

STATE OF INDIANA
COUNTY OF MARION

)
)
) SS:
)

BEFORE THE INDIANA
COMMISSIONER OF INSURANCE

IN THE MATTER OF:)
)
Lone Star National Insurance Company)
8888 Keystone Crossing, Suite 250)
Indianapolis, Indiana 46240)

Examination of **Lone Star National Insurance Company**

NOTICE OF ENTRY OF ORDER

Enclosed is the Final Order entered by Stephen W. Robertson, Commissioner of the Indiana Department of Insurance, after fully considering and reviewing the Verified Report of Examination of **Lone Star National Insurance Company**, any relevant examination work papers, and any written submissions or rebuttals. The Verified Report of Examination, as sent to you on December 12, 2012, has been adopted by the Commissioner.

Pursuant to Ind. Code § 27-1-3.1-12(b), within thirty (30) days of receipt of the Final Order, each director of **Lone Star National Insurance Company** shall file an affidavit with the Indiana Department of Insurance stating that he/she has received a copy of the Verified Report of Examination and the Final Order.

The Final Order is a final administrative decision that may be appealed pursuant to Ind. Code § 4-21.5-5.

January 16, 2013
Date

Cynthia D. Donovan
Cynthia D. Donovan
Chief Financial Examiner

CERTIFIED MAIL NUMBER: 9214 8901 0661 5400 0008 8167 15

STATE OF INDIANA)
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COUNTY OF MARION) COMMISSIONER OF INSURANCE

IN THE MATTER OF:)
)
Lone Star National Insurance Company)
8888 Keystone Crossing, Suite 250)
Indianapolis, Indiana 46240)

Examination of **Lone Star National Insurance
Company**

FINDINGS AND FINAL ORDER

The Indiana Department of Insurance conducted an examination into the affairs of the **Lone Star National Insurance Company** (hereinafter "Company") for the time period January 1, 2007 through December 31, 2011.

The Verified Report of Examination was filed with the Commissioner of the Department of Insurance (hereinafter "Commissioner") by the Examiner on October 31, 2012.

A copy of the Verified Report of Examination, along with a Notice of Opportunity to Make Written Submission or Rebuttal, was mailed to the Company via Certified Mail on December 12, 2012 and was received by the Company on December 14, 2012.

The Company did not file any objections.

NOW THEREFORE, based on the Verified Report of Examination, I hereby make the following **FINDINGS**:

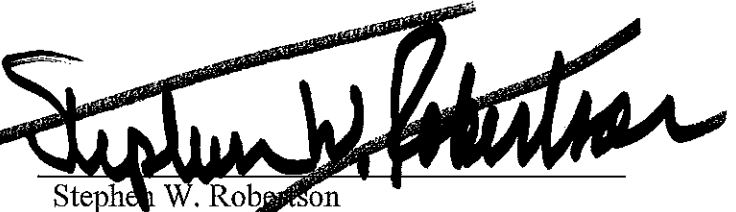
1. That the Verified Report of Examination is a true and accurate report of the financial condition and affairs of the **Lone Star National Insurance Company** as of December 31, 2011.
2. That the Examiner's Recommendations are reasonable and necessary in order for the **Lone Star National Insurance Company** to comply with the laws of the State of Indiana.

Based on the FINDINGS, the Commissioner does hereby ORDER:

1. Pursuant to Ind. Code § 27-1-3.1-11(a)(1), the Verified Report of Examination is adopted and shall be filed. Hereafter the Verified Report of Examination, may constitute prima facie evidence of the facts contained therein in any action or proceeding taken by the Indiana Department of Insurance against the Company, its officers, directors, or agents.
2. The Company shall comply with the Examiner's Recommendations enumerated in summary form and throughout the text of the Verified Report of Examination. A written response to these recommendations should be provided to the Department within 30 days of receipt of this order.
3. Compliance with the Examiner's recommendations shall be completed on or before the filing of the subsequent annual statement. In the event it is not feasible to comply with a recommendation before the filing of the subsequent annual statement, the Company shall submit a written explanation as to why it was not feasible with the filing of the annual statement.

Signed and Sealed this 16th day of

January, 2013.



Stephen W. Robertson
Insurance Commissioner
Indiana Department of Insurance

STATE OF INDIANA
Department of Insurance
REPORT OF EXAMINATION
OF

LONE STAR NATIONAL INSURANCE COMPANY

NAIC Co. CODE 11087
NAIC GROUP CODE 0246

As of

December 31, 2011

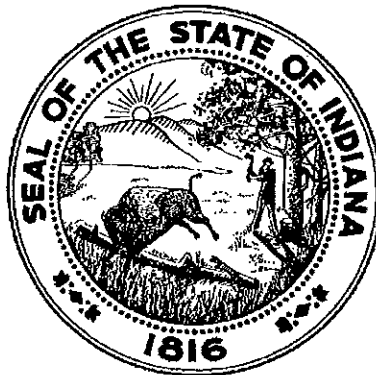


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STATE OF INDIANA

MITCHELL E. DANIELS, JR., Governor

IDOI

INDIANA DEPARTMENT OF INSURANCE

311 W. WASHINGTON STREET, SUITE 300
INDIANAPOLIS, INDIANA 46204-2787
TELEPHONE: (317) 232-2385
FAX: (317) 232-5251

October 31, 2012

Stephen W. Robertson, Commissioner

Honorable Stephen W. Robertson, Commissioner
Indiana Department of Insurance
311 West Washington Street, Suite 300
Indianapolis, Indiana 46204-2787

Dear Commissioner:

Pursuant to the authority vested in Appointment Number 3714, an examination has been made of the affairs and financial condition of:

Lone Star National Insurance Company
8888 Keystone Crossing, Suite 250
Indianapolis, Indiana 46240

hereinafter referred to as the "Company," or "LSN," an Indiana domestic, property and casualty insurance company. The examination was conducted at the offices of Noble Consulting Services, Inc. in Indianapolis, Indiana.

The Report of Examination, reflecting the status of the Company as of December 31, 2011, is hereby respectfully submitted.

ACCREDITED BY THE
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

AGENCY SERVICES
(317) 232-2413

COMPANY COMPLIANCE
(317) 233-0697

CONSUMER SERVICES
(317) 232-2395
In-State 1-800-622-4461

EXAMINATIONS / FINANCIAL SERVICES
(317) 232-2390

MEDICAL MALPRACTICE
(317) 232-2402

SECURITIES / COMPANY RECORDS
(317) 232-1991

SCOPE OF EXAMINATION

The Company was last examined by representatives of the Indiana Department of Insurance (INDOI) as of the period ending December 31, 2006. The present risk-focused examination was conducted by Noble Consulting Services, Inc. (Noble) and covered the period from January 1, 2007, through December 31, 2011.

Noble conducted the risk-focused examination pursuant to and in accordance with the NAIC *Financial Condition Examiners Handbook* (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, and 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.

HISTORY

LSN was incorporated in Illinois in March, 2001. The Company was organized and funded by its parent, Indiana Lumbermens Mutual Insurance Company (ILM), a mutual property and casualty insurance company domiciled in Indiana. On June 9, 2006, LSN transferred its state of domicile from Illinois to Indiana. LSN operates in conjunction with ILM and ILM's other wholly-owned insurer, National Building Material Insurance Company (NBM), to form the Indiana Lumbermens Group (the Group). ILM formed this subsidiary to enable the Group to expand its existing product offerings by allowing multi-tiered rating programs and expanding its geographical territory to transact business.

CAPITAL AND SURPLUS

The Company has 1,000,000 shares authorized, with 130,000 of these shares issued and outstanding. All shares are \$10 par value common shares. ILM contributed \$150,000 in paid-in capital and \$66,949 in paid-in surplus to LSN in 2011 in exchange for 15,000 additional shares of common stock. This contribution was made in accordance with Texas House Bill 1476, which increased the minimum capital and surplus requirements for property and casualty companies conducting business in the state of Texas. These contributions will continue annually for ten (10) years. ILM is the Company's sole shareholder. No dividends were paid to the shareholder during the examination period.

TERRITORY AND PLAN OF OPERATION

Since its inception in 2001, LSN has obtained licenses to conduct business in six (6) different states; Illinois, Kansas, Nebraska, Tennessee, Texas, and Indiana. LSN is primarily involved in the sale of various commercial lines of property and casualty insurance to the forest products and building material industries. It wrote commercial automobile liability in all years under examination. The Company wrote other liability and products liability beginning in 2011. LSN, along with the rest of the Group, stopped writing workers' compensation insurance in 2009. The Company cedes 95% of premium writings to ILM.

GROWTH OF THE COMPANY

The following exhibit summarizes the financial results of the Company during the examination period:

<u>Year</u>	<u>Admitted</u> <u>Assets</u>	<u>Liabilities</u>	<u>Surplus and</u> <u>Other Funds</u>	<u>Premiums</u> <u>Earned</u>	<u>Net</u> <u>Income</u>
2011	\$ 3,845,482	\$ 476,833	\$ 3,368,650	\$ 18,891	\$ 35,776
2010	3,951,788	835,863	3,115,926	27,452	53,974
2009	3,899,600	1,053,788	2,845,812	43,026	33,492
2008	3,952,794	1,142,009	2,810,785	54,576	51,518
2007	4,051,705	1,291,200	2,760,505	81,322	108,191

Surplus and other funds have increased since the Company's inception, primarily from investment income earned. Admitted assets and net income have fluctuated slightly throughout the examination period. Premiums have also decreased steadily throughout the examination period and have been affected by the competitive premium rate environment.

MANAGEMENT AND CONTROL

Directors

The Bylaws provide that the Board of Directors shall be composed of not less than five (5) nor more than nine (9) persons. No person under 25 nor over 72 years of age shall be nominated or elected. At least one (1) of the directors must be a resident of Indiana. The shareholders, at each annual meeting, elect the members of the Board of Directors.

The following is a listing of persons serving as directors at December 31, 2011, and their principal occupations as of that date:

<u>Name and Address</u>	<u>Principal Occupation</u>
John F. Wolf Noblesville, Indiana	President and Chief Executive Officer Indiana Lumbermens Mutual Insurance Company
Don W. Blackwell Fishers, Indiana	Secretary, Treasurer, and Chief Financial Officer Indiana Lumbermens Mutual Insurance Company
Howard L. Shearon Indianapolis, Indiana	Retired Ernst & Young, LLP
Raymond R. Campisi Fishers, Indiana	Vice President of Claims Indiana Lumbermens Mutual Insurance Company
Susan K. Knotts Indianapolis, Indiana	Vice President of Human Resources and Operations Indiana Lumbermens Mutual Insurance Company

Officers

The Bylaws state that the officers of the Company shall consist of a president, a chairman of the board, a chief executive officer, vice president(s), a secretary, a treasurer, and any such additional officers as may be authorized from time to time by the Board of Directors. All officers are appointed by resolution of the Board of Directors, and hold office until termination of employment or removal by resolution of the Board of Directors. Any two (2) or more offices can be held by the same person, except the duties of chief executive officer and secretary, or president and secretary, shall not be performed by the same person. The following is a list of key officers and their respective titles as of December 31, 2011:

<u>Name</u>	<u>Office</u>
Howard L. Shearon	Chairman of the Board
John F. Wolf	President and Chief Executive Officer
Don W. Blackwell	Secretary, Treasurer, and Chief Financial Officer

CONFLICT OF INTEREST

Officers and directors are required to review and sign Conflict of Interest statements annually. It was determined that all officers and directors listed in the management and control section of this Report of Examination have reviewed and signed their statements as of December 31, 2011.

OATH OF OFFICE

Indiana Code (IC) 27-1-7-10(i) stipulates that every director, when elected, shall take and subscribe to an oath stating that he or she will faithfully, honestly, and diligently administer the affairs of the Company and will not knowingly violate any of the laws applicable to such Company. Each director subscribed to an Oath of Office statement in 2011.

CORPORATE RECORDS

Articles of Incorporation

The only amendment to the Articles of Incorporation during the examination reflected a change of address of the Company headquarters in October, 2011. The amendment was appropriately approved by the Board of Directors.

Bylaws

The only amendment to the Bylaws during the examination period reflected a change of address of the Company headquarters in October, 2011. The amendment was properly approved by the Board of Directors.

Minutes

The annual shareholder and quarterly Board of Director meeting minutes were reviewed for the period under examination through the fieldwork date. Significant actions taken during each meeting were noted.

AFFILIATED COMPANIES

Organizational Structure

The following organizational chart shows the affiliated companies of the Group as of December 31, 2011. All subsidiaries are 100% owned by ILM:

	<u>NAIC Co.</u> <u>Code</u>	<u>Domiciliary</u> <u>State</u>
Indiana Lumbers Mutual Insurance Company	14265	IN
Lone Star National Insurance Company	11087	IN
National Building Material Assurance Company	11089	IN
Allied Building Material Agency, Inc		

Affiliated Agreements

The following affiliated agreements and transactions were disclosed as part of the Form B – Holding Company Registration Statement and were filed with the INDOI, as required, in accordance with IC 27-1-23-4.

Administrative Services Agreement

Effective January 1, 2001, LSN pays ILM \$1,311 quarterly, in arrears, to provide administrative services and comprehensive management as required for operation. ILM agrees to provide all personnel, automated systems, and work processes required by the subsidiaries, LSN and NBM. The services to be provided by ILM include marketing, sales, agency administration, underwriting, policy administration, claims adjudication and payment, information technology, investment management, accounting, tax, regulatory reporting and compliance, loss control assessment and executive and strategic management, and other services that may be requested by the subsidiaries. In 2011, LSN paid ILM a total of \$5,244 in exchange for these services.

Reinsurance Treaty Agreement

The reinsurance program is summarized in the Reinsurance section of this report of examination.

Tax Allocation Agreement

Effective January 1, 2001, ILM will pay federal and state income taxes on behalf of LSN and the other subsidiaries. The ILM accounting department will then allocate taxes paid to the appropriate subsidiary and the subsidiary will reimburse ILM for the taxes paid on its behalf.

FIDELITY BOND AND OTHER INSURANCE

The Company protects itself against loss from fraudulent or dishonest acts by its employees through a financial institution bond issued by St. Paul Fire and Marine Insurance Company. The bond has a blanket coverage of \$2,500,000 with a deductible of \$25,000. The fidelity bond is adequate to meet the prescribed minimum coverage specified by the NAIC.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company had no employees during the examination period and subsequently there were no employee pension or insurance plans. All employees necessary to conduct the business operations of the Company are provided by ILM pursuant to the aforementioned Administrative Services Agreement.

STATUTORY DEPOSITS

The Company reported one (1) statutory deposit as of December 31, 2011. This statutory deposit is held by the state of Indiana for the benefit of all policyholders and has a book value of \$1,666,883 and a fair value of \$1,710,002.

REINSURANCE

Reinsurance Assumed

The Company does not maintain an active assumed reinsurance program. At December 31, 2011, the only assumed reinsurance balance was a minor amount of reserves resulting from the Company's participation in the National Workers' Compensation Reinsurance Pool. This balance was under \$10,000 and was regarded as immaterial for examination purposes.

Reinsurance Ceded

Reinsurance contracts do not relieve the Company from its obligations to policyholders and the failure of reinsurers to honor their obligations could result in additional losses to the Company. The Company's reinsurance intermediary, Holborn, monitors the financial position of reinsurers engaged using AM Best and S&P ratings. In general, management works closely with Holborn to negotiate reinsurance arrangements with what they consider to be stable, financially responsible carriers and to negotiate contract terms to protect the Company from excessive risk.

The Company cedes a 95% quota share reinsurance to its parent company, ILM, under the terms of an inter-company reinsurance agreement designed to limit the Company's maximum net risk to no more than \$20,000. During 2011, the Company ceded a total of \$296,000 in premium and \$668,000 in combined reserves to its parent pursuant to the terms of this reinsurance treaty.

ACCOUNTS AND RECORDS

The Company's accounting procedures, practices, account records, and supporting data were reviewed and tested to the extent deemed necessary. The trial balances prepared from the Company's general ledger for the years ending December 31, 2010 and December 31, 2011, were agreed to the respective Annual Statements without exception. The Company's accounting procedures, practices, and account records were deemed satisfactory.

ILM has a permitted practice from the INDOI that exempts LSN from the annual independent audit requirement.

LONE STAR NATIONAL INSURANCE COMPANY

FINANCIAL STATEMENTS

Assets

As of December 31, 2011

	<u>Per Annual Statement</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>	<u>December 31, Prior Year</u>
Assets:				
Bonds	\$ 3,287,985	\$ -	\$ 3,287,985	\$ 3,304,724
Cash, cash equivalents, and short-term investments	294,406	-	294,406	46,758
Subtotals, cash and invested assets	3,582,391	-	3,582,391	3,351,482
Investment income due and accrued	15,837	-	15,837	17,122
Premiums and considerations:				
Deferred premiums, agents' balances and installments booked but deferred and not yet due	118,272	-	118,272	154,252
Reinsurance:				
Amounts recoverable from reinsurers	53,521	-	53,521	330,682
Net deferred tax asset	1,640	-	1,640	1,689
Receivables from parent, subsidiaries and affiliates	72,033	-	72,033	89,899
Aggregate write-ins for other than invested assets	1,789	-	1,789	6,663
Total	\$ 3,845,482	\$ -	\$ 3,845,482	\$ 3,951,788

LONE STAR NATIONAL INSURANCE COMPANY

FINANCIAL STATEMENTS

Liabilities, Surplus and Other Funds

	As of December 31, 2011			
	<u>Per Annual Statement</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>	<u>December 31, Prior Year</u>
Liabilities:				
Losses	\$ 34,371	\$ -	\$ 34,371	\$ 28,324
Loss adjustment expenses	31,190	-	31,190	29,503
Other expenses	57,446	-	57,446	48,940
Current federal and foreign income taxes	43,267	-	43,267	26,003
Unearned premiums	8,267	-	8,267	11,578
Ceded reinsurance premiums payable	237,801	-	237,801	325,548
Amounts withheld or retained by company for accounts of others	220	-	220	294
Payable to parent, subsidiary and affiliates	64,237	-	64,237	365,486
Aggregate write-ins for liabilities	35	-	35	188
Total liabilities	<u>476,833</u>	<u>-</u>	<u>476,833</u>	<u>835,863</u>
Common capital stock	1,300,000	-	1,300,000	1,150,000
Gross paid in and contributed surplus	1,383,945	-	1,383,945	1,316,949
Unassigned funds (surplus)	684,704	-	684,704	648,977
Surplus as regards policyholders	<u>3,368,650</u>	<u>-</u>	<u>3,368,650</u>	<u>3,115,926</u>
Totals	<u>\$ 3,845,482</u>	<u>\$ -</u>	<u>\$ 3,845,482</u>	<u>\$ 3,951,788</u>

LONE STAR NATIONAL INSURANCE COMPANY

FINANCIAL STATEMENTS

Statement of Income

As of December 31, 2011

	<u>Per Annual Statement</u>	<u>Examination Adjustments</u>	<u>Per Examination</u>	<u>December 31, Prior Year</u>
Premiums earned	\$ 18,891	\$ -	\$ 18,891	\$ 27,452
DEDUCTIONS:				
Losses incurred	9,817	-	9,817	12,660
Loss adjustment expenses incurred	8,133	-	8,133	(16,484)
Other Underwriting expenses incurred	16,081	-	16,081	26,930
Aggregate write-ins for underwriting deductions				
Total underwriting deductions	<u>34,031</u>	<u>-</u>	<u>34,031</u>	<u>23,105</u>
Net income of protected cells				
Net underwriting gain (loss)	(15,140)	-	(15,140)	4,347
Net investment income earned	68,004	-	68,004	70,385
Net realized capital gains (losses) less capital gains tax	<u>181</u>	<u>-</u>	<u>181</u>	<u>3,576</u>
Net investment gain (loss)	68,184	-	68,184	73,960
Net gain (loss) from agents' or premium balances charged off	<u>(4)</u>	<u>-</u>	<u>(4)</u>	<u>3,414</u>
Total other income	<u>(4)</u>	<u>-</u>	<u>(4)</u>	<u>3,414</u>
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	<u>53,041</u>	<u>-</u>	<u>53,041</u>	<u>81,721</u>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	53,041	-	53,041	81,721
Federal and foreign income taxes incurred	<u>17,264</u>	<u>-</u>	<u>17,264</u>	<u>27,748</u>
Net income	<u>\$ 35,776</u>	<u>\$ -</u>	<u>\$ 35,776</u>	<u>\$ 53,974</u>

LONE STAR NATIONAL INSURANCE COMPANY

FINANCIAL STATEMENTS

Capital and Surplus Reconciliation

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital and surplus, Dec 31, prior year	\$ 3,115,926	\$ 2,845,812	\$ 2,810,785	\$ 2,760,505	\$ 2,653,671
Net income	35,776	53,974	33,492	51,518	108,191
Change in net deferred income tax	(770)	(37)	1,534	(4,476)	(1,122)
Change in nonadmitted assets	721	(772)	-	3,238	(235)
Capital changes:					
Paid in	150,000	150,000	-	-	-
Surplus adjustments:					
Paid in	66,996	66,949	-	-	-
Change in surplus as regards policyholders for the year	<u>252,724</u>	<u>270,114</u>	<u>35,027</u>	<u>50,280</u>	<u>106,834</u>
Capital and surplus, Dec 31, current year	<u>\$ 3,368,650</u>	<u>\$ 3,115,926</u>	<u>\$ 2,845,812</u>	<u>\$ 2,810,785</u>	<u>\$ 2,760,505</u>

COMMENTS ON THE FINANCIAL STATEMENTS

There were no recommended adjustments to the Financial Statements as of December 31, 2011, based on the results of this examination.

SUBSEQUENT EVENTS

There were no events subsequent to the examination date and prior to the completion of fieldwork that were considered material events requiring disclosure in this Report of Examination.


AFFIDAVIT

This is to certify that the undersigned is a duly qualified Examiner-in-Charge appointed by the Indiana Department of Insurance and that he, in coordination with staff assistance from Noble Consulting Services, Inc., hereinafter collectively referred to as the "Examiners", performed an examination of **Lone Star National Insurance Company**, as of December 31, 2011.

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

This examination was performed in accordance with those procedures required by the NAIC Financial Condition Examiners Handbook and other procedures tailored for this examination. Such procedures performed on this examination do not constitute an audit made in accordance with generally accepted auditing standards and no audit opinion is expressed on the financial statements contained in this report.

The attached report of examination is a true and complete report of condition of **Lone Star National Insurance Company** as of December 31, 2011, as determined by the undersigned.

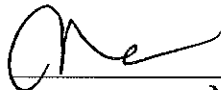


James Kattman, CFE
Noble Consulting Services, Inc.

State of:
County of:

On this 31 day of October, 2012, before me personally appeared, **James Kattman**, to sign this document.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my notarial seal in said County and State, the day and year last above written.

My commission expires: July 4, 2019 

Notary Public

