EXAMINATION REPORT

OF

KNIGHT SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2016

Trinidad Navarro
Commissioner

Delaware Department of Insurance

I, Trinidad Navarro, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of December 31, 2016 of the

KNIGHT SPECIALTY INSURANCE COMPANY

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

Attest By: Rufynn Brown

Date: May 29, 2018

In Witness Whereof, I have hereunto set my hand and affixed the official seal of this Department at the City of Dover, this 1ST day of June, 2018.

Trinidad Navarro
Insurance Commissioner

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Trinidad Navarro
Commissioner

Delaware Department of Insurance

REPORT ON EXAMINATION

OF THE

KNIGHT SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2016

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.

Trinidad Navarro
Insurance Commissioner

Dated this 1st day of June, 2018

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TABLE OF CONTENTS

SALUTATION

February 28, 2018

Honorable Trinidad Navarro
Commissioner of Insurance
Delaware Department of Insurance
Rodney Building
841 Silver Lake Boulevard
Dover, Delaware 19904

Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Exam Authority No. 17.011, dated December 15, 2016, an examination has been made of the affairs, financial condition and management of

KNIGHT SPECIALTY INSURANCE COMPANY

with its statutory home office located at 4751 Wilshire Blvd., Suite 111, Los Angeles, California 90010. The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

We have performed our multi-state examination of Knight Specialty Insurance Company (the "Company"). The last examination of the Company was an organizational examination performed as of October 18, 2013. This examination of the Company covers the period of October 19, 2013 through December 31, 2016. Our examination was conducted concurrently with our examination of the Company's affiliate, KnightBrook Insurance Company ("KBIC"). Our examination was coordinated with the New York Department of Financial Services examination of KnightBrook Insurance Company's wholly owned subsidiary, Guilderland Reinsurance Company ("GRC").

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 evaluate the financial condition, assess corporate governance, identify current and prospective risks of the company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, pursuant to the General Corporation Laws of the State of Delaware as required by 18 Del. C. §321, along with general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

During the course of this examination, consideration was given to work performed by the Company's external accounting firm, Ernst & Young LLP. Certain auditor work papers have been incorporated into the examination work papers.

SUMMARY OF SIGNIFICANT FINDINGS

There were no significant findings or material changes to the Company's financial statements as a result of this examination given remediation efforts made by the Company prior to the examination report date.

COMPANY HISTORY

General

The Company was incorporated under the laws of the State of Delaware on July 10, 2013 and began business on April 16, 2014. The Company has remained under the ultimate control of its founder, Don Robert Hankey, since its inception.

Capitalization

The Company's Certificate of Incorporation authorizes the issue of one million shares of common stock with a $1.0 par value. As of December 31, 2016, the Company had one million common shares issued and outstanding totaling $1.0 million. All outstanding common shares of the Company are owned by Knight Insurance Company, Ltd. ("KIC"). As of December 31, 2016, the Company reported gross paid-in and contributed surplus of $44.3 million, which was an increase of $25.3 million over the examination period. The following chart summarizes the Company's reported capital stock and gross paid-in and contributed surplus from the prior examination date to December 31, 2016:

	Capital Stock	Gross Paid-in & Contributed Surplus	Total Capital Stock and Gross Paid-in & Contributed Surplus
October 18, 2013	$ 1,000,000	$ 19,000,000	$ 20,000,000
Activity	-	25,274,388	25,274,388
December 31, 2016	$ 1,000,000	$ 44,274,388	$ 45,274,388

Dividends

The Company paid no shareholder dividends during the examination period.

MANAGEMENT AND CONTROL

Directors

Pursuant to the general Corporation Laws of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, the business and affairs of the Company must be exercised by, or under the authority of, its Board of Directors ("Board"). The Company's bylaws require that its Board consist of not less than three or more than ten members. In accordance with the bylaws, the members of the Board are elected annually. As of December 31, 2016, the following Directors were properly elected by the shareholder as follows:

Name	Business Affiliation
Don Robert Hankey	Chairman of the Board and Chief Executive Officer Hankey Group
Bret Conrad Hankey	President Hankey Group
Amit Bharatkumar Shah	President Knight Insurance Group
Dong Mok Keum	Chief Financial Officer Knight Insurance Group
John Martin Rygh	General Counsel Knight Insurance Group

Officers

Officers were appointed in accordance with the Company's bylaws during the period under examination. The bylaws require the following officers be elected by the Board: Chairman of the Board; Chief Executive Officer; President; Chief Financial Officer; Chief Operating Officer; Secretary; Treasurer and one or more Vice-Presidents. The Board may appoint other officers and agents at its discretion. Any number of offices may be held by the same person, but no officer may act in more than one capacity where action of two or more

officers is required. The primary officers of the Company serving as of December 31, 2016, were as follows:

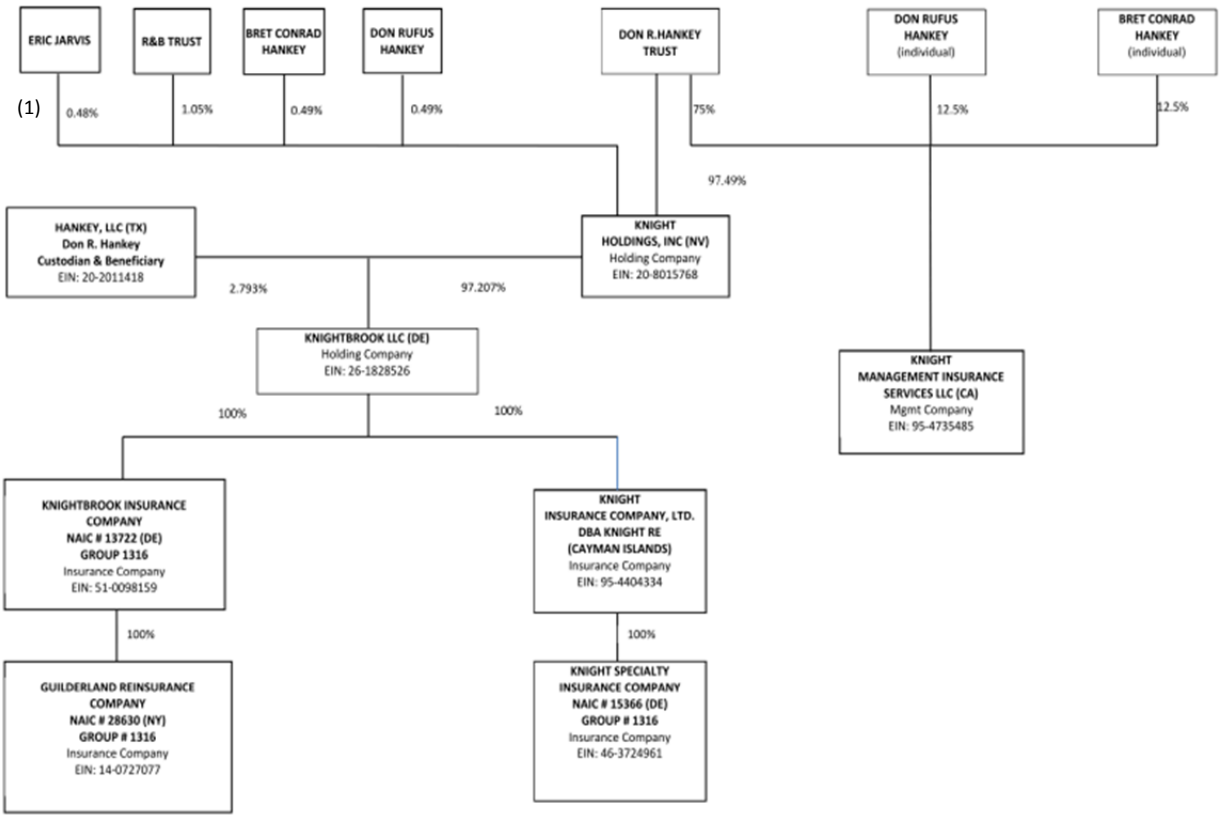
Name	Title
Don Robert Hankey	Chairman & Chief Executive Officer
Amit Bharatkumar Shah	President
Dong Mok Keum	Chief Financial Officer and Treasurer
John Martin Rygh	General Counsel and Secretary
Bret Conrad Hankey	Assistant Secretary

Corporate Records

The recorded minutes of the sole shareholder and Board meetings were reviewed for the period under examination. The minutes adequately documented and approved Company transactions and events, including the Board approval of investment transactions in accordance with 18 Del. C. §1304.

Insurance Holding Company System

The Company is a member of an insurance holding company system as defined under 18 Del. C. §5001 of the Delaware Insurance Code. Knight Holdings, Inc. ("KHI" or "Holding Company") and Hankey, LLC indirectly own 97.207% and 2.793% of the Company, respectively. As of December 31, 2016, KHI was ultimately owned and controlled by Don Robert Hankey as Trustee of the Don Hankey Trust with minority ownership held by R&B Trust and the following individuals: Don Rufus Hankey, Bret Conrad Hankey and the former President of Knight Insurance Group, Eric Jarvis. Don Robert Hankey is the ultimate owner of Hankey, LLC via an Individual Retirement Account ("IRA"), whereby Don Robert Hankey is the custodian and beneficiary of the IRA. The following is a full organizational chart of the Holding Company including its related party general agency:



(1) Eric Jarvis was divested of his ownership in KHI subsequent to the examination period and the Company's new President, Amit Shah, obtained comparable ownership interest in KHI.

Collectively, the Holding Company and its affiliated general agency are referred to as Knight Insurance Group (the "Group"). The Group provides underwriting capability for niche insurance program business. Lines of business and its respective programs include commercial auto liability, commercial general liability, specialty and general liability insurance. The Group partners with Managing General Agents ("MGA's") and program administrators to participate in different insurance programs. The following is a description of the primary entities in the Group:

- KHI was incorporated in the State of Nevada on December 7, 2006, to own subsidiaries engaged in insurance activities.

- KIC was incorporated as an exempted company under the laws of the Cayman Islands in 1993 and is the holder of a Class B (iii) Insurer's License. The majority of the insurance assumed by KIC is related to automobile and general liability coverages. Most of KIC's premium is produced by Knight Management Insurance Services, LLC ("KMIS"), Westlake Financial Services, LLC or unaffiliated MGA's. KIC's business is assumed via fronting arrangements with unaffiliated insurers or from reinsurance treaties with affiliates, including the Company and KBIC.
- KBIC is a property and casualty insurance company domiciled in the State of Delaware. Historically, KBIC has primarily written commercial auto liability lines of business and personal non-standard auto lines of business on a program basis. The business is written by affiliated and nonaffiliated MGA's.
- GRC is a property and casualty reinsurance company domiciled in the State of New York. GRC was acquired by KB LLC in 2008 as an existing wholly owned subsidiary of Excess Reinsurance Company - the entity that is now the Company. The Company has been in run-off since 2007, having cancelled, non-renewed, or allowed to expire all its assumed reinsurance business.
- KMIS is a California Limited Liability Company organized in 1999. KMIS is a licensed property and casualty insurance agent, which provides program management, underwriting, policy production and claims management services to affiliated and unaffiliated insurers.

Affiliated Agreements

- Management Agreement - Effective November 1, 2013, the Company entered an affiliated Management Agreement with KMIS. In accordance with the agreement, KMIS

provides all personnel, equipment and facilities to the Company. KMIS is authorized and responsible for management of direct and third-party assigned services including: underwriting risk management services, regulatory services, home office services, accounting services, claims management services and accounting and cash records services. Underwriting risk management services consist of all program administration duties including risk evaluation and related pricing services, program reinsurance placement and related underwriting reporting and results. Claims management services include management of all direct claims services as well as management of responsibilities assigned to any third-party claims manager. The Company reimburses KMIS for direct costs and an allocation of indirect and shared costs associated with the services provided. Per the agreement, indirect and shared expenses must be allocated in accordance with the NAIC *Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principles No. 70 – Allocation of Expenses*.

- Information Technology Service Agreement - The Company is party to an affiliated Information Technology Service Agreement between KMIS and Nowcom Corporation, Inc. ("Nowcom"). In accordance with the agreement, Nowcom provides KMIS hardware, software, network, web, email and internet goods and services as it relates to the Company. In return, KMIS reimburses Nowcom for direct costs based on Nowcom's actual cost without a profit factor. Per the agreement, indirect and shared expenses must be allocated in accordance with the NAIC *Accounting Practices and Procedures Manual*, *Statement of Statutory Accounting Principles No. 70 – Allocation of Expenses*.
- Tax Allocation Agreement - Effective August 23, 2013, the Company entered a Tax Allocation Agreement with its direct parent, KIC. In accordance with the agreement,

each participant calculates its federal corporate tax liability as if it were filing on a separate return basis. KIC is responsible to file and pay all federal corporate tax liabilities, and each participant makes/receives payment to/from the Company based on a separate return basis. Estimated payments made by KIC are reimbursed by each participant quarterly when tax is due.

- Other – The Group is considered part of the Hankey Group, which is a privately held financial services organization comprised of seven companies controlled by Don Robert Hankey. Beyond the Hankey Group, the ultimate controlling party also owns, or ultimately controls, a number of other entities. The following entities participated in affiliated transactions with the Group during the examination period: Hankey Wealth Management, LLC, HV Fund, LLC, and Knight Services, Inc. ("KSI") doing business as Hankey Cash Management ("HCM"). The following entities were party to a written Cash Management Agreement with HCM during the examination period: WFS, TNH Motors, Inc., Midway Rent A Car, Inc., KMIS (including KIC) and HFC Acceptance, LLC. The following additional entities participated in the cash management arrangement during the examination period: the Company, KBIC, Nowcom, Hankey Investment Company, LP, Hankey Finance Company, CULA, LLC, 2900 Wilshire, LLC, 4751 Wilshire, LLC, 4128 Wilshire, LLC, 4727 Wilshire, LLC, Marina Business Center, LLC, MSQ, LLC, CIRCA 1200, LLC and HIC DB Portfolio, LLC.

TERRITORY AND PLAN OF OPERATION

The Company is an excess and surplus line insurer with authority to write in all fifty states. Since beginning operations in 2014, the Company has operated as a provider of specialized insurance product offerings on a program basis. The Company partners with MGAs

and program administrators to participate in different insurance programs. Gross written premium for the year ended December 31, 2016 was primarily produced by the following MGAs:

MGA	Program	2016	% of Gross Written Premium
Venture Underwriters, Inc.	Commercial General Liability	$ 21,797	81.2%
* Next Wave Insurance Services, LLC	Cannabis Products Liability	4,207	15.7%
* Franchise Risk Solutions, Inc.	Quick Serve Restaurants	702	2.6%
Various	Various	146	0.5%
Total		$ 26,852	100%

*: Produced under an agency agreement between the MGA and KMIS.

Historically, the Company's largest program has been the commercial general liability program. For the year ended December 31, 2016, the Company's primary written premium was produced under a commercial general liability program and a cannabis products liability program. For the year ended December 31, 2016 approximately 82% of the Company's direct written premium was derived from the states of Colorado, Florida, Arizona, Texas, New Jersey, Oregon and Washington. Colorado represented the largest state by volume with approximately 20% of total direct written premiums.

REINSURANCE

The Company's reinsurance program consists of external reinsurance strategically acquired for individual programs and an affiliated quota share agreement with KIC covering one hundred percent of all business written net of external reinsurance.

The following is a summary of the Company's gross written and assumed premium, ceded premium and net written and assumed premium for the year ended December 31, 2016:

	12/31/2016	% of Written Premium
Total direct written premium	$ 26,851,688	
Ceded to affiliates	17,493,689	65.1%
Ceded to non-affiliates	9,357,999	34.9%
Total ceded	$ 26,851,688	100%
Net written and assumed premium	$ -	

As of December 31, 2016, the Company's reinsurance inforce consists primarily of affiliated reinsurance and both the affiliated and unaffiliated reinsurance is mostly with unauthorized reinsurers, secured principally by funds held or letters of credit, as demonstrated by the following:

(In Thousands)

	Affiliated Reinsurers	Unaffiliated Reinsurers	Total as of 12/31/2016
Unauthorized Reinsurers			
Paid losses and loss adjustment expenses	$ -	$ -	$ -
Known case loss and loss adjustment expenses	3,916	1,189	5,105
Incurred but not reported	12,415	3,037	15,452
Unearned premiums	3,176	989	4,165
Total Reinsurance Recoverables - Unauthorized	$ 19,507	$ 5,215	$ 24,722
	(1)	(2)	
Authorized Reinsurers			
Paid losses and loss adjustment expenses	$ -	$ -	$ -
Known case loss and loss adjustment expenses	-	708	708
Incurred but not reported	-	1,806	1,806
Unearned premiums	-	1,316	1,316
Total Reinsurance Recoverables - Authorized	$ -	$ 3,830	$ 3,830
Total Reinsurance Recoverables - All	$ 19,507	$ 9,045	$ 28,552

(1) Secured by 'funds held' with affiliate, KIC.
(2) Secured by letters of credit with qualified financial institutions.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Delaware Department of Insurance and present the financial condition of the Company for the period ending December 31, 2016:

- Statement of Assets
- Statement of Liabilities, Capital and Surplus
- Statement of Income
- Reconciliation of Capital and Surplus

Statement of Assets
As of December 31, 2016

	Ledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 33,612,169	$ -	$ 33,612,169	1
Common stocks	31,073,634	-	31,073,634	2
Cash	7,787,659	-	7,787,659	
Investment income due and accrued	131,524	-	131,524	
Uncollected premiums and agents' balances	5,398	-	5,398	
Aggregate write-ins for other than invested assets	723,982	-	723,982	
Total assets	$ 73,334,366	$ -	$ 73,334,366	

Statement of Liabilities, Capital and Surplus
As of December 31, 2016

		Notes
Losses	$ -	3
Loss adjustment expenses	-	3
Other expenses	240,200	
Current federal income taxes	307,233	
Net deferred tax liability	752,134	
Ceded reinsurance premiums payable	319,869	
Funds held by company under reinsurance treaties	23,829,249	4
Payable to parent, subsidiaries and affiliates	98,405	
Total liabilities	$ 25,547,090	
Common capital stock	$ 1,000,000	
Gross paid in and contributed surplus	44,274,388	
Unassigned funds (surplus)	2,512,888	
Total capital and surplus	$ 47,787,276	
Total liabilities, capital and surplus	$ 73,334,366	

Statement of Income
For the Year Ended December 31, 2016

UNDERWRITING INCOME	
Premiums earned	$ -
Losses incurred	$ -
Loss adjustment expenses incurred	-
Other underwriting expenses incurred	565,529
Total underwriting deductions	$ 565,529
Net underwriting gain (loss)	$ (565,529)
INVESTMENT INCOME	
Net investment income	$ 1,299,148
Net realized capital gains (losses)	234,090
Total net investment gain (loss)	$ 1,533,238
Net gain from operations before federal income tax	$ 967,709
Federal and foreign income taxes incurred (benefit)	217,339
Net income (loss)	$ 750,370

Reconciliation of Capital and Surplus
for the Period from the Prior Examination
October 18, 2013 to December 31, 2016

(In Thousands)

		Common Capital Stock	Gross Paid-in & Contributed Surplus	Unassigned Funds Surplus	Total
Balance at October 18, 2013		$ 1,000	$ 19,000	$ -	$ 20,000
2013 Net income (loss)		-	-	64	64
2013 Changes in capital & surplus - other	(2)	-	-	600	600
Balance at December 31, 2013		$ 1,000	$ 19,000	$ 664	$ 20,664
2014 Net income (loss)		-	-	476	476
2014 Changes in capital & surplus - other	(2)	-	-	1,421	1,421
Balance at December 31, 2014		$ 1,000	$ 19,000	$ 2,561	$ 22,561
2015 Net income (loss)		-	-	186	186
2015 Changes in capital stock paid-in surplus	(1)	-	25,274	-	25,274
2015 Changes in capital & surplus - other	(2)	-	-	(3,261)	(3,261)
Balance at December 31, 2015		$ 1,000	$ 44,274	$ (514)	$ 44,760
2016 Net income (loss)		-	-	750	750
2016 Changes in capital & surplus - other	(2)	-	-	2,277	2,277
Balance at December 31, 2016		$ 1,000	$ 44,274	$ 2,513	$ 47,787

(1): On April 30, 2015, the Company received additional paid in capital of $22.5 million from KHI. The contribution was paid with $12 million cash and transfer of securities with a cost basis of $13.2 million and fair value of $10.5 million.
(2): Changes in capital & surplus - other for each year may include: change in net unrealized capital gain/loss, change in net deferred income tax, and changes in non-admitted assets.

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE EXAMINATION

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

COMMENTS ON FINANCIAL STATEMENT ITEMS

Note 1:
Schedule D – Part 1 - Bonds **$ 33,612,169**

As of December 31, 2016, the Company reported total bond investments on Schedule D – Part 1 with book adjusted carrying values in the amount of $33.6 million, which was $513 thousand less than the total fair market value of $34.1 million. As of December 31, 2016, bonds were comprised of the following classes:

Schedule D - Bonds:	Book Value	% of Book Value	Fair Value
Industrial and Miscellaneous - Issuer Obligations	$ 32,632,257	97.1%	$ 33,130,933
U.S. Government Bonds - Issuer Obligations	979,912	2.9%	994,570
Total Bonds	$ 33,612,169	100.0%	$ 34,125,503

Of the Company's total bond holdings, $20.7 million or 61.6% were categorized as Class 1 with respect to NAIC credit quality standards. NAIC Class 2 bonds totaled $12.4 million and represented 36.9% of total bonds. NAIC Class 3 bonds totaled $490 thousand and 1.5% of total bonds. Of the total bond holdings, 100% were publicly traded securities. As of December 31, 2016, bond maturities were structured with 23.3% and 76.7% maturing in one to five years and five to ten years, respectively.

Note 2:
Schedule D – Part 2 – Section 2 – Common Stock **$ 31,073,634**

As of December 31, 2016, the Company reported total unaffiliated common stock investments on Schedule D – Part 2 – Section 2 with book/fair market values in the amount of $31.1 million and actual cost of $28.0 million. As of December 31, 2016, total common stock holdings represented 42.9% and 42.4% of the Company's reported total invested assets and total admitted assets, respectively.

Note: 3

Net Losses	**$0**
Net Loss Adjustment Expense ("LAE")	**0**

As of December 31, 2016, the Company reported carried gross and net loss and LAE by reserve segment as follows:

(In Thousands)

Reserve Segment		Gross Loss and LAE	% of Total Gross Loss & LAE	Net Loss and LAE
Venture	(1)	$ 18,376	79.7%	$ -
FRS	(2)	3,245	14.1%	-
Other		1,442	6.3%	-
Total Loss and LAE		$ 23,063	100%	$ -

(1) The Venture reserve segment is produced by Venture Underwriters, Inc. under the Commercial General Liability program. The program consists of primary and excess limits policies for other liability. The Group began participating in the program with KIC on October 1, 2012. The Company began writing the program in 2014.

(2) The FRS reserve segment is business produced by Franchise Risk Solutions, Inc. under the Quick Serve Restaurants program. The program insures franchised fast food restaurants (i.e. quick service and casual dining restaurants) utilizing a business owners policy.

INS Consultants, Inc. ("Consulting Actuary") assisted in the review of the inherent risks, management oversight and other mitigating controls over the Company's actuarial processes and procedures. The Consulting Actuary's review included detail testing and an independent calculation of the Company's gross and net loss and loss adjustment expense reserves as of December 31, 2016.

Note 4:

Funds held by the Company under reinsurance treaties	**$ 23,829,249**

As of December 31, 2016, all the reported funds held by the Company in the amount of $23.8 million was related to collateral held under reinsurance treaties with the Company's affiliated unauthorized reinsurer, KIC. The collateral held consists primarily of publicly traded

common stock and bond securities. The examination reviewed the reported funds held balances including review of the inherent risks, management oversight and other mitigating controls over the management of reinsurance collateral.

SUBSEQUENT EVENTS

There were no significant events subsequent to the examination date of December 31, 2016.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The Company complied with prior examination findings or recommendations in all material respects.

SUMMARY OF RECOMMENDATIONS

There were no examination findings or recommendations as a result of the examination.

CONCLUSION

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. and consulting information technology firm, INS Services, Inc. is acknowledged. In addition, the assistance and cooperation of the Company's external audit firm, Ernst & Young LLP, and the Company's management and staff is appreciated and acknowledged.

Respectfully submitted,

Richard E. Palmatary, CPA, CFE
Examiner-In-Charge
Delaware Department of Insurance

James Call, CFE
Supervisory Examiner
Delaware Department of Insurance