STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

REPORT OF LIMITED-SCOPE EXAMINATION

OF

Quality Casualty Insurance Company, Inc.

Alexander City, Alabama

AS OF

DECEMBER 31, 2011

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EXAMINER'S AFFIDAVIT

STATE OF ALABAMA
COUNTY OF MONTGOMERY

Rhonda B. Ball, CFE, being first duly sworn, states as follows:

1. I have the authority to represent the State of Alabama in the examination of Quality Casualty Insurance Company, Inc.

2. The Alabama Department of Insurance is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination workpapers and examination report, and the examination of Quality Casualty Insurance Company, Inc. was performed in a manner consistent with the standards and procedures required by the State of Alabama.

The affiant says nothing further.

Rhonda B Ball
Examiner-in-Charge

Subscribed and sworn before me by Leah M. deButts on this 1st day of June, 2012.

(SEAL)

Leah M deButts
(Signature of Notary Public)

My Commission expires 9/1/2013.

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
EXAMINATION DIVISION
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EDWARD S. PAULK

GENERAL COUNSEL
REYN NORMAN

RECEIVER
DENISE B. AZAR

LICENSING MANAGER
JIMMY W. GUNN

Alexander City, Alabama
June 1, 2012

Honorable Jim Ridling
Commissioner of Insurance
Alabama Department of Insurance
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104

Dear Commissioner Ridling:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a limited-scope examination as of December 31, 2011 has been made of

Quality Casualty Insurance Company, Inc.

located at 1244 Cherokee Road, Alexander City, Alabama 35010. The report of examination is submitted herewith.

Where the description "Company" appears herein, without qualification, it will be understood to indicate *Quality Casualty Insurance Company, Inc.*

SCOPE OF EXAMINATION

The Company was last examined for the five-year period ended December 31, 2008 by examiners representing the Alabama Department of Insurance. The current limited-scope examination is as of December 31, 2011 and was also conducted by examiners representing the State of Alabama. Where deemed appropriate, transactions subsequent to December 31, 2011 were reviewed.

The limited-scope examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the Alabama Insurance Code and the Alabama Insurance Department's regulations and bulletins; in accordance with the applicable guidelines and procedures promulgated by the NAIC; and in accordance with generally accepted examination standards.

The limited-scope examination is not intended to communicate all matters of importance for an understanding of the Company's financial condition. The examination was limited to a review of the Company's outstanding claims and its reported receivables.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2011. A signed letter of representation was also obtained at the conclusion of the examination whereby Company management represented that, through the date of this examination report, complete disclosure was made to the examiners regarding asset and liability valuation, financial position of the Company, and contingent liabilities.

Within this report, commentary has been limited to the review of the Company's outstanding claims and reported receivables and other items as deemed relevant by the examiner.

ORGANIZATION AND HISTORY

COMPANY BACKGROUND

The Company was incorporated on January 30, 2001, under the laws of the State of Alabama. The Articles of Incorporation were filed for record with the Judge of Probate, Michael F. Bolin, in Jefferson County, Alabama.

Article II of the Company's Articles of Incorporation lists the purpose or purposes for which the organization was incorporated. The primary purpose of incorporation was "(a) To engage in the business of selling casualty insurance (b) To engage in the transaction of any or all lawful business for which corporations may be incorporated under the laws of Alabama."

Article III of the Company's Articles of Incorporation authorized 500,000 shares of common stock with a par value of $1 per share, with an aggregate value of $500,000.

The Company issued 500,000 shares of common capital stock to Chappell Insurance Services, Inc. (CIS), fully paid-up, and commenced business with capitalization of $1,250,000. The paid-in capital consisted of 500,000 shares of common capital stock with a par value of $1 per share, for $500,000, and paid-in surplus for $750,000. At December 31, 2011, the Company had $500,000 in Common capital stock, $1,615,218 for Gross paid in and contributed surplus, $-1,537,554 for Unassigned funds, and total Capital and Surplus of $577,664. See the "Notes to Financial Statements" on page 7 for changes to these amounts per the examination.

The Company was issued an Order to Show Cause on April 10, 2009 because of its weak financial strength and because its reinsurer, Lincoln General (assumed 80% of the Company's business), was placed in mandatory run-off by the Pennsylvania Insurance Department. The reinsurance agreement with Lincoln General was replaced during 2009 with Scor Reinsurance Company and NGM Insurance Company. See "Reinsurance Ceded" on page 6 for additional information. On July 1, 2010, the Company entered into voluntary run-off with the last six-month personal auto policy being issued on June 30, 2010.

CORPORATE RECORDS

The Company's Certificate of Incorporation, as filed with the Jefferson County Judge of Probate, and By-laws, as established by the Board of Directors, were not amended during the course of the examination.

Minutes of the meetings of the Board of Directors were reviewed for the period under examination. The minutes appeared to be complete with regard to actions taken on matters before the respective bodies for deliberation and action, except as noted otherwise in this report.

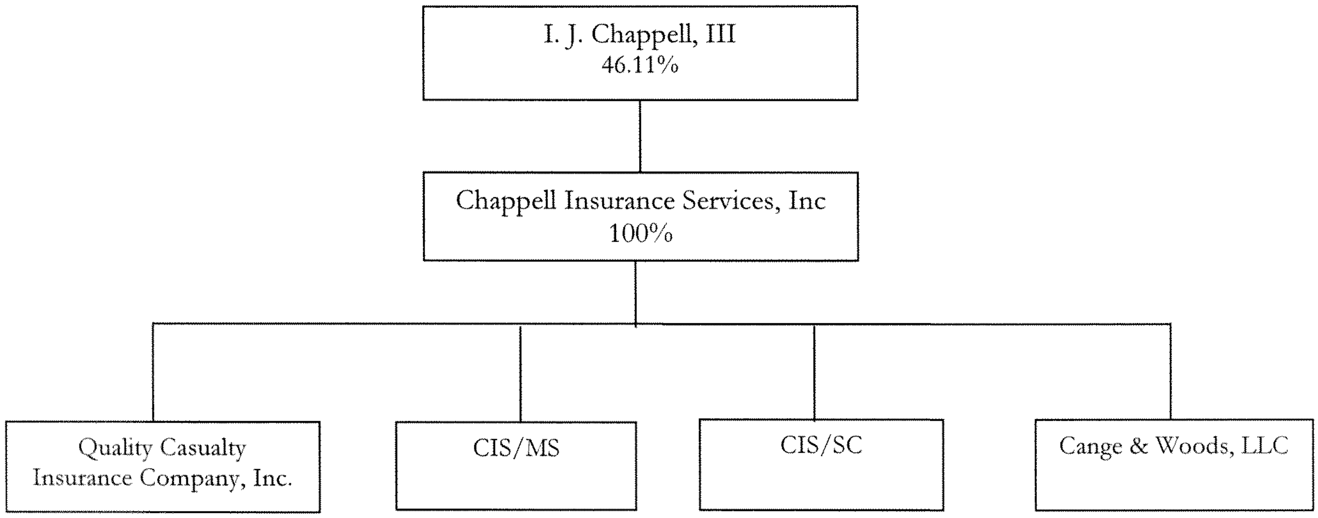
HOLDING COMPANY AND AFFILIATE MATTERS

Management and Service Agreements

The Management and Service Agreements were documented in the prior examination. See the Report of Examination of Quality Casualty Insurance Company, Inc. as of December 31, 2008. Company management represented that there were no other management and service agreements subsequent to the last examination date as of December 31, 2008. According to the Company's 2011 Notes to Financial Statements, there were no management fees or payments disbursed for claims services in 2011 because compensation was based on earned premium and the Company began voluntary run-off on July 1, 2010.

Organizational Chart

The organizational chart on the following page represents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2011:


I. J. Chappell, III
46.11%
Chappell Insurance Services, Inc
100%
Quality Casualty Insurance Company, Inc.
CIS/MS
CIS/SC
Cange & Woods, LLC

REINSURANCE

Reinsurance Ceded

The Company's reinsurance agreement with Lincoln General Insurance Company (LGIC) was terminated effective October 1, 2009. Effective August 6, 2008, the Company and LGIC entered into a trust agreement whereby LGIC established a trust account with the Company named beneficiary in the event of LGIC's insolvency. Claims in run-off continue to be paid under this agreement. See the Company's Report of Examination as of December 31, 2008 for documentation on this reinsurance agreement. Effective October 1, 2009, the Company entered into a quota share reinsurance agreement with Scor Reinsurance Company and NGM Insurance Company that was substantially the same as the LGIC agreement. In this agreement, the Company cedes 80% and retains 20% of the maximum policy limits. The policy limits were as follows:

- Bodily Injury Liability- $100,000 each person/$300,000 each occurrence;
- Property Damage Liability- $100,000 each occurrence;
- Comprehensive/Collision Coverage- Actual Cash Value up to $50,000 per vehicle; and,
- Uninsured Motorists Coverage- $20,000 each person/$40,000 each occurrence/$10,000 Property Damage each occurrence.

The contract contained an insolvency clause, which provided for reinsurance payments to a liquidator, receiver or statutory successor without diminution in the event of the insolvency of the Company.

FINANCIAL STATEMENTS INDEX

Because this was a limited-scope examination, only certain areas of the Company's financial condition were reviewed. Emphasis was on the Company's receivables and the Company's outstanding claims. No opinion is expressed on the Company's overall financial statements. With the exception of the amount reported in the Notes to the Financial Statements in this Report of Examination, the amounts reported on pages 8, 9, and 10 of this report were compiled based solely on the Company's filed 2011, 2010, and 2009 Annual Statements. The statements are presented in the following order:

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

Quality Casualty Insurance Company, Inc.
Statement of Assets, Liabilities, Surplus and Other Funds
For the Year Ended December 31, 2011

ASSETS	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 413,976	$ -	$ 413,976
Cash	-111,056	-	-111,056
Subtotal, cash and invested assets	$ 302,920	$ -	$ 302,920
Investment income due and accrued	205	-	205
Reinsurance:			
Amounts recoverable from reinsurers **(Note 1)**	32,774	-	32,774
Net deferred tax asset	266,297	266,297	-
Electronic data processing equipment and software	605	-	605
Receivable from parent, subsidiaries and affiliates **(Note 2)**	361,674	361,674	-
TOTAL ASSETS	$ 964,474	$ 627,971	$ 336,503

LIABILITIES	
Losses **(Note 3)**	$ 102,033
Loss adjustment expenses	-
Other expenses	1,101
Ceded reinsurance premiums payable	17,378
TOTAL LIABILITIES	$ 120,513
CAPITAL AND SURPLUS	
Common capital stock	$ 500,000
Gross paid and contributed surplus	1,615,218
Unassigned funds (surplus) **(Note 4)**	-1,899,228
Surplus as regards policyholders	$ 215,990
TOTAL LIABILITIES, CAPITAL AND SURPLUS	$ 336,503

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEROF.

Quality Casualty Insurance Company, Inc.
Statement of Income
For the Years Ended December 31, 2011, 2010, and 2009

	2011	2010	2009
UNDERWRITING INCOME			
Premiums earned	$ -133	$ 700,418	$ 967,084
DEDUCTIONS:			
Losses incurred	$-42,090	$ 538,502	$ 688,684
Loss adjustment expenses	35,912	60,789	87,985
Other underwriting expenses incurred	65,996	277,611	360,366
Total underwriting deductions	$ 59,817	876,902	1,137,035
Net underwriting loss	$-59,951	$-176,485	$ -169,951
INVESTMENT INCOME			
Net investment income earned	$ 6,863	$ 9,234	$ 18,715
Net realized capital gains (losses)	1,545	-1,962	-277
Net investment gain (loss)	$ 8,408	$ 7,272	$ 18,487
OTHER INCOME			
Net gain (loss) from agents' or premium balances	$ -706	$ -13,410	$ 9,710
Aggregate write-ins for miscellaneous income	72	6,866	6,695
Total other income	$ -634	$ 6,543	$ 16,405
Net income or (loss) after capital gains tax and before other federal income taxes	$-52,176	$ 175,756	$-135,058
Federal income taxes incurred	$ -	$ -	$ -
Net income (loss)	**$-52,176**	**$ 175,756**	**$-135,058**

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

Quality Casualty Insurance Company
Statement of Income (continued)
For the Years Ended December 31, 2011, 2010, and 2009

Capital and Surplus Account	**2011**	**2010**	**2009**
Capital and surplus prior reporting period	$629,117	$801,175	$932,236
Net income	-52,176	-175,756	-135,058
Change in nonadmitted assets	-360,951	3,699	3,997
Rounding	-	-1	-
Net change in capital and surplus	-413,127	-172,058	-131,061
Capital and surplus end of reporting period	**$215,990**	**$629,117**	**$801,175**

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEROF.

NOTES TO FINANCIAL STATEMENTS

Note 1- Amounts recoverable from reinsurers $32,774

The captioned amount is the same as reported by the Company in its 2011 Annual Statement.

During a review of receipts subsequent to December 31, 2011, the examiner determined that the Company received the captioned amount reported at December 31, 2011.

Note 2- Receivables from parent, subsidiaries and affiliates $0

The captioned amount is $361,674 less than the $361,674 reported by the Company in its 2011 Annual Statement.

According to the Company's 2011 Notes to the Financial Statements- Note 10.D. regarding amounts due from related parties, "Pursuant to the terms of the cost sharing agreement described in paragraph F. below, at December 31, 2011, QCIC was due approximately $318,500 from its parent company, Chappell Insurance Services ("CIS"). CIS may incur future operating costs related to the run-off and may charge QCIC for services provided as an offset to this receivable. The total amount due QCIC by CIS at December 31, 2011 was approximately $362,000. The majority of this balance will not be funded until the voluntary run-off is complete and the remaining balance is netted from the final QCIC surplus amount to be returned to CIS. Note that as of December 31, 2011 QCIC had 17 open claims on minimum limits personal auto policies previously written." According to the Company's Intercompany Analysis, the Receivable from parent of $361,674 was well over 90 days old at December 31, 2011 ($205,505.72 from December 31, 2010 and $156,169 from January 1, 2011 through April 30, 2011). The NAIC *Accounting Practices and Procedures Manual* – SSAP No. 25 paragraph 6 states "… Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted…" The cost sharing agreement with CIS states that the Company is to bill CIS on a quarterly basis. Amounts billed shall be due and payable to the Company within thirty days after the end of each calendar quarter.

During a review of the Company's cash transactions made during 2011 through February 2012, the examiner noted that the Company transferred funds to CIS. According to Company management, these funds were transferred to provide funds needed to cover claims checks issued and presented for payment; however, no supporting documentation was provided for these disbursements, which was not in accordance with ALA. CODE § 27-27-30 (1975). This statute states

> (a) No insurer shall make any disbursement of $25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money. (b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. (c) If the disbursement is in connection with any matter pending before any legislature or public body or before any public official, the voucher or other document shall also correctly describe the nature of the matter and of the insurer's interest therein.

Also, according to ALA. CODE § 27-41-36 (1975),

> (a) After January 1, 1978, an insurer shall not invest in nor lend its funds upon the security of any note or other evidence of indebtedness of any director, officer, or controlling stockholder of the insurer, ...

Note 3- Losses	**$102,033**
Loss adjustment expenses	**$0**

The captioned amounts are the same as reported by the Company in its 2011 Annual Statement.

The examiner reviewed the Actuarial Opinion Summary as of December 31, 2011 prepared by the Company's opining actuary, Peter A. Scourtis, FCAS, MAAA, who is associated with the consulting actuarial firm of Merlinos &Associates, Inc. According to the Actuarial Opinion Summary, the opining actuary's selected gross reserves for loss and loss adjustment expenses were $515,000 and net reserves were $103,000. The Company recorded gross reserves of $510,000 and net reserves of $102,000 in its 2011 Annual Statement.

The opining actuary disclosed in his Statement of Actuarial Opinion as of December 31, 2011 the following:

> Risk of Material Adverse Deviation: I have analyzed the risk of adverse deviation using the materiality standard of $57,766 (10% of surplus) as disclosed in Item 5 of Exhibit B. Due to the nature of the business written by the Company and limited amount of company surplus, I do reasonably believe

that there are significant risks and/or uncertainties to which the Company is exposed that could result in material adverse deviation.

The examiner reviewed the Company's January and February 2012 claims activity and determined the following:

1. There were loss payments totaling $53,500 on three claims reserved for at December 31, 2011. For these claims with loss payments, the Company reserved $32,500. The Company had a reserve deficiency of $22,500 for one of these claims.
2. There were loss payments totaling $22,675 on claims not reserved for at December 31, 2011.
3. There were loss adjustment expense payments totaling $1,241 on seven claims with unpaid loss reserves at December 31, 2011.
4. There were loss adjustment expense payments totaling $6,305 on five claims without unpaid loss reserves at December 31, 2011.
5. Two claims with unpaid loss reserves established of $2,599 at December 31, 2011 were closed in 2012 and one was added during 2012 for $25,000.

All of the amounts listed in one through five above are gross of reinsurance. The Company cedes 80% of these amounts via reinsurance agreements (see "Reinsurance ceded" on page 6). Company management represented that allocated loss adjustment expense reserves were included within the IBNR reserves recorded at December 31, 2011. The Company recorded gross IBNR reserves of $143,000 and net IBNR reserves of $28,000 at December 31, 2011. The Company recorded gross case basis loss reserves of $367,000 and net case basis reserves of $74,000 at December 31, 2011, which represented 18 outstanding claims.

Note 4- Unassigned funds **$-1,899,228**

The captioned amount is $361,674 less than the $-1,537,554 reported by the Company in its 2011 Annual Statement.

The following presents a reconciliation of unassigned funds per the Company's filed 2011 Annual Statement to the unassigned funds per this limited-scope examination.

Unassigned funds per Company		**$-1,537,554**
Examination increase/(decrease) to assets:		
Receivables from parent, subsidiaries and affiliates	$-361,674	
NET CHANGES IN ASSETS		$ -361,674
Examination (increase)/decrease to liabilities:		$ 0
TOTAL UNASSIGNED FUNDS PER LIMITED-SCOPE EXAMINATION		**$-1,899,228**

COMMENTS AND RECOMMENDATIONS

Receivables from parent, subsidiaries and affiliates - Page 11

It is recommended that the Company nonadmit all receivables over 90 days past due from the written agreement due date in accordance with the NAIC *Accounting Practices and Procedures Manual* – SSAP No. 25 paragraph 6, which states "… Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted…"

It is recommended that the Company maintain supporting documentation for all disbursements over $25 in accordance with ALA. CODE § 27-27-30 (1975), which states

> (a) No insurer shall make any disbursement of $25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money. (b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. (c) If the disbursement is in connection with any matter pending before any legislature or public body or before any public official, the voucher or other document shall also correctly describe the nature of the matter and of the insurer's interest therein.

It is recommended that the Company not advance money to its parent in accordance with ALA. CODE § 27-41-36 (1975), which states

(a) After January 1, 1978, an insurer shall not invest in nor lend its funds upon the security of any note or other evidence of indebtedness of any director, officer, or controlling stockholder of the insurer, ...

CONCLUSION

Acknowledgment is hereby made of the courtesy and cooperation extended by Company management in the process of conducting the examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with this limited-scope examination. Since this was a limited-scope examination, most areas of the Company's financial condition were not reviewed. Emphasis was on the Company's receivables and outstanding claims. The Company's surplus as regards policyholders was determined to be $215,990, which was $361,674 less than the $577,664 reported by the Company in its 2011 Annual Statement.

Respectfully submitted,

Rhonda B Ball

Rhonda B. Ball, CFE
Examiner-in-Charge
Alabama Department of Insurance