REPORT ON EXAMINATION

OF THE

DALLAS NATIONAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2011

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, 2011 of the

DALLAS NATIONAL INSURANCE COMPANY

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

Attest By: Brenda Riddle

Date: October 22, 2013

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 22nd day of October, 2013.

Karen Weldin Stewart, CIR-ML
Insurance Commissioner

Karen Weldin Stewart, CIR-ML
Commissioner

Delaware Department of Insurance

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DALLAS NATIONAL INSURANCE COMPANY

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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 22nd day of October, 2013

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SALUTATION

September 30, 2013

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

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 13.033, dated March 25, 2013, an examination has been made of the affairs, financial condition and management of the

DALLAS NATIONAL INSURANCE COMPANY

hereinafter referred to as (Company or DNIC) and incorporated under the laws of the state of Delaware as a private company with its statutory home office located at One Commerce Center, 1201 Orange Street #600, Wilmington, Delaware, 19899. The examination was conducted at the administrative office of the Company located at 5501 LBJ Freeway, Suite 1200, Dallas, Texas 75240.

The report of this examination is submitted herewith.

SCOPE OF EXAMINATION

This is the first Delaware regulatory examination of the Company. This examination will cover the five year (5) period from January 1, 2007 through December 31, 2011. The Company was a Texas domiciled insurer until March 15, 2013, at which time the Company was sold to Lonestar HoldCo, LLC (Lonestar) (DE) and simultaneously re-domesticated to Delaware. Due to the simultaneous re-domestication associated with the filed Form A application, the Texas Department of Insurance (TX DOI) granted and deferred to the Delaware Department of Insurance (DE DOI) permission to conduct the examination this cycle. As such, this mandatory five (5) year examination, as of December 31, 2011, will cover a period when the Company was not a Delaware domestic.

Due to the change in ownership of the Company in 2013 and simultaneous re-domestication to the state of Delaware, emphasis was equally placed on reviewing transactions subsequent to the examination date.

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 the 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 NAIC Model Laws; Statutory Accounting Principles; and Annual Statement Instructions.

All accounts and activities of the Company were considered in accordance with the risk focused examination process. The examination report addresses regulatory issues reviewed during the examination process.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, Ernst & Young, LLC (E&Y). Certain auditor work papers of their 2011 external audit have been incorporated into the work papers of this examination and have been utilized principally in the area of risk mitigation and substantive tests of account balances.

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

Corporate Records
Conflict of Interest
Fidelity Bond and Other Insurance
Pensions, Stock Ownership and Insurance Plans
NAIC Ratios
Legal Actions
Regulatory Agency Correspondence
All other Assets and Liabilities not mentioned

SUMMARY OF SIGNIFICANT FINDINGS

1. Bonds - Refer to Note 1 to Financial Statements
2. Real Estate Held for the Production of Income – Refer to Note 3 to Financial Statements
3. Cash and Short Term Investments - Refer to Note 4 to Financial Statements
4. Receivable from Parent, Subsidiaries and Affiliates – Refer to Note 5 to Financial Statements
5. Workers Compensation Collateral Due from AMS – Refer to Note 6 to Financial Statements
6. Loss and LAE Reserves - Refer to Note 7 to Financial Statements
7. Collateral Deficiency on Large Deductible WC Policies - Refer to Note 7 to Financial Statements
8. Off-book High Deductible Losses Not Reported by Aspen – Refer to Note 7 to Financial Statements
9. Mepco Litigation - Refer to Note 9 to Financial Statements

SUBSEQUENT EVENTS

Due to the acquisition of the Company by Lonestar and the significant organizational changes that were taking place during the examination, along with examination issues identified subsequent to the examination date, significant attention has been given to matters subsequent to the examination date. Due to the volume of information, refer to an expanded discussion of "Subsequent Events" on page 41 of this Report.

COMPANY HISTORY

DNIC represents the combination of Dallas Fire Insurance Company (DFIC) (NAIC Code 18449) and California Indemnity Insurance Company (CIIC) (NAIC Code 32271) (surviving company). DFIC was incorporated in Texas in 1962. DFIC was purchased by Charles David Wood, Jr. (Mr. or Dave Wood) on February 11, 2003. CIIC was incorporated in California in 1987 and began business on April 1, 1988. On August 23, 2005, CIIC was approved for admission in Texas and for the simultaneous re-domestication from California to Texas. On August 24, 2005, Mr. Wood's purchased control of CIIC.

On December 6, 2005, CIIC amended its Articles of Association changing its name from CIIC to DNIC. On January 2, 2006 and effective December 31, 2005, the merger of DFIC into DNIC was approved with DNIC being the surviving entity.

Subsequent to this examination, on March 1, 2012, DNIC Holdings, Inc. (DNIC Holdings) entered into a Transaction Agreement with Lonestar, a subsidiary of Southport Lane, L.P. (Southport), a New York based privately held investment holding company focused on active investments in insurance and reinsurance companies to acquire one hundred percent (100%) of the common stock of DNIC. Effective March 7, 2013, the DE DOI approved DNIC to be re-domesticated to Delaware. Refer to the caption "Subsequent Events" for more discussion on the sale and the re-domestication of the Company subsequent to the examination date.

CAPITALIZATION

Common Capital Stock

The Company has 140,000 authorized and issued shares of common stock, with a par value of $50 per share for a total capital paid in of $7,000,000.

Gross Paid-In and Contributed Surplus

As of December 31, 2011, the Company reported $33,700,547 in gross paid-in and contributed surplus. No changes were made to this amount during the exam period.

Refer to the caption "Subsequent Events" for a discussion on the change in capitalization as a result of the acquisition of the Company by Lonestar in 2013.

Dividends

During the examination period the Company paid $2 million in dividends in 2007 and $4.5 million in 2008.

CORPORATE RECORDS

The recorded minutes of the Stockholders and Board of Directors were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events; including authorization of investments as required by 18 Del. C. § 1304 "Authorization; record of investments."

MANAGEMENT AND CONTROL

Article III, Section 2 of the Company's amended bylaws, states: "The Board shall consist of seven (7) or more directors. The directors shall be elected at the annual meeting of stockholders and each director shall be elected to serve until his successor shall be elected and shall qualify. Directors need not be residents of Texas or stockholders."

At December 31, 2011, the members of the board of directors together with their principal business affiliations were as follows:

Directors

Directors Name	Principal Business Affiliation
Charles David Wood, Jr.	Chairman and Shareholder Dallas National Holdings, Inc.
Christopher Allan Nehls	President and Chief Executive Officer Dallas National Insurance Company
Marta Prado-Butterworth	Chief Operating Officer Citadel Med LLC
Karen Ann Meredith	Principal Meredith and Associates, Inc.
Elizabeth Anthony Patterson	Principal Betty Patterson Consulting, LLC
James Michael Pickens	Principal, Attorney at Law Mike Pickens Law Firm
William E. Reid	Principal, Attorney at Law Reid and Dennis PC
Robert Henry Thompson	Commissioner Oklahoma State Banking Department
Laura Jean Wehrle	Insurance Consultant

Officers

Article V, Section 1 and 3 of the Company's bylaws state that the officers of the corporation shall be chosen by the board of directors and shall be a president, one or more vice-presidents, a secretary and a treasurer. The board of directors may also choose assistant secretaries and assistant treasurers. One person may hold two or more offices, except that the offices of president and secretary shall not be held by the same person.

Article V, Section 3 states "The board of directors may from time to time elect such other officers and appoint such committees, employees, or other agents as the business of the Corporation may require, including one or more assistant secretaries, and one or more assistant treasurers. Each shall hold office for such period, have such authority, and perform such duties as are provided in the bylaws, or as the board of directors may from time to time determine.

At December 31, 2011, the Company's principal officers and their respective titles were as follows:

Officer	Title
Christopher Allan Nehls	President and Chief Executive Officer
Eric William Vogelsberg	Vice-President, Chief Financial Officer, Secretary and Treasurer
Harriet Penan Berenstein	Vice President and Controller
Robert E. McGowan	Chief Operating Officer
Randy Achten	Compliance Officer
Larry Klaplan	General Counsel

Inspection of Company files indicated that ethics statement/conflict of interest affidavits were distributed, completed and returned by all employees at a manager level or above for the examination period. It was noted that written correspondence was not submitted to the Texas or Delaware Department of Insurance in regards to the changes in officers and directors during the period under examination.

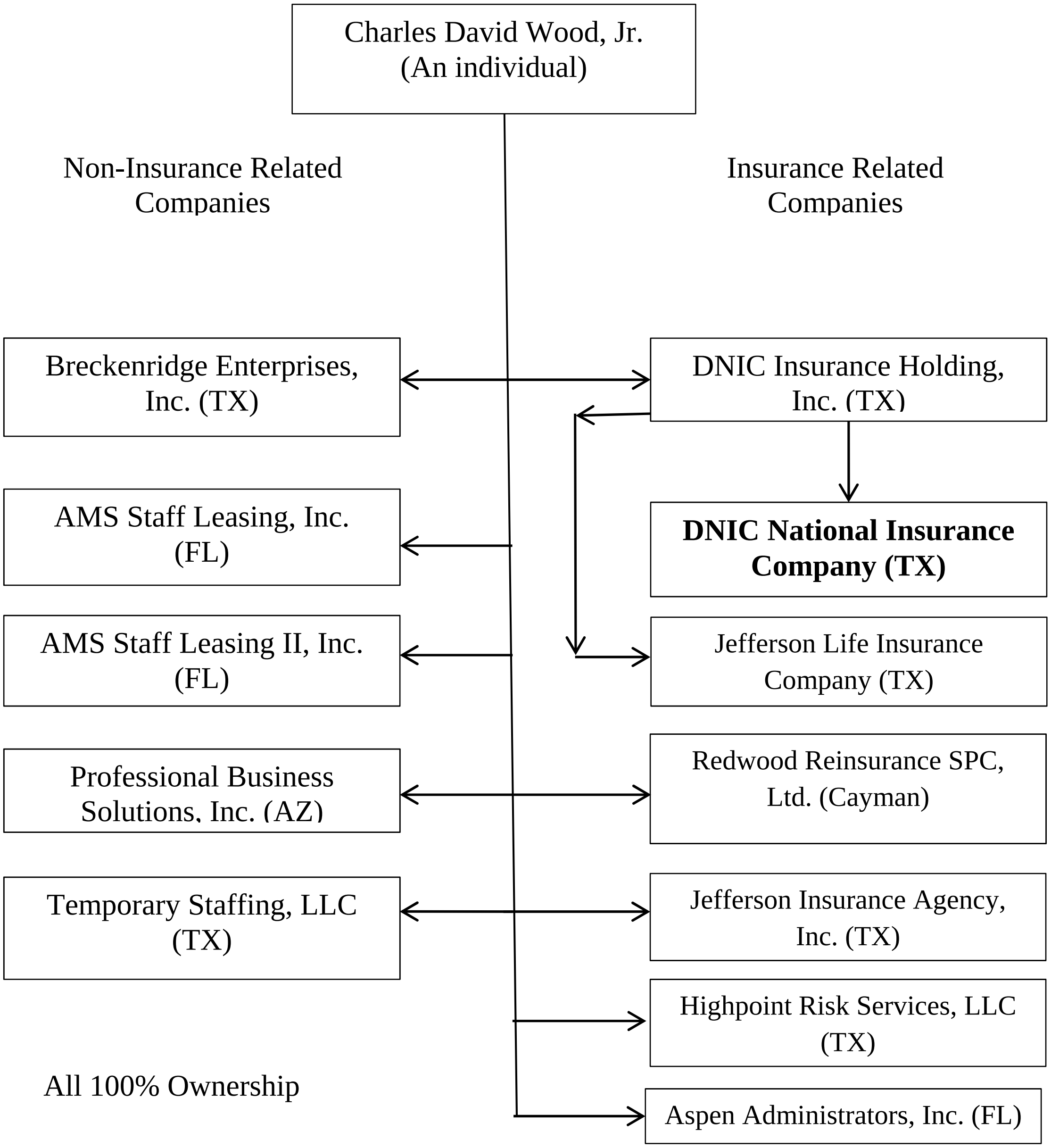
It is recommended that the Company properly notify the DE DOI of any changes in officers and directors.

Subsequent to the examination date, all officers and directors resigned their respective positions as a direct result of the acquisition of the Company by Lonestar. Refer to "Subsequent Events" for further discussion.

Insurance Holding Company System

The Company is one hundred percent (100%) owned by DNIC which is one hundred percent (100%) owned by Mr. Wood. Therefore, the ultimate controlling person of DNIC was Mr. Wood, through his direct ownership of DNIC Holdings. Mr. Wood owned directly and indirectly other insurance companies and non-insurance companies.

The following is an organizational chart that reflects the identities and interrelationships between the Company and certain affiliates as of December 31, 2011.



Based on a review of the Insurance Company Annual Registration Statement filings (Forms B and C) made by the Company for all years under examination, no concerns were noted.

Affiliated Agreements

As of December 31, 2011, the Company had three (3) affiliated agreements in place that it was operating under and are summarized as follows:

Staff Leasing Agreement

The Company entered into a management and service agreement with AMS Staff Leasing, NA., Ltd. (AMS) on January 1, 2006. Under the terms of the agreement, AMS provided personnel, premises, and computer equipment necessary for the operations of the Company. The Company shared its office facilities with AMS, and the shared costs and expenses were allocated to the Company and its affiliates based on time and usage studies. Under the terms of the agreement, DNIC agrees to pay AMS in accordance with payroll plus $12.47 per $100. Payment is due no later than the date payroll checks are issued.

The Company's allocated share of operating expenses was $5,963,092 for the year ended December 31, 2011. The agreement contains all statutory requirements and clauses as they pertain to the domiciliary state.

During the review of the AMS agreement, it was noted that it contained no effective date and not all required signatures of the identified parties. The Company has been operating under the agreement since 2002.

It is recommended that the Company prepare all agreements with an effective date and all signatures be provided with the agreement.

General Agency Agreement

Effective January 1, 2011, the Company entered into a General Agency Agreement with its affiliate; Highpoint Risk Services, LLC (Highpoint) to solicit business as general agent for workers compensation, general liability, and occupational accident, collect premium, and to provide premium reconciliations for the business that is produced. The term of the agreement is for three years with renewals pending regulatory approval.

Under the terms of the agreement, DNIC shall pay Highpoint in accordance with the stated commission schedule. All payments are made on a monthly basis not later than 30 days after the end of the account month in which the statement was prepared. For the period ending 2011, $11,781,818 was paid to Highpoint under the terms of the agreement.

During the review of the Agency Agreement, it was noted that it contained no effective date and required signatures of identified parties to the agreement.

It is recommended that the Company prepare all agreements with an effective date and all signatures be provided with the agreement.

Third Party Claims Administration Agreement

The Company has operated under a claims administrative services agreement with Aspen Administrators, Inc. (Aspen), an affiliate since 2008. In accordance with the terms of the agreement, Aspen is to provide all administrative services in regards to the claims of workers compensation and general liability lines of insurance. According to the agreement, DNIC shall pay Aspen at a rate of five percent (5%) of the gross earned premium of the policies serviced. For the year ended 2011, Aspen was paid $3,380,645 under the terms of the agreement.

It was noted that the agreement did not contain an effective date. Based on a review of payments remitted under the agreement, it was determined that the agreement has been in effect since 2008.

It is recommended that the Company prepare all agreements with an effective date and all signatures be provided with the agreement.

As a result of the acquisition by Lonestar, the above agreements have been subsequently terminated. Refer to “Subsequent Events” for additional discussion.

TERRITORY AND PLAN OF OPERATION

The Company was admitted in Delaware on August 1, 2000 to write casualty business including: workers’ compensation and employers’ liability. As of December 31, 2011, DNIC was licensed in forty-two (42) states/territories including D.C. During the examination period, the Company utilized Companion Property and Casualty Insurance Company (Companion) (SC) through a reinsurance agreement to front its business in Florida (not currently licensed) and California (DNIC has a license in California but is currently prohibited from writing directly in that state). Companion is a non-affiliated property and casualty writer organized in the state of South Carolina and owned by Blue Cross Blue Shield of South Carolina.

The Company primarily wrote workers’ compensation and employers’ liability lines of business. The distribution for workers compensation is through Highpoint, its affiliated agency who provides marketing, sales support and established relationships directly with independent brokers (roughly 200 independent broker relationships as of 2011). In 2011, 3.31% of the $70,721,885 direct workers compensation premiums or $2.3 million was written on the shareholder’s owned staffing and PEO companies. The remaining $68.4 million of workers compensation business was written to non-affiliated companies through Highpoint. Total commission and fees paid to Highpoint as of the examination date amounted to $11,781,818. See “Affiliated Agreements” for a related discussion.

During the examination period, Highpoint produced two large deductible workers’ compensation master policies to affiliated companies: AMS Staff Leasing II, Inc. (AMS II) and

AMS. To comply with various insurance statutes, including its state of domicile, Texas (at the time), the Company attaches an appropriate endorsement for the collection of collateral from policyholders associated with large deductible policies. It was determined that the Company had not attached this endorsement on the two master policies issued to AMS since 2010 and subsequent thereto and therefore not in compliance with applicable state statutes. It was also disclosed that collateral in the amount of $50,681,774 as of the examination date had not been remitted to the Company by AMS or its ultimate parent, Mr. Wood. The collateral deficiency has continued subsequent to the examination date despite efforts to collect by current parent, Southport Lane, LLC. See Note 7 to Financial Statements and "Subsequent Events" for additional discussion.

It is recommended that the Company ensure that all large deductible workers' compensation policies contain endorsements for the collection of collateral in order to comply with applicable state statutes.

The current distribution of Dallas National is comprised of a mix of over 450 independent agency and broker relationships throughout sixteen (16) states. More specifically, the number of agencies and brokers numbered 404 as of 2013. One hundred percent (100%) of direct premiums for general liability coverage were written to non-affiliated companies through these independent agencies and brokers.

Occupational Accident (OA) is distributed through a non-affiliate Managing General Agent (MGA), Highpoint Risk Underwriters via twenty six (26) marketing groups.

As of the examination date, the Company utilized the following MGAs and Third Party Administrators (TPA's):

Third Party Administrators

- Aspen Administrators, Inc. (Affiliate): Claims Services – WC and OA
- The Littleton Group, Claims Services (GL)
- Cottingham and Butler Claims Services, Inc. (WC)
- Crawford and Company; Claim Services (WC)

Aspen was the only material and significant TPA. See “Affiliated Agreements” for additional discussion.

Managing General Agents

- High Point Underwriters, LLC
- NGM Insurance Company
- Dovetail Insurance Company and Dovetail Managing Agency

None of the above MGAs were considered significant and material.

Refer to “Subsequent Events” on page 40 of this Report for discussion on the termination of the Aspen and Highpoint affiliated agreements.

GROWTH OF THE COMPANY

The following information was obtained from the Company’s filed Annual Statements and covers the past five years through December 31, 2011, and does not include examination adjustments detailed in this Report and discussed in Notes to Financial Statements:

Year	Net Admitted Assets	Capital and Surplus	Gross Written Premiums	Net Income (Loss)
2007	$256,655,078	$87,966,798	$108,510,859	$23,154,691
2008	258,282,160	84,545,500	84,105,093	7,506,061
2009	289,412,689	88,518,316	72,358,674	(823,580)
2010	323,507,466	87,888,209	132,078,757	2,811,894
2011	326,685,392	64,197,327	117,506,471	($20,728,220)

For the period covered by this examination, the Company was domiciled in the state of Texas and doing business under the name of Dallas National Insurance Company, prior to its acquisition by Lonestar in 2013.

In 2008, net income decreased $15.6 million compared to the prior year due to a decrease in earned premiums, an increase in losses and loss adjustment expenses, and lower investment income.

In 2009, net income decreased approximately $8.3 million over the prior year resulting in a net loss of $823,580 due to a continued decrease in earned premiums, an increase in losses, and establishing a premium deficiency reserve of $5.5 million related to the Company's auto warranty program that has since been cancelled.

In 2010, the Company had a large increase in premium volume and funds held, resulting in an increase in its reported assets. The increase in premiums was due to the increased writing of workers compensation business. Reported net income of $2.8 million was mostly offset by a change in non-admitted assets and change in the provision for reinsurance, resulting in a net decrease of $630,107 in surplus for 2010.

During 2011, the Company reported a loss before income taxes of $24.0 million. The material loss was primarily due to adverse development of $16.7 million and higher loss ratios for the current year in the workers compensation business and higher underwriting expenses. Also, earned premiums decreased by $20.1 million compared to 2010 and the Company also recognized a premium deficiency reserve of $4.2 million relating to a general liability block of business on auto warranties that the Company has cancelled. See Note 7 to Financial Statements for additional discussion.

LOSS EXPERIENCE

The reserves for losses and loss adjustment expenses as of December 31, 2011 were $145,977,905 and $49,784,997 respectively. Phase 5 detailed procedures were performed for key activity, Actuarial, and the conclusions of these detailed procedures are made a part of this examination. The findings of that review are discussed in Note 7 to Financial Statements.

REINSURANCE

Assumed

Assumed Business (all from Non Affiliates)

Lines of Business	2007	2008	2009	2010	2011
Homeowners multiple peril	$ -	$ -	$ -	$ -	$ 6,907,406
Group accident & health	1,225,053	3,752,952	2,263,482	2,480,743	10,418,247
Workers' compensation	19,783,071	11,698,559	7,734,026	35,575,351	(1,317,369)
Other liability-occurrence	6,811,872	12,250,374	9,219,459	11,321,986	13,411,504
Total Assumed	$ 27,819,996	$ 27,701,885	$ 19,216,967	$ 49,378,080	$ 29,419,788

The Company and other affiliates (AMS, Breckenridge Enterprises, Inc., AMS II, Personnel Advantage East, Inc., and Equity Group Leasing I, Inc.) entered into a Coverage Agreement effective December 1, 2005 with Companion to write workers' compensation and general liability in states in which the Company was not licensed; primarily Florida and California. Workers' compensation and general liability business written by Companion was for policies issued to AMS, a professional employer organization whose clients primarily consist of construction contractors other than general contractors.

The Coverage Agreement also included a Third Party Agreement with Aspen to provide policy and claims services for Companion as required in the Coverage Agreement.

A Guaranty Indemnity Agreement was also a part of the above Coverage Agreement that provided for Mr. Wood as the Guarantor to unconditionally guarantee Companion the full and prompt performance and pay, when due, of all obligations of each obligor under the subject agreement. As part of this Guaranty Agreement and in accordance with a Pledge Agreement, Mr. Wood granted a first priority lien and security interest in the equity interest for five companies owned by himself, (1) AMS Staff Leasing Inc., (2) AMS Staff Leasing II, Inc., (3) AMS Staff Leasing NA, (4) Personnel Advantage East, Inc., and (5) Equity Group Leasing I, Inc.

Quota Share Reinsurance Agreement

Effective December 1, 2005, the Company and Companion entered in to a one hundred percent (100%) quota share reinsurance agreement that requires the Company to indemnify Companion in respect to losses occurring under all workers compensation and employer's liability policies classified by the Company as “Temporary Staffing Accounts”, polices written on behalf of AMS primarily in Florida, a state in which the Company was not licensed.

Excess of Loss Reinsurance Agreement

Effective October 1, 2010, the Company and Companion entered into an excess of loss reinsurance ageement that provides for the Company to be liable for the amount of ultimate net loss in excess of $1,500,000 any one occurrence, but the limit of liability of the Company would not exceed $18,500,000 with respect to any one occurrence, subject to a limit of $5 million Maximum Any One Life.

The Company’s maximum policy limit for employer’s liability will be $1,000,000 any one loss occurrence.

Both of the above assuming agreements were related to the Coverage Agreement with Companion discussed above.

Homeowners Quota Share Reinsurance Contract

Effective January 1, 2011, the Company and NGM Insurance Company (FL) (NGM) entered into a one hundred percent (100%) quota share reinsurance contract for the Company to assume policies in force as of the effective date. In 2011, the Company assumed $6.9 million under this agreement.

This agreement was not renewed and a settlement was entered into to resolve and terminate this contract effective October 3, 2012.

Ceded

As illustrated in the below chart, ceding reinsurance is not a significant activity for the Company. Most of the ceding agreements are XOL agreements for workers' compensation and general liability business. The primary agreements in effect as of the examination date are summarized below.

Ceded Business (all to Non Affiliates)

Lines of Business	2007	2008	2009	2010	2011
Fire	$ 414,514	$ 104,407	$ (443)		$ 112,500
Farm owners multiple peril	12,031	(66)			
Homeowners multiple peril	2,486,934		85,234	(1,448)	
Group accident & health	3,684,517	19,357			
Workers' compensation	1,257,000	1,968,091	651,172	1,119,100	2,578,524
Other liability - occurrence	5,895,793	3,231,110	2,400,224	1,626,212	1,427,816
Total Assumed	$ 13,750,789	$ 5,322,899	$ 3,136,187	$ 2,743,864	$ 4,118,840
Gross Premiums	$ 108,510,859	$ 84,105,093	$ 72,358,674	$ 132,078,757	$ 117,506,471
% Ceded to Gross Premiums	12.7%	6.3%	4.3%	2.1%	3.5%

Per Occurrence Excess of Loss Reinsurance Contract

Effective October 1, 2011, the Company entered into a per occurrence workers' compensation excess of loss reinsurance agreement with nine (9) subscribing reinsurers.

In accordance with the agreement, the subscribing reinsurers are liable for the amount of ultimate net loss in excess of the Company's retention of $5 million each loss occurrence, subject to a limit of liability to the reinsurer of one hundred percent (100%) of $5 million each loss occurrence.

The reinsurer's liability in respect of all losses occurring during the term of this agreement shall not exceed one hundred percent (100%) of $10 million. As respects the statutory portion of any workers' compensation policy, the reinsurer's liability shall not exceed $10 million as respects any one employee.

Catastrophe Excess of Loss Reinsurance Contract

Effective October 1, 2011, the Company entered into a workers' compensation catastrophe excess of loss reinsurance contract with seven (7) subscribing reinsurers.

In accordance with the agreement the reinsurers are liable for the amount of Ultimate Net Loss in excess of the Company's retention of $10 million each loss occurrence, subject to a limit of liability to the reinsurer of one hundred percent (100%) of $20 million each loss occurrence.

The reinsurer's liability in respect of all losses occurring during the term of this agreement shall not exceed one hundred percent (100%) of $40 million. As respects the statutory portion of any workers' compensation policy, the reinsurer's liability shall not exceed $10 million as respects any one employee.

Umbrella / Excess Liability Quota Share Reinsurance Contract

Effective October 1, 2011, the Company entered into an umbrella/excess liability ninety percent (90%) quota share reinsurance contract with four (4) subscribing reinsurers that assumed ninety percent (90%) of the excess liability subject to a limit of liability of $2 million.

First Clash Excess of Loss Reinsurance Contract

Effective July 1, 2011, the Company and Companion entered into a first clash excess of loss reinsurance contract with five (5) subscribing reinsurers that assumed excess liability of the Company under its policies in force at the effective time classified by the Company as casualty business, including but not limited to general liability business.

Casualty Excess of Loss Reinsurance Contract

Effective July 1, 2011, the Company and Companion entered into a casualty excess of loss reinsurance contract with four (4) subscribing reinsurers that assumed one hundred percent (100%) of the ultimate net loss in excess of the Company's retention, being $500,000 any one loss occurrence, subject to a limit of liability to the reinsurers of $500,000 any one loss occurrence.

ACCOUNTS AND RECORDS

Accounting System and Information

The Company uses a mixture of customized vendor purchased and internally developed software applications running on a client/server platform. The Company's core business functions, policy administration and claims processing, utilized various applications. Some of the applications included: DNIC-GL, Policy Master, WQC, DalGen, Aspen and Helm. The

Company uses internally developed software to process its reinsurance transactions. The Company currently uses iWorks by Sungard for investment transaction processing and records management as well as for financial reporting purposes.

In 2011, the investment management advisory services were provided by Sage Advisory Services who utilized Eagle TM software to furnish investment reports to Dallas National Insurance Company.

The Company hosts its systems in an onsite datacenter. The main computer hardware are Dell Servers and Storage with Windows Server 2003, 2008 R2 (and 2012) operating systems.

The Company uses customized software of Axapta by Microsoft for its general ledger system to process its cash, GAAP and statutory accounting transactions, which runs on a client/server platform.

The Axapta system is the Company's check writing system that provides a centralized environment to produce checks, create general ledger accounting, process vendor payments, accounts payable, and reconcile checks. Invoices are authorized by designated approvers and processed through Axapta. Claim disbursements are processed in the Aspen and DNIC-GL systems.

Additionally, the Company uses third party administrators for administration of certain products including policy administration, bill review and payment of claims.

Independent Accountants

The Company’s financial statements are audited each year by the firm of Ernst & Young, LLC, of Dallas, Texas. For all years under review, E&Y issued an unqualified opinion. The examiners reviewed the E&Y’s 2011 work papers, and incorporated their work and findings as deemed applicable to the current examination.

Actuarial Opinion

In 2011, the Company's loss reserves and actuarial items were reviewed by Wayne E. Blackburn, FCAS, MAAA of Milliman, Inc. who issued a statement of actuarial opinion based on the financial information presented by the Company and provided an opinion that the reserves and related actuarial values carried on the balance sheet were fairly stated and met the requirements of the insurance laws of the state of Texas.

Subsequent to December 31, 2011, a change was made by new management in its appointed actuary. The Company's loss reserves and related actuarial items are now currently being reviewed by Pat Whatley, FCAS, MAAA of Bickerstaff Whatley Ryan & Burkhalter.

STATUTORY DEPOSITS

The Company's state statutory deposits are comprised of U.S. Treasury Notes and other bonds. The schedule on the following page reflects statutory deposits that were on file with the respective states as of December 31, 2011:

	Deposits For The Benefit of All Policyholders		All Other Special Deposits	
State	Book/Adjusted Carrying Value	Fair Value	Book/Adjusted Carrying Value	Fair Value
Arizona*	$ -	$ -	$ 816,399	$ 817,317
California			1,497,399	1,534,111
Delaware*			100,297	100,297
Georgia			75,025	75,025
Idaho			300,986	302,448
Idiana			30,083	30,083
Kentucky			234,330	234,330
Louisiana			20,000	20,000
Maryland			100,329	100,816
Massachusetts			155,509	156,265
Montana			25,067	25,104
Nevada			311,088	313,317
New Mexico			105,302	105,882
North Carolina*			205,889	205,889
Oklahoma			321,008	321,008
Oregon			576,112	576,810
Texas	3,351,723	3,386,934		
Virginia			250,970	261,543
Total Deposits	$ 3,351,723	$ 3,386,934	$ 5,125,792	$ 5,180,245

All statutory deposits were directly confirmed with the individual states and traced back to Schedule D of the 2011 Annual Statement with the following exceptions noted.

During the review of the Oregon Special Deposit, it was noted that the Company omitted a deposit for Oregon in the amount of $300,239. This amount has been added to the schedule above.

In addition to the errors found with the Oregon special deposit, the Company also misstated the reported value of three additional deposits on Schedule E, Part 3. The Arizona, North Carolina, and Delaware deposits were overstated in the amount of $25,000 on Schedule E, Part 3.

Based on the above exceptions, the following recommendation has been made:

It is recommended that the Company properly reflect all special deposits on its Annual Statement in accordance with the Annual Statement instructions.

Subsequent to the examination date and a direct result of the Company's re-domestication to Delaware, the Company increased its special deposits with the state of Delaware. Refer to "Subsequent Events" on page 40 for further discussion.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2011, as determined by this examination, along with supporting exhibits as detailed below:

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Capital and Surplus Account
Reconciliation of Capital and Surplus
Schedule of Examination Adjustments

The narratives on the individual accounts, with the exception of invested assets and reserve related balances, are presented on the "exception basis" in the Notes to the Financial Statements section of this Report.

Analysis of Assets
As of December 31, 2011

	Assets	Nonadmitted Assets	Net Admitted Assets	Notes
Bonds	$ 170,321,107	$ -	$ 170,321,107	1
Common stocks	15,037,023		15,037,023	2
Real estate:				
Properties held for the production of income	355,428	355,428	0	3
Cash and short-term investments	72,570,063	25,000	72,545,063	4
Receivable for securities	1,868,967		1,868,967	
Aggregate write-ins for invested assets	1,603,952		1,603,952	
Investment income due and accrued	1,471,020		1,471,020	
Uncollected premiums and agents' balances in course of collection	27,496,574	5,449,341	22,047,233	
Amounts recoverable from reinsurers	623,290		623,290	
Funds held by or deposited with reinsured companies	26,773,465		26,773,465	
Other amounts receivable under reinsurance contracts and interest thereon	37,800	37,800	-	
Current federal and foreign income tax recoverable	3,659,865		3,659,865	
Net deferred tax asset	2,765,430		2,765,430	
Guaranty funds receivable or on deposit	89,598		89,598	
Receivables from parent, subsidiaries & affiliates	5,287,593	500,464	4,787,129	5
Aggregate write-ins:				
Workers comp collateral due from affiliate	52,636,321	52,636,321	-	6
Bills Receivable taken for premiums	2,097,948	44,474	2,053,474	
Prepaid reinsurance premiums	35,066		35,066	
Texas windstorm assesment	122,820		122,820	
Rounding	(2)		(2)	
Total Assets	$ 384,853,328	$ 59,048,828	$ 325,804,500	

Statement of Liabilities, Surplus and Other Funds
As of December 31, 2011

		Note
Losses	$ 212,827,520	7
Reinsurance Payable on paid losses and loss adjustment expenses		
Loss adjustment expenses	49,784,997	7
Commissions payable, contingent commissions and other similar charges		
Other expenses	717,594	
Taxes, licenses and fees	880,323	
Unearned premiums	14,818,890	
Ceded reinsurance premiums payable	43,173	
Amounts withheld or retained for the account of others	35,316,137	
Remittances and items not allocated	(28,355)	
Provision for reinsurance	914,200	
Payable for securities	2,813,078	
Aggregate write-ins for liabilities:		
Deferred interest on tax credits - Accent Capital	67,114	
Payable to Companion Property and Casualty	1,275,630	
Premium deficiency reserve - Tier 1	0	8
Mepco litigation reserve	5,400,000	9
Payable to National Grange Mutual	4,150,018	
Other liabilities	1,530,362	
Total Liabilities	$ 330,510,681	
Common capital stock	$ 7,000,000	
Gross paid in and contributed surplus	33,700,547	
Unassigned funds (surplus)	(45,406,728)	
Surplus as regards policyholders	$ (4,706,181)	
Total Liabilities, Capital and Surplus	$ 325,804,500	

Statement of Income
As of December 31, 2011

UNDERWRITING INCOME		
Premiums earned	$	112,545,982
DEDUCTIONS		
Losses incurred	$	65,637,763
Loss adjustment expenses incurred		31,737,586
Other underwriting expenses incurred		41,353,612
Premium deficiency reserve - Tier One		4,227,000
Total underwriting deductions	$	142,955,961
Net underwriting gain or (loss)	$	(30,409,979)
INVESTMENT INCOME		
Net investment income earned	$	3,634,959
Net realized capital gains or (losses)		1,964,846
Net investment gain or (loss)	$	5,599,805
OTHER INCOME		
Net gain or (loss) from agents' or premium balances charged off	$	-
Finance and service charges not included in premiums		603,984
Aggregate write-ins for miscellaneous income		
Interest on future tax credits		94,548
Miscellaneous income		80,548
Total other income	$	779,080
Net income before federal income taxes	$	(24,031,094)
Federal and foreign income taxes incurred	$	(3,302,873)
Net income	$	(20,728,221)

Capital and Surplus Account
As of December 31, 2011

Surplus as regards policyholders, December 31, 2010	$ 87,888,209
GAINS AND (LOSSES) IN SURPLUS	
Net income	(20,728,221)
Change in net unrealized capital gains (losses)	(1,508,287)
Prior Period Adjustment - Adverse Loss Development	(14,213,294)
Prior Period Adjustment - Losses - Uncollectible Collateral	(52,636,321)
Change in net deferred income tax	(6,900,336)
Change in premium deficiency reserve	4,227,000
Change in Mepco Litigation Reserve	(5,400,000)
Change in non-admitted assets	2,842,865
Change in provision for reinsurance	1,722,203
Change in surplus as regards policyholders for the year	(92,594,391)
Surplus as regards policyholder, December 31, 2011	$ (4,706,182)

Reconciliation of Capital and Surplus
December 31, 2006 through December 31, 2011

The following reconciliation of capital and surplus represents the period covered by this examination:

Capital and Surplus, December 31, 2006			$ 67,355,938
	2007		
Net income	$	23,154,691	
Change in net unrealized capital gains or (loss)		(72,792)	
Change in net deferred income tax		(1,295,941)	
Change in nonadmitted assets		675,502	
Change in provisions for reinsurance		149,400	
Dividends to stockholders		(2,000,000)	
	$	20,610,860	
Capital and Surplus, December 31, 2007			$ 87,966,798
	2008		
Net income	$	7,506,061	
Change in net unrealized capital gains or (loss)		(3,761,095)	
Change in net deferred income tax		2,809,283	
Change in nonadmitted assets		(5,596,348)	
Change in provisions for reinsurance		120,800	
Dividends to stockholders		(4,500,000)	
	$	(3,421,298)	
Capital and Surplus, December 31, 2008			$ 84,545,500
	2009		
Net income	$	(823,580)	
Change in net unrealized capital gains or (loss)		2,270,648	
Change in net deferred income tax		399,048	
Change in nonadmitted assets		30,332	
Change in provisions for reinsurance		1,811,000	
Cumulative effect of adoption of SSAP 10R		1,680,607	
Prior period adjustment - OCAC		(1,395,238)	
	$	3,972,816	
Capital and Surplus, December 31, 2009			$ 88,518,316
	2010		
Net income	$	2,811,894	
Change in net unrealized capital gains or (loss)		(47,880)	
Change in net deferred income tax		786,055	
Change in nonadmitted assets		(2,880,174)	
Change in provisions for reinsurance		(1,637,203)	
Cumulative effect of adoption of SSAP 10R		337,200	
	$	(630,107)	
Capital and Surplus, December 31, 2010			$ 87,888,209
	2011		
Net income	$	(20,728,220)	
Change in net unrealized capital gains or (loss)		(1,508,287)	
Change in net deferred income tax		(6,900,336)	
Examination Adjustments		(68,903,507)	
Change in nonadmitted assets		3,723,757	
Change in provisions for reinsurance		1,722,203	
	$	(92,594,390)	
Capital and Surplus, December 31, 2011			$ (4,706,181)

Schedule of Examination Adjustments

The following financial adjustments were made to the Company's balance sheet as a result of this examination.

Item	Per Company	Per Examination	Difference	Unassigned Surplus Effect
Beginning Surplus Per Company				$ 64,197,327
			-	-
Real Estate Held for the Production of Income	355,428	-	(355,428)	(355,428)
Cash and Short Term Invesments	72,570,063	72,545,063	(25,000)	(25,000)
Receivable from Parent Subsidiaries and Affiliates	5,287,593	4,787,129	(500,464)	(500,464)
Losses - Uncollectable Collateral	-	(50,249,156)	(50,249,156)	(50,249,156)
Losses - Uncollectable Collateral/Off Book Large Deductibles		(2,387,165)	(2,387,165)	(2,387,165)
Losses - 2011 & Prior Adverse Development - Prior Period Adjustment 2012	-	(13,000,000)	(13,000,000)	(13,000,000)
Losses - 2011 & Prior Adverse Development - Prior Period Adjustment 2013	-	(1,213,294)	(1,213,294)	(1,213,294)
Premium Deficiency Reserve - Mepco	(4,227,000)	-	4,227,000	4,227,000
Mepco Litigation Reserve	-	(5,400,000)	(5,400,000)	(5,400,000)
Total Examination Adjustments				$ (68,903,507)
Ending Surplus Per Examination				$ (4,706,180)

Based on the examination findings noted and examination adjustments reflected in the balance sheet of this Report, the Company's adjusted capital and surplus is below the NAIC's Authorized Control Level Risk-Based Capital of $19,091,783 as of December 31, 2011.

NOTES TO FINANCIAL STATEMENTS

Assets

Note 1 - Bonds **$170,321,107**

Investments in bonds are reported at values (amortized cost) adopted and approved by the Securities Valuation Office (SVO) of the NAIC. Bonds owned (rounded in millions) by the Company as of December 31, 2011 were as follows:

	Statement Value
Governments	$62,375,869
U.S. States, Territories & Possessions	4,542,368
U.S. Political Subdivisions	3,247,670
U. S. Special Revenue	39,122,797
Industrial and Miscellaneous	61,032,403
Total	$170,321,107

The Company's bond holdings represent 65.1% of the Company’s total invested assets and 52.1% of total admitted assets at December 31, 2011. Approximately eighty eight percent (88%) of the Company’s total bond holdings were categorized as Class 1 with respect to NAIC credit quality standards. The remainder of the Company’s reported bonds were categorized as Class 2.

The Company maintains a conservative investment philosophy with an investment strategy to invest in high quality corporate securities of staggered duration in order to service its ongoing obligations.

As of December 31, 2011, the Company’s custodians were JP Morgan Chase Bank and Merrill Lynch Wealth Management. The agreements were examined to ensure that they contained provisions recommended in the NAIC Handbook. During this review, two exceptions were noted. The agreement with JP Morgan did not include three provisions as required by the NAIC Handbook. Additionally, the Company also reported assets of approximately $35 million with Merrill Lynch Wealth Management; however, the Company was unable to provide an executed agreement between itself and the bank. Based on the foregoing, the following recommendation is made:

It is recommended that the Company obtain custodial agreements for all custodial accounts which meet the requirements of the NAIC Examiners Handbook.

Note 2 – Common Stocks $15,037,023

The Company's investment in common stocks was comprised entirely of highly rated mutual funds readily traded on the open markets.

Note 3 - Real Estate – Properties Held For Production of Income $0

The captioned amount is $355,428 less than the amount reported by the Company in its 2011 Annual Statement.

At December 31, 2011, the Company held a single parcel of real estate in Fort Myers Florida that was valued at amortized cost. The last appraisal for the property was dated November 6, 2006. In accordance with NAIC Statement of Statutory Accounting Principles (SSAP) No. 40, any property the Company holds for the production of income must have an appraisal not more than five years old as of the reporting date. In accordance with SSAP No. 40 the asset in the amount of $355,428 has been non-admitted in the balance sheet of this Report. It was also noted that the Company did not maintain any insurance coverage on the property.

It is recommended that the Company obtain an updated appraisal for all of its real estate held for the production of Income in accordance with SSAP No. 40.

Note 4 - Cash, Cash Equivalents and Short Term Investments $72,545,063

Cash, cash equivalents and short term investments represented approximately twenty two percent (22%) of total admitted assets at December 31, 2011 and were made up of the following:

Cash	$ 26,347,951
Short term investments	46,197,112
	$72,545,063

Cash on deposit was held at four (7) financial institutions with over ninety eight (98%) or $25,894,505 on deposit at North Dallas Bank and Trust, and JP Morgan Chase Bank, NA; the Company's custodial bank.

Short-term investments were comprised of bonds, a mortgage loan and money market funds. During the review of short term investments, the Company reported $132,164 in money market funds. The bank confirmations reflected a balance of $107,164, representing an overstatement in Short Term Investments of $25,000. As a result, this amount has been not admitted in the balance sheet of this Report and the following recommendation is made:

It is recommended that the Company properly report short term investments in compliance with the Annual Statement instructions.

Note 5 - Receivable from Parent, Subsidiaries and Affiliates $4,787,129

The captioned receivable is $500,464 less than the amount of $5,287,593 reported by the Company in its 2011 Annual Statement. This intercompany receivable originated in 2011 for interest payments to its immediate parent; DNIC Holdings on surplus debentures. According to management, the interest payments are normally made by DNIC Holdings, however in 2011, the Company made the scheduled interest payments for the interest due and setup a receivable from Dallas National Holdings. The balance remains unsettled as of 2013. It is further noted that the transaction occurred without any related party agreement.

In accordance with the SSAP No. 96, transactions between related parties must be in the form of a written agreement. According to SSAP No. 96; "The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be non-admitted, except to the extent this is specifically addressed by other SSAP's. If the due date is not addressed by the written agreement, any uncollected receivable is non-admitted."

Based on the foregoing, the amount of $500,464 has been reported as non-admitted in the balance sheet of this Report.

It is recommended that the Company settle all intercompany transactions in accordance with SSAP No. 96.

Note 6 – Workers Comp Collateral Due from Affiliate $0

The examiners' established the captioned receivable in the amount of $52,636,321 for uncollected collateral due from AMS and AMS II, entities owned by Mr. Wood. The receivable was established as a result of unremitted workers' compensation collateral determined deficient against ultimate reserves for large deductible master policies issued to AMS. Ordinarily, this receivable would have been reported under the caption "Receivable from Parent, Subsidiaries and Affiliates"; however, due to the prominence of the issue, it was established under separate caption.

Under policy endorsement, the policyholder/employer is to provide collateral to minimize credit risk exposure for issued large deductible policies since reserves stated and reported are net of deductible. As of the examination date and subsequent thereto, a deficiency remains despite the Company's and Southport's failed efforts to collect the collateral from AMS and/or Mr. Wood. Therefore, the established receivable was determined to be uncollectible in accordance with the SSAP No. 65, paragraph 35 and was not admitted on the balance sheet of this report. Also, the examination balance sheet reflects an increase of $52,636,321 to the liability Losses. See Note 7 below.

Also refer to "Subsequent Events" for additional discussion on the collateral deficiency the Company continues to recognize subsequent to the examination date.

Liabilities

Note 7 – Losses and LAE **$262,612,517**

The Delaware Department of Insurance contracted with INS Consultants, Inc. (INS) to perform actuarial services in conjunction with this financial condition examination. The actuarial services performed by INS included Phase 5 detailed procedures concerning the Company's booked Loss and Loss Adjustment Expense (LAE) reserves. As of December 31, 2011, DNIC held reserves primarily for workers compensation, and general liability lines of business.

Due to the claims data issues noted below with the Company's affiliated claims administrator; Aspen, it was determined that material and systemic weaknesses existed to such an extent that underlying loss data was not reliable, therefore, the INS contracting actuary was unable to opine on the adequacy of the Company's booked Loss and LAE reserves.

The captioned amount however does reflect an increase of $66,849,615 over the Company's reported loss and LAE reserves of $145,977,905 as of December 31, 2011. Discussion on the examination changes is provided in the accompanying comments.

The examination adjustments reflected under this caption are based on unfavorable development recognized by the Company in its 2012 and 2013 Annual and Quarterly Statements respectively, and do not represent the findings of the INS contracting actuary.

The increase in reserves is the result of:

1. Unfavorable loss and LAE development recognized by the Company subsequent to the examination date for accident years 2011 and prior
2. Collateral deemed uncollectible in connection with its high deductible workers compensation policies and,
3. Off-book deductible losses not reported by Aspen; the Company's affiliated claims administrator.

The examination adjustments associated with the preceding are as follows:

	Amount
2012 reserve strengthening by the Company for accidents years 2011 and prior.	$13,000,000
Uncollectable collateral from AMS as of 2011	50,249,156
2013 reserve strengthening by the Company for off book deductible losses not reported by Aspen	1,213,294
Additional collateral required on 2013 reserve strengthening for off book high deductible losses not reported by Aspen	2,387,165
Total	$66,849,615

2012 Reserve Strengthening by the Company

As of December 31, 2011, management's booked net loss and LAE reserve were $10.0 million less than the Appointed Actuary's; Milliman, Inc. (Milliman) central estimate for the same period ending. Based on examination materiality, INS determined that managements booked reserves were materially different from the Milliman's central estimate. Further, the appointed actuary made a finding in their actuarial report that the Company's carried net loss and LAE reserve differs materially from the appointed actuary's central estimate of net loss and LAE.

At the end of calendar year 2012, DNIC strengthened net loss and LAE reserves for accident years 2011 and prior by approximately $13,000,000 primarily for its workers compensation book of business. As a result, loss and LAE reserves have been increased $13,000,000 for the purpose of this Report.

<u>Uncollectable Collateral from AMS as of 2011</u>

On large deductible workers' compensation policies, the policyholder/employer is responsible for all claims within the deductible. However, under SSAP No. 65, the Company is required to pay first dollar and the policyholder is responsible for reimbursing the Company for losses paid within the deductible. Reserves are actuarially established to the ultimate reserve and the Company reports reserves on the policies net of the deductible. In addition, considering the credit risk exposure of the policyholder/employer, many state insurance laws require collection of collateral which is based on the ultimate actuarial reserve calculations. To comply with applicable state insurance statutes, the Company attaches an endorsement to the master policy requiring the mentioned collateral.

As of December 31, 2011, the Company had two (2) master policies with staff leasing companies owned by Mr. Wood; AMS and AMS Staff Leasing II.

From a review of Company documentation, it was determined that the following occurred during the examination period and subsequent thereto:

- The endorsement requiring collection of collateral on the two master policies was not attached from 2010 and subsequent (see “Territory and Plan of Operation”).
- The Company’s parent failed to pay or reimburse the Company for amounts billed to AMS for losses paid within the deductible.
- After efforts to collect or get reimbursed, the Company reduced its held collateral to reimburse itself for amounts billed to AMS.
- A deficiency in collateral occurred as a result of drawdown in collateral and the failure of AMS to provide additional or sufficient collateral based on the actuarially determined ultimate reserve calculation.
- For the high deductible policies, reserves were actuarially established net of the deductible in accordance with SSAP No.65, paragraph 35 by Milliman. However, the deficiency of the collateral was not taken into consideration since the collateral may have been expressed as adequate and collectible by management.
- The Company failed to establish a receivable from AMS for losses and LAE paid and billed and not admit the respective amounts in accordance with SSAP No. 65, paragraph 37.

Based on SSAP No.65, paragraph 35, it was determined that the Company’s failed efforts to collect or receive sufficient collateral from AMS rendered the collateral due as uncollectible; thereby, increasing the Company’s credit risk and hazardous financial condition. As a result, loss and LAE reserves have been increased by $50,249,156.

Based on the foregoing, the following recommendation has been made:

It is recommended that the Company take appropriate steps to comply with SSAP No. 65, paragraph 35; obtain required collateral and reconsider its policy to compensate reimbursement of billed losses paid but uncollected against collected collateral.

It is also recommended that the Company properly report unreimbursed losses paid and determine and report proper accounting treatment in its filed financial statements per SSAP No. 65, paragraph 37.

A corresponding asset was established under the caption "Aggregate Write-ins: Workers' Comp Collateral Due from Affiliate for the amount of the collateral deficiency. See Note 6 above.

Also refer to "Subsequent Events" for additional discussion on the collateral deficiency the Company continues to recognize subsequent to the examination date.

Off- Book High Deductible Losses Not Reported By Aspen

In the 2nd quarter of 2013, the Company recognized another $11,854,317 in unfavorable development for accident year 2012 and prior. Of this amount, $1,213,294 represents unfavorable development for accident year 2011 and prior and has been reflected as an increase in losses and LAE for the purpose of this Report.

The increase in loss and LAE reserves followed a thorough review of the Company's operations by Southport subsequent to acquiring DNIC. Several problems were discovered with the Company's affiliated claims administrator; Aspen. According to management, the issues involved:

1. Mischaracterization of certain open claims as being closed;
2. Deficiency in timely reporting of claims;
3. Incorrect application of certain deductible amounts;
4. Failure to fully integrate data from certain third party claims administrators

As a result of the foregoing issues, the Company terminated its agreement with Aspen effective July, 15, 2013. Aspen is a David Wood owned entity and was not part of the subsequent acquisition by Lonestar.

As a result of the additional development mentioned above, additional high deductible collateral of $2,387,165 was determined to be required for revised ultimate losses and LAE for the accident year 2011 and prior. Since collateral was determined to be uncollectible, loss and LAE reserves have been increased by $2,387,165.

Note 8 – Premium Deficiency Reserve **$0**

As of December 31, 2011, the Company reported a Premium Deficiency Reserve in the amount $4,227,000. In 2011, the Company's appointed actuary determined that the claims reserves for the Tier One auto warranty program was under reserved. As a result, the Company established the deficiency reserve. Subsequently, in 2012 it was determined by the Company's outside actuary that claims reserves were adequate and the premium deficiency reserve was no longer required based on improved development. Based on the foregoing, the captioned reserve was decreased to $0 for purposes of this Report.

Also refer to Note 9 to Financial Statements for related discussion on the auto warranty program and related litigation.

Note 9 - Mepco Litigation Reserve **$ 5,400,000**

In July 2010, Mepco Finance Corp. (Mepco) filed suit against the Company for breach of contract related to the Company's Tier One auto warranty program. The Company did not establish a liability for this lawsuit until 2012 which was for $4.227 million (unrelated to the Premium Deficiency Reserve – Tier One reported amount discussed in Note 8 to Financial Statements). The lawsuit settled subsequent to the examination date on September 16, 2013 for $5.4 million. As a result, a liability has been established for $5.4 million in the balance sheet of this Report.

It is noted that the Company subsequently recovered $1,173,000 from Mr. Wood in connection with the Mepco settlement.

SUBSEQUENT EVENTS

The following captions were covered in preceding sections of this report. Due to the significant changes, and material examination findings occurring subsequent to 2011, it was determined to include an expanded discussion under this caption to update the related examination findings through June 30, 2013.

Management and Control

As a direct result of the Company's acquisition by Lonestar, the existing directors and officers were asked to resign. The following directors were elected at the first shareholder's meeting held on August 20, 2013.

Directors

Name	Principal Business Affiliation
William Blaine Richardson	Chairman Former New Mexico Governor
Glenn Ronald Weber	CEO Southport Lane, LLC.
H. Marc Carter, Jr.	President and Chief Executive Officer Dallas National Insurance Company
Eric P. Serna	Attorney at Law Goldwater Taplin Law Group
Andrew Peter Bustillo	Principal, Red Bank Re, LLC
James Michael Pickens	Principal, Attorney at Law Goldwater Taplin Law Group
William Edward Reid	Principal Reid and Dennis, PC

Officers

Name	Title
H. Marc Carter, Jr.	President and Chief Executive Officer
Eric William Vogelsberg	Vice-President, Chief Financial Officer, Secretary and Treasurer
Harriet Penan Berenstein	Vice President and Controller
Stephen Su	Chief Underwriting Officer

Committees

The following Committees of the Board were formed on August 20, 2013:

Audit Committee

Andrew P. Bustillo, Chairman
William Edward Reid
Glenn Ronald Weber

Investment Committee

Eric P. Serna, Chairman
Glenn Ronald Weber
James Michael Pickens

Recapitalization by Southport

Subsequent to December 31, 2011, the Company entered into a Transaction Agreement dated March 1, 2012 to sell the Company to Lonestar, a subsidiary of Southport. Southport is managed by a team of financial industry veterans with a diverse base of expertise.

The sale of the Company to Lonestar and its simultaneous re-domestication was effective March 12, 2013. As part of the sale of the Company to Lonestar, it received $50 million in cash, $2.5 million for 2,500 shares of newly-issued common stock, $40.0 million in cash and securities in exchange for a $20 million surplus note issued by DNIC to Lonestar and non-voting preferred shares, and an additional $7.5 million in cash and securities.

In summary, Lonestar paid in $50 million to purchase the Company and is illustrated in the following schedule:

$ 1,250,000	25,000 (2,500 and 22,500) newly issued shares at $50 par
20,000,000	100,000 preferred stock shares at $0.01 per share for $20 Million
20,000,000	Surplus Note issued by DNIC
15,750,000	Gross Paid-in & Contributed Surplus
(7,000,000)	Common Stock moved to Treasury Stock
$ 50,000,000	Total Surplus added to Company in 2013

The following schedule reconciles the changes to the Company's capital structure from the examination date to the Company's filed June 30, 2013 quarterly statement:

	Common Capital Stock	Preferred Stock	Surplus Note	Gross Paid-in and Contributed Surplus	Unassigned Surplus	Less Treasury Stock	Total
December 31, 2011	$7,000,000	$ -	$ -	$ 33,700,547	$ 23,496,779	$ -	$ 64,197,326
Operations 2012					(6,590,711)		(6,590,711)
Operations 2nd Quarter 2013					(10,261,374)		(10,261,374)
Change in surplus note			20,000,000				20,000,000
Capital changes	1,250,000	20,000,000		15,750,000			37,000,000
Chance in treasury stock						(7,000,000)	(7,000,000)
June 30, 2013	$8,250,000	$ 20,000,000	$20,000,000	$ 49,450,547	$ 6,644,694	$ (7,000,000)	$ 97,345,241

The above schedule does not include the examination changes reflected in the balance sheet of this Report as of December 31, 2011.

MANAGEMENT AND CONTROL

Holding Company System

The accompanying organizational chart represents the new Holding Company structure subsequent to the examination date as a result of the acquisition by Southport/Lonestar:

Alexander Chatfield Burns – Ultimate Controlling Person

- Southport Lane Management, LLC (DE)
  - Southport Lane Advisors, LLC (DE)
  - Southport Specialty Finance, LLC (DE)
  - Southport Intermediaries, LLC (NY)
- Southport Lane, L.P. (DE)
  - Southport Re, LLC (DE)
    - Southport Re (Cayman), Ltd. (Cayman Island)
    - Archer National Insurance Company, LLC (DE)
  - Lonestar HoldCo, LLC (DE)
    - **Dallas National Insurance Company (DE)**
    - Redwood Reinsurance SPC, Ltd. (Cayman)
  - Southport Insurance Holdings, LLC (DE)
    - Imperial Management Corporation (LA)
      - Imperial Fire and Casualty (LA)

Affiliated Agreements

As a result of the acquisition of the Company by Southport in 2013, the affiliated agreements with Highpoint Risk Services, and Aspen Administrators were all terminated as of August, 2013. The agreement with AMS Staff Leasing will be terminated effective December 31, 2013.

In 2013, the Company entered into a new Investment Management agreement with its affiliate Southport Lane Advisors, LLC. The agreement, effective May 2012, provides for investment management services including: execution of account transactions, operate under the terms of the custodian agreement in place, and provide monthly and annual reports of the Company's asset portfolio performance.

DNIC will pay the named affiliate a management fee, which is a percentage (1.5% annual) of the total market value of all assets in the portfolio as of the last trading day of each month. This agreement will remain in effect until written notice is provided by either party. All indemnity clauses were included in the agreement to protect both parties.

TERRITORY AND PLAN OF OPERATION

Subsequent to the examination date, the following material producer and TPA agreements were terminated with the former parent's affiliated companies:

- Highpoint Risk Services, LLC; terminated July 9, 2013
- Aspen Administrators, Inc.; terminated August 15, 2013

The Company replaced Aspen with Sedgwick Claims Management Services (Sedgwick) on August 15, 2013. Sedgwick will provide claims services for all WC and OA business. All GL claims are performed internally. The Company entered into other MGA agreements in 2012 and 2013 but none were considered material and significant.

STATUTORY DEPOSITS

In 2013, as a direct result of the Company's acquisition by Lonestar and simultaneous re-domestication to Delaware, the Company increased its statutory deposits by $2,900,000 to cover reciprocity among several states. As of June 30, 2013, the Company's total deposit for the benefit of all policyholders was $3,000,298 compared to $100,297 as of December 31, 2011.

Amounts Withheld or Retained by Company for the Account of Others

On March 20, 2013, the Company received an additional $11,400,000 in collateral from AMS/David Wood toward reducing the outstanding collateral deficiency. As of June 30, 2013, unremitted collateral (deficiency) was $42,699,365 despite continued efforts by the Company and Southport. See Note 7 to Financial Statements additional discussion.

FINANCIAL STATEMENTS AS OF JUNE 30, 2013

The following pages contain a statement of assets, liabilities, surplus and other funds as of the Company's June 30, 2013 filed Quarterly Statement. The purpose for inclusion in this Report is to reflect material examination findings that continue to adversely affect the Company's financial condition as of June 30, 2013.

Assets
Liabilities, Surplus and Other Funds
Statement of Income
Capital and Surplus Account
Schedule of Examination Adjustments

The amounts reported in the above exhibits were not examined; however, they have been updated to reflect the effects of the 2011 adjustments through June 30, 2013.

Analysis of Assets
As of June 30, 2013

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 106,026,134	$ -	$ 106,026,134
Preferred stocks	28,500,000		28,500,000
Common stocks	63,497,148		63,497,148
Real estate:			
Properties held for the production of income	339,750	339,750	0
Cash and short-term investments	91,863,085		91,863,085
Contract loans			0
Derivatives	(76,140)		(76,140)
Other invested assets			0
Receivable for securities	1,475,000		1,475,000
Aggregate write-ins for invested assets	1,094,772		1,094,772
Investment income due and accrued	424,000		424,000
Uncollected premiums and agents' balances in course of collection	43,414,033	2,917,493	40,496,540
Amounts recoverable from reinsurers	1,087,075		1,087,075
Funds held by or deposited with reinsured companies	46,873,160		46,873,160
Other amounts receivable under reinsurance contracts	215,434		215,434
and interest thereon			-
Current federal and foreign income tax recoverable	677,655		677,655
Guaranty funds receivable or on deposit	88,120		88,120
Receivables from parent, subsidiaries & affiliates			-
Aggregate write-ins:			
Workers comp collateral due from affiliate			-
Bills Receivable taken for premiums	2,004,301	22,753	1,981,548
Prepaid reinsurance premiums	316,436		316,436
Texas windstorm assesment	122,800		122,800
Prepaid Expenses	229,343	229,343	-
Due from Companion	1,449,670		1,449,670
Subrogation Receivable`	2,196,023		2,196,023
Receivable from Holdings	1,088,139	1,088,139	-
PremiumAssessments	573,832		573,832
Due from Aspen Administrators	869,334		869,334
Refundable Security Deposit - NCCI	136,969	136,969	-
Total Assets	$ 394,486,073	$ 4,734,447	$ 389,751,626

Statement of Liabilities, Surplus and Other Funds
As of June 30, 2013

Losses	$ 207,766,120
Reinsurance Payable on paid losses and loss adjustment expenses	1,794,651
Loss adjustment expenses	48,273,988
Commissions payable, contingent commissions and other similar charges	64,569
Other expenses	822,157
Taxes, licenses and fees	2,394,474
Unearned premiums	22,620,755
Ceded reinsurance premiums payable	14,261,273
Amounts withheld or retained for the account of others	29,763,184
Provision for reinsurance	858,400
Aggregate write-ins for liabilities:	
Deferred interest on tax credits - Accent Capital	9,766
Mepco litigation reserve	3,907,705
Tier 1 Other	1,492,295
Payabble to TPA	991,029
MGA Claims Payable - Auto	381,942
Escheat	1,791,344
Deferred Rent Liability	480,741
ACH REM Timing differences on claims	156,987
Other liabilities	11,038
Total Liabilities	$ 337,842,418
Common capital stock	$ 8,250,000
Preferred Capital Stock	20,000,000
Surplus Notes	20,000,000
Gross paid in and contributed surplus	40,450,547
Unassigned funds (surplus)	(29,791,339)
Less Treasury Sock	(7,000,000)
Surplus as regards policyholders	$ 51,909,208
Total Liabilities, Capital and Surplus	$ 389,751,626

Statement of Income
As of June 30, 2013

UNDERWRITING INCOME		
Premiums earned	$	45,150,702
DEDUCTIONS		
Losses incurred	$	34,551,158
Loss adjustment expenses incurred		10,519,112
Other underwriting expenses incurred		13,740,027
Total underwriting deductions	$	58,810,297
Net underwriting gain or (loss)	$	(13,659,595)
INVESTMENT INCOME		
Net investment income earned	$	1,272,996
Net realized capital gains or (losses)		1,386,103
Net investment gain or (loss)	$	2,659,099
OTHER INCOME		
Finance and service charges not included in premiums	$	240,713
Aggregate write-ins for miscellaneous income		
Interest on future tax credits		9,768
Miscellaneous income		1,316
Total other income	$	251,797
Net income after dividends to policyholder but before federal income taxes	$	(10,748,699)
Federal and foreign income taxes incurred	$	-
Net income	$	(10,748,699)

Capital and Surplus Account
As of June 30, 2013

Surplus as regards policyholders, December 31, 2012	$ 57,606,616
GAINS AND (LOSSES) IN SURPLUS	
Net income	$ (10,748,699)
Change in net unrealized capital gains (losses)	(746,933)
Change in admitted assets	(193,631)
Change in Mepco Litigation Reserve	(1,308,781)
Prior period adjustment - Losses-Uncollectible Collateral	(42,699,365)
Change in non-admitted surplus notes	20,000,000
Capital Changes:	
Paid-in	37,000,000
Aggregate write-ins for gains and losses in surplus	(7,000,000)
Change in surplus as regards policyholders for the year	$ (5,697,409)
Surplus as regards policyholder, June 30, 2013	$ 51,909,207

In order to cure the collateral deficiency in the amount of $42.7 million as of June 30, 2013, the Board of Directors of the Company authorized the issuance of 50,000 shares of Senior Preferred Stock to Southport Lane, LP and or an affiliate in exchange for $50 million in cash and securities. The purchase of the shares will take place only in the event that the Company is unable to perfect its claim of collateral from the prior owner of the Company or his affiliates (See Note 6).

EXAMINATION ADJUSTMENTS AS OF JUNE 30, 2013

The following adjustments reflect the effects of the 2011 adjustments through June 30, 2013.

Item	Per Company	Per Examination	Difference	Unassigned Surplus Effect
Surplus per Company as of June 30, 2013				$ 97,345,242
			-	-
Real Estate	339,750	-	(339,750)	(339,750)
Receivable from DNIC Holdings	1,088,139	-	(1,088,139)	(1,088,139)
Losses - Uncollectable Collateral	(29,763,184)	(72,462,549)	(42,699,365)	(42,699,365)
Mepco Litigation Reserve	(4,091,219)	(5,400,000)	(1,308,781)	(1,308,781)
Net effect of changes				$ (45,436,035)
Surplus after adjustments				$ 51,909,207

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

This was the first financial examination by the Delaware Department of Insurance; therefore there are no prior examination recommendations.

SUMMARY OF RECOMMENDATIONS

The Company's attention is directed to the following:

1. **It is recommended that the Company properly notify the DE DOI of any changes in officers and directors. (See Page 7)**

2. **It is recommended that the Company prepare all agreements with an effective date and all signatures be provided with the agreement. (See Pages 9, 10)**

3. **It is recommended that the Company obtain an updated appraisal for all of its real estate held for the production of income in accordance with SSAP No. 40. (See Note 3)**

4. **It is recommended that the Company assure endorsement of all large deductible workers' compensation policies in compliance with applicable state statutes and continue its effort to collect the collateral deficiency held by AMS or any other policyholder. (See Note 7)**

5. **It is recommended that the Company properly reflect all special deposits on its Annual Statement in accordance with the NAIC Annual Statement instructions. (See Page 23)**

6. **It is recommended that the Company obtain custodial agreements for all custodial accounts which meet the requirements of the NAIC Examiners Handbook. (See Page 31)**

7. **It is recommended that the Company properly report short term investments in compliance with the Annual Statement instructions. (See Page 32)**

8. **It is recommended that the Company settle all intercompany transactions in accordance with SSAP No. 96. (See Page 33)**

9. **It is recommended that the Company take appropriate steps to comply with SSAP No. 65, paragraph 35; obtain required collateral and reconsider its policy to compensate reimbursement of billed losses paid but uncollected against collected collateral. (See Note 7)**

10. **It is recommended that the Company properly report unreimbursed losses paid and determine and report proper accounting treatment in its filed financial statements per SSAP No. 65, paragraph 37. (See Note 7)**

CONCLUSION

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

Description	December 31, 2006	December 31, 2011	Increase (Decrease)
Assets	$ 208,607,912	$ 325,804,500	$ 117,196,588
Liabilities	141,251,974	330,510,681	189,258,707
Special Surplus Funds	-	-	-
Common Capital Stock	7,000,000	7,000,000	-
Gross Paid In and Contributed Surplus	33,700,547	33,700,547	-
Unassigned Funds (Surplus)	26,655,391	(45,406,728)	(72,062,119)
Total Surplus as Regards Policyholders	$ 67,355,938	$ (4,706,181)	$ (72,062,119)
Totals	$ 208,607,912	$ 325,804,500	$ 117,196,588

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. is acknowledged. In addition, the assistance and cooperation of the Company's outside audit firm, E&Y, and the Company's management and staff were appreciated and are acknowledged.

Respectfully submitted,

Donald Hollier

Don Hollier, CFE
Examiner-In-Charge
State of Delaware