilities
- A 44.58 % increase in Surplus as Regards Policyholders
- A 613.87 % increase in Net Income

The general decreases over the examination period were attributed to the soft market and down turn in the economy relative to direct writings and assumed business via the Company's participation in the "Pooling Agreement" with SNIC and NSIC.

LOSS EXPERIENCE

The reserves for losses and loss adjustment expenses as of December 31, 2010 were $2,530,235. During 2011, favorable development of $653,000 was incurred for loss and loss adjustment expense attributable to insured events of prior years. According to Note 25 of the 2011 Annual Statement, this favorable development was a result of re-estimation of unpaid losses and loss adjustment expenses principally on commercial auto, commercial multi-peril and credit, and the net decrease was the result of ongoing analysis of recent loss development trends. The Company has historically experienced a small amount of favorable loss development relative to surplus.

REINSURANCE

As of December 31, 2010, the Company's reinsurance program consisted primarily of ceded reinsurance. In the ordinary course of business, the Company reinsures certain risks to limit its maximum losses and protect itself from catastrophes. Where applicable, the Company further protects itself by requiring collateral from authorized reinsurers.

The Company is a member of an intercompany reinsurance pooling agreement ("Pooling") with its parent, SNIC and affiliate, NSIC, by Addendum 2, that became effective April 1, 2006. The Company's share of the pool is 25%. Under the Pooling Agreement, SNIC cedes 35% of all remaining policy liabilities, after cession to non-affiliates, to the Company and NSIC after the Company and NSIC retrocede all of its total policy liabilities to SNIC.

The impact of reinsurance on the premiums of the Company and SNIC in 2010 is shown below:

	USIC	SNIC
Direct Written Premiums	$64,385,058	$446,019,864
Assumed (other than inter-company)	0	(400,492)
Gross Written Premiums	$64,385,058	$445,619,372
Ceded:		
Various property and casualty treaties	62,329,979	358,556,818
Quota Share Base	$ 2,055,079	$ 87,062,554
Assumed from (ceded to) pool	20,997,314	5,147,016
Total Pool	$23,052,393	$ 92,209,570
Net after Pooling	$ 23,052,393	$69,157,177*

*Net pooled for SNIC includes NSIC

Ceded Reinsurance

The Company cedes business to SNIC per the Pooling Agreement as discussed above, and to various third party reinsurers. The Company's reinsurance program has historically included fixed and variable quota share treaty reinsurance from third party reinsurers on its program business. The State of California required that the Company retain 10% of business written during the examination period. Facultative reinsurance is also used when necessary to maintain limits within underwriting guidelines. The Company also incorporated per risk excess of loss reinsurance on certain lines of business where applicable.

The Pooling Agreement was amended by Addendum 3 effective January 1, 2012.

FIDELITY BONDS AND OTHER INSURANCE

The Company maintained fidelity bond coverage but did not adequately cover the suggested minimum amount of coverage as recommended by the NAIC "Handbook."

It is recommended that the Company increase its fidelity bond coverage in regard to the suggested minimum amount as recommended by the NAIC Handbook.

The Company has maintained General Liability, Excess Liability, and Workers Compensation and Automobile insurance coverage as a named insured under its parent's policies.

ACCOUNTS AND RECORDS

All accounting, administration and services required by the Company are provided under various agreements with affiliated (primarily) and external service providers.

The accounts and records reviewed during the examination included an evaluation of the Company's operational and organizational controls. Areas evaluated included computer systems; structure and control; accounting systems; Company organizational structures; and account processing structure. During the examination, under a coordinated examination approach, the Texas Department of Insurance expert performed an Exhibit C review of the Company's IT operations.

The independent certified public accounting firm, Ernst and Young, LLP., audited the Company's accounts and records for the last two of the five (5) years under examination and issued an unqualified audit opinion in each year. Audit reports and applicable work papers were made available for the examiners' use.

The accounts and records reviewed also included an assessment of the Company's risk management process in identifying and controlling risks in the key operational areas of the Company. In making the assessment in each key area, processes were reviewed, risks were identified, operational and organizational controls were identified and tested, and the Company's methodology for assessing the effectiveness of the established mitigation factors was evaluated.

All records were maintained at the home office of SNIC with the exception of records related or maintained by the program managers. The Company utilizes the accounting firm, Sutton Frost Cary, LLP to provide audit services for its program managers/MGAs.

STATUTORY DEPOSITS

The Company reported on Schedule E Part 3 Special Deposits, the following statutory deposits as of December 31, 2010:

	Deposits For The Benefit of All Policyholders		All Other Special Deposits	
STATE	Book/Adjusted Carrying Value	Fair Value	Book/Adjusted Carrying Value	Fair Value
Arkansas	$ 107,561	$ 120,725	$ 0	$ 0
Delaware	2,802,540	3,015,858		
Kentucky	750,000	750,000		
Louisiana	100,061	102,938		
Massachusetts	726,958	773,094		
New Mexico	103,851	110,442		
Total Deposits	$ 4,590,971	$ 4,873,057	$ 0	$ 0

The examination verified ownership of security, traced and agreed by par value to the amounts in Exhibit E, as obtained directly from the financial institution and/or state of special deposit.

FINANCIAL STATEMENTS

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2010.

Assets
Liabilities, Surplus and Other Funds
Capital and Surplus Account
Statement of Income
Analysis of Changes in Financial Statement

ASSETS

As of December 31, 2010

	Assets	Non-Admitted Assets	Admitted Assets	Notes
Bonds	$ 41,879,146	$ 0	$ 41,879,146	1
Cash	3,895,964	0	3,895,964	
Subtotals, cash and invested assets	$ 45,775,110	$ 0	$ 45,775,110	
Investment income due and accrued	370,035	0	370,035	
Uncollected premiums, agents' balance in the course of collections	4,320,534	0	4,320,534	
Reinsurance:				
Amounts recoverable from reinsurers	41,010	0	41,010	
Other amounts receivable under reinsurance contracts	479,995	0	479,995	
Current federal income tax recoverables	101,468	0	101,468	
Net deferred tax asset	1,731,021	0	1,731,021	
Aggregate write-ins for other than invested assets	1,291,893	2,457	1,289,436	
Totals	$ 54,111,066	$ 2,457	$ 54,108,609	

LIABILITIES, SURPLUS AND OTHER FUNDS

As of December 31, 2010

			Notes
Losses		$ 2,299,436	2
Reinsurance payable on paid losses and LAE		2,300,242	
Loss adjustment expenses		230,799	2
Commissions payable, contingent commissions		2,468,708	
Other expenses		-	
Taxes, licenses and fees due and accrued		0	
Current federal and foreign income taxes		-	
Unearned premiums		8,738,244	
Ceded reinsurance premiums payable		1,424,664	
Funds held by company under reinsurance treaties		0	
Amounts withheld or retained by company for account of others		0	
Remittances and items not allocated		130,660	
Provision for reinsurance		0	
Payable to parent, subsidiaries and affiliates		1,375,025	
Aggregate write-ins:		3,805,708	
Total Liabilities		$ 22,773,486	
Capital stock		3,500,000	
Gross paid in and contributed surplus	$ 16,500,000		
Unassigned funds (surplus)	11,335,123		
Surplus		27,835,123	
Surplus as regards policyholders		31,335,123	
Total Liabilities, Surplus and Other Funds		$ 54,108,609	

CAPITAL AND SURPLUS

As of December 31, 2010

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2009	$ 28,764,468
Gains and (losses) in surplus	
Net income	2,359,772
Change in net unrealized capital gains or (losses) less capital gains tax of $72,105	138,113
Change in net unrealized foreign exchange capital gain (loss)	0
Change in net deferred income tax	220
Change in non-admitted assets	72,549
Change in provisions for reinsurance	0
Surplus adjustments:	
Paid in	0
Dividends to stockholders	0
Aggregate write-ins for gains and losses in surplus	0
Change in surplus as regards policyholders for the year	$ 2,570,654
Surplus as regards policyholders, December 31, 2010	$ 31,335,122

STATEMENT OF INCOME

FOR THE YEAR END AS OF DECEMBER 31, 2010

Underwriting Income	
Premiums earned	$ 22,976,553
Deductions	
Losses incurred	7,677,186
Loss adjustment expenses incurred	1,569,619
Other underwriting expenses incurred	12,194,217
Total underwriting deductions	$ 21,441,022
Net underwriting gain or (loss)	$ 1,535,531
Investment Income	
Net investment income earned	$ 2,083,768
Net realized capital gains or (losses)	(188,020)
Net investment gain or (loss)	$ 1,895,748
Other Income	
Net gain or (loss) from agents' or premium balances charged off	0
Miscellaneous income	5,591
Total other income (loss)	$ 5,591
Net income before dividends to policyholders and before federal income taxes	$ 3,436,871
Dividends to policyholders	0
Net income after dividends to policyholders and before federal income taxes	$ 3,436,871
Federal income taxes incurred	$ 1,077,099
Net income	$ 2,359,772

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS

DECEMBER 31, 2010

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

NOTES TO FINANCIAL STATEMENTS

Assets

(Note 1) - Bonds: 41,879,146

The Company's bond holdings totaled $41,879,146 million and were approximately 77.40% of total admitted assets and 91.5% of the Company's total invested assets. Security composition for the year ending 2010 was comprised of the following:

U.S. Governments	$ 100,061
U.S. States and Territories and Possessions	2,897,822
U.S. Political Subdivisions of States, Territories and Possessions	1,039,626
U.S. Special Revenue and Special Assessment	19,503,121
Industrial & Miscellaneous	18,338,516
Total	$ 41,879,146

The Company's bond holdings were categorized with respect to NAIC credit quality standards which were all above Class 4 rating with Class 1 having the largest percentage to the total with approximately 88.1%.

Liabilities

(Note 2) - Losses $ 2,299,436
(Note 2) - Loss Adjustment Expenses (LAE) $ 230,799

The Company's aggregate reserve for Losses and LAE were reviewed during the examination and accepted.

As part of the coordinated approach, the Department relied on the actuarial review by the Texas Department as lead in the "Pool" to conduct a review of the Company's reserve methodologies and adequacy. The review was based on information provided by the Company's staff, and the reserve analysis performed by Lewis and Ellis, Inc. The reserve analysis was performed on both a gross and net of reinsurance basis and did not address the collectability of reinsurance recoverables.

SUMMARY OF RECOMMENDATIONS

It is recommended that the Company cancel and execute new stock issuance to be consistent with its Articles as amended and as approved by the Board of Directors.

It is recommended that the Company submit, via Form D, Agreement for Management Services Addendum 5 for approval with the Department in accordance with 18 Del. C. § 5005(a)(2)d.

It is recommended that the Company assure compliance with SSAP 25 and 18 Del. C. § 5005(b) with regard to amounts paid to upstream parents.

It is recommended that the Company submit, via Form D, Agency Agreement Addendum 2 for approval with the Department.

It is recommended that the Company, via Form D, submit the Financial Guaranty Agreement to the Department for approval in accordance with 18 Del C § 5005(a)(2)d.

It is recommended that the Company take steps to update the current Custodial Agreement with Frost Bank to the guidelines required by the "Handbook."

It is recommended that the Company take the necessary steps to assure compliance with 18 Del. C. § 1805(e) and (f) with regard to specific duties of domiciled insurers relative to MGA's for which compliance is required.

It is recommended that the Company increase its fidelity bond coverage in regard to the suggested minimum amount as recommended by the NAIC.

CONCLUSION

As a result of this examination, the financial condition of the United Specialty Insurance Company, as of December 31, 2010, was determined as follows:

Description	12/31/2006 Prior Examination	12/31/2010 Current Examination	Increase (Decrease)
Assets	$ 49,153,228	$ 54,108,609	$ 4,955,381
Liabilities	$ 27,480,527	$ 22,773,486	$ (4,707,041)
Common capital stock	3,500,000	3,500,000	0
Gross paid in and contributed capital	16,500,000	16,500,000	0
Unassigned funds (surplus)	1,672,703	11,335,123	9,662,420
Total surplus as regards policyholders	$ 21,672,703	$ 31,335,123	$ 9,662,420
Totals Liabilities and Surplus	$ 49,153,230	$ 54,108,609	$ 4,955,379

The assistance of Texas' actuary and information systems staff and Company management and staff is acknowledged.

Respectfully submitted,

Darryl Reese, CFE, CIE, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC