PROPERTY & CASUALTY CASE STUDY

Red Rock Insurance Company ("Red Rock" or "the Company") formerly BancInsure, Inc.

March 13, 2014: Status—Hazardous Financial Condition
August 21, 2014: Status—Liquidation

Root Causes of Insolvency

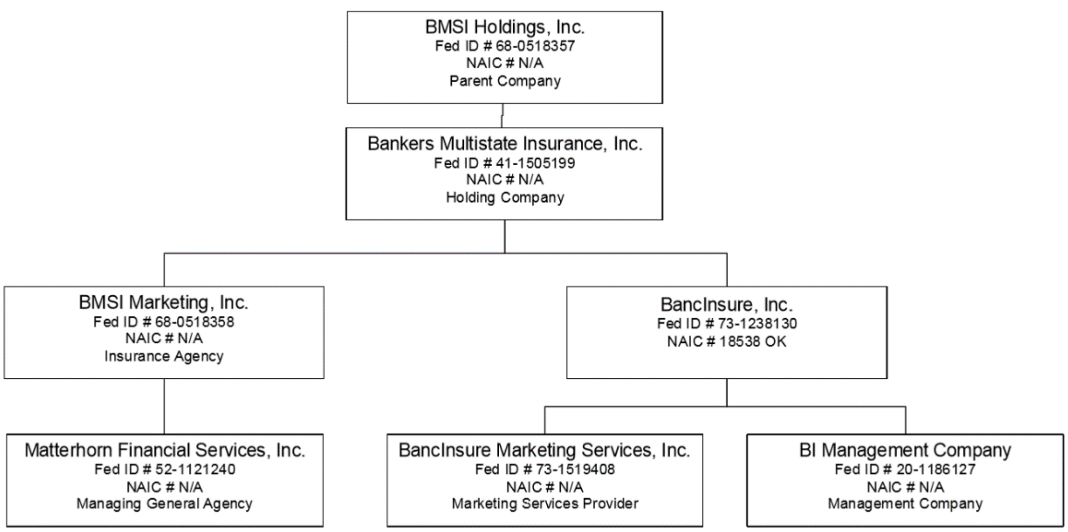
- Poor underwriting results related to workers' compensation (WC) and professional liability
- Limited diversification—niche business model catering to community banks and financial institutions
- Economic downturn and resulting bank failures of 2008–2011, resulting in poor investment results and underwriting losses related to professional liability coverage
- Capital investment intended to allow Company to recover from financial distress ultimately non-admitted
- Significant growth in workers compensation business

Section I—Background

Company Summary

Incorporated in 1985, BancInsure, Inc. ("BancInsure" or "the Company") was a multi-line property and casualty insurance carrier domiciled in Oklahoma and licensed to write in 49 states. The Company was a wholly owned subsidiary of Bankers Multistate Insurance, Inc. (figure 1). BancInsure was initially formed to address the lack of affordable insurance coverage available to the banking industry, namely directors' and officers' (D&O) coverage and fidelity bonds. While under the BancInsure name, the Company provided a variety of insurance products to community banks and financial institutions nationwide.

Figure 1
RED ROCK (BANCINSURE) ORGANIZATIONAL CHART

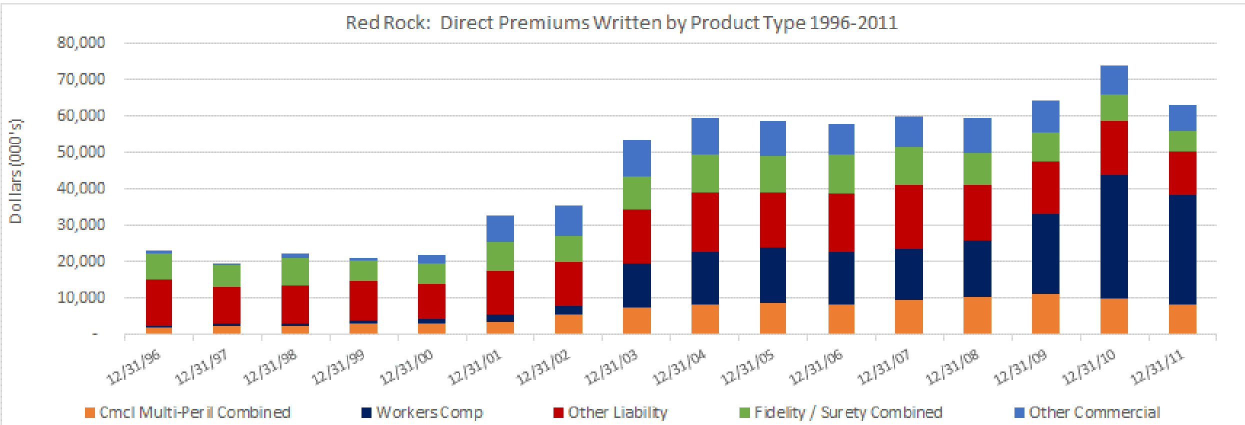


The insurance products offered by BancInsure included financial institution bonds, D&O liability, workers' compensation (WC), and other property and casualty coverages. Prior to 2011, BancInsure wrote annual premiums ranging between $47 and $76 million within this niche industry segment. Premium growth was significant between 2000 and 2004 and then stabilized after 2004. In its last few years of operations, BancInsure's largest line of business was WC (figure 2). Relative to the overall property and casualty industry, BancInsure's market share was small, though for certain states and lines of business, such as Oklahoma WC, the Company was a significant writer during its peak years.

BancInsure's largest state, based on 2010 direct premium, was Oklahoma, followed by Texas and Nebraska. BancInsure's geographical mix of business was well-diversified (figure 3).

Figure 2

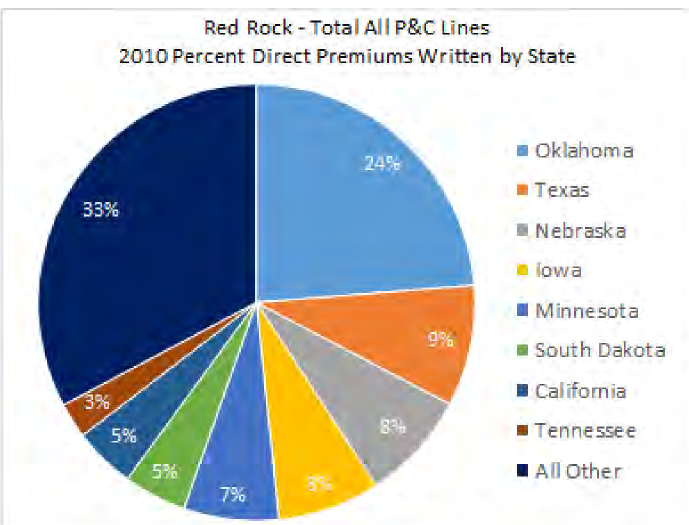
RED ROCK (BANCINSURE) HISTORICAL PREMIUM AND PRODUCT MIX



Note: "Cmcl Multi-Peril Combined" in chart above refers to Commercial Multi-Peril Casualty and Property

Figure 3

RED ROCK (BANCINSURE) 2010 PREMIUM MIX BY STATE



Beginning in 2003, BancInsure began increasing its WC premium volume and likewise loss reserves. WC reserve increases were relatively consistent with premium growth until 2010, when the loss ratio deteriorated and reserves spiked (figure 4).

Figure 4

RED ROCK (BANCINSURE) HISTORICAL RESERVES

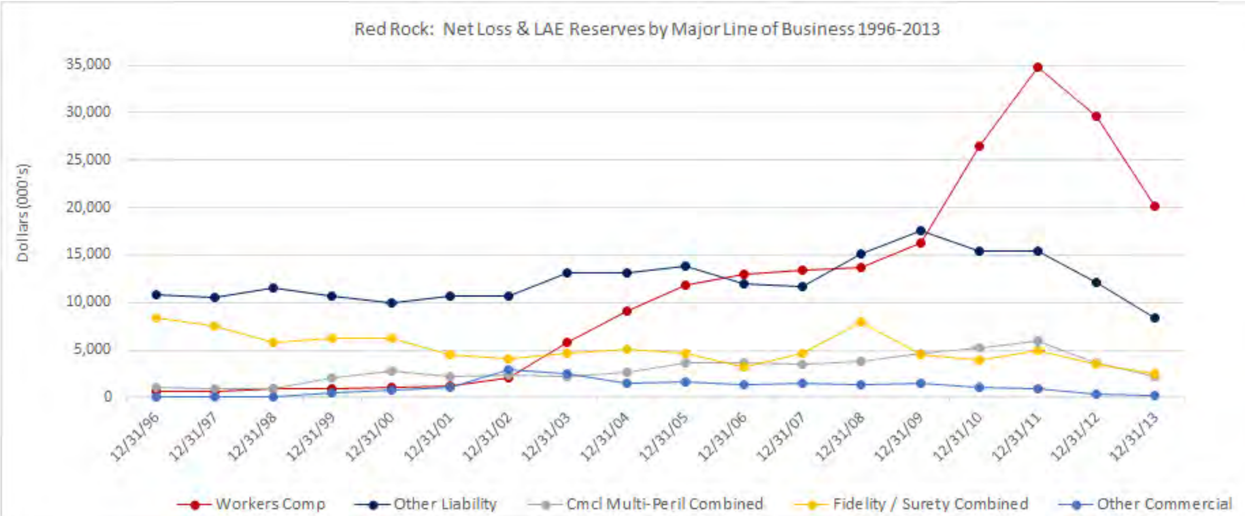
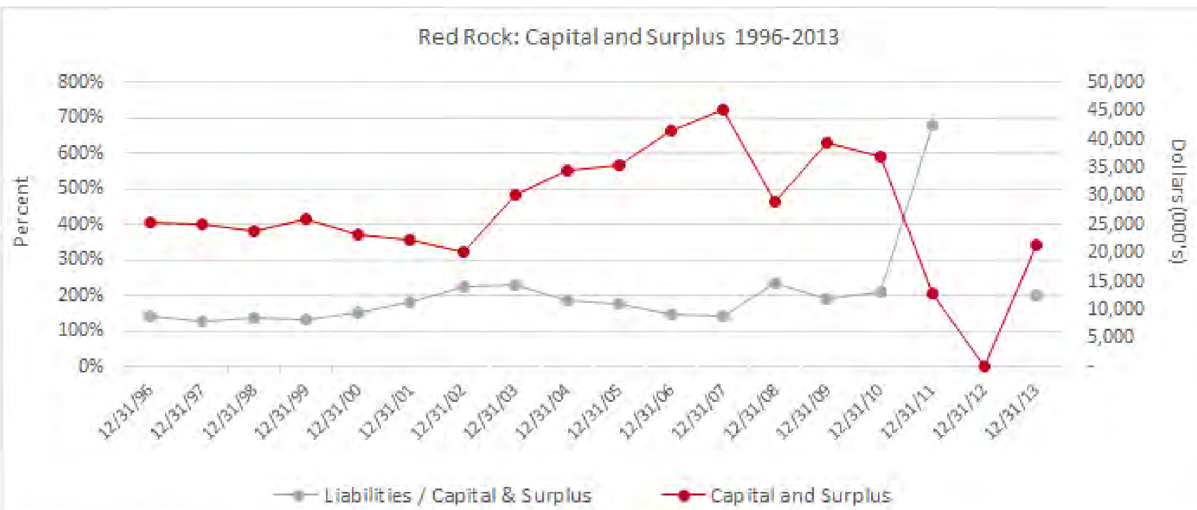


Figure 5

RED ROCK (BANCINSURE) HISTORICAL CAPITAL AND SURPLUS



2008 marked the Company's initial impact on capital and surplus from the financial market downturn and recession. According to a report by the United States Government Accountability Office, "during the time between 2008 and 2011—a period of economic downturn in the United States—414 insured U.S. banks failed. Of these, 85 percent were considered small banks." BancInsure's financial performance and surplus deteriorated during this period as a result of investment losses as well as underwriting losses related to the professional liability coverage provided to banks.

In 2009, the Company received a $7.5 million capital contribution. In 2010, surplus declined by $2.2 million due to continued financial institution claims, a property catastrophe loss, and deteriorating workers' compensation loss ratios.

Figure 6

US GOVERNMENT ACCOUNTABILITY REPORT – NUMBER OF BANK FAILURES 2008-2011

Source: GAO analysis of FDIC data; Map Resources (map).

A message addressing financial concerns was issued by BancInsure's chairman and CEO during 2009: "There is no denying that 2008 witnessed a perfect storm in the financial services sector that devastated banks and insurance carriers. BancInsure was not spared by the crisis, incurring a Net Loss of ($7.179M), down from 2007 Profits of $3.089M. Statutory Capital and Surplus declined by 35.8% in 2008 to $29 million."

In 2008, the Company implemented the following actions, according to the same statement from their chairman and CEO:

- Creation of Chief Underwriting Officer
- New Director of Professional Lines Underwriting
- Review of entire book of professional lines business with focus on quality and profitability

By year-end 2010, BancInsure's financial statements continued to highlight a positive outlook of diversification efforts and sustained profitability. However, BancInsure's surplus decreased significantly, from $37M to $13M, over the course of 2011. This 66 percent reduction in surplus reflected in part an 18 percent increase in Loss and LAE Reserves. A historical view of some of the Company's key operating figures from 2007 thought 2013 shows a clear variance in financial health between 2010 and 2011.

Period Ended, ($000's)	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**	**12/31/13**
Total Loss and LAE Reserves	36,738	43,251	45,813	52,862	62,455	50,040	33,712
Capital and Surplus	45,090	28,961	39,338	37,104	12,796	223	21,507
Net Premiums Written	47,384	46,481	50,674	60,592	50,147	(7,040)	(3,731)
Combined Ratio	101.47	128.95	118.21	119.19	146.72	NM	NM
Risk Based Capital Ratio	706.75	381.16	527.04	467.08	150.13	4.57	333.93
Reserves / C&S	81%	149%	116%	142%	488%	22486%	157%

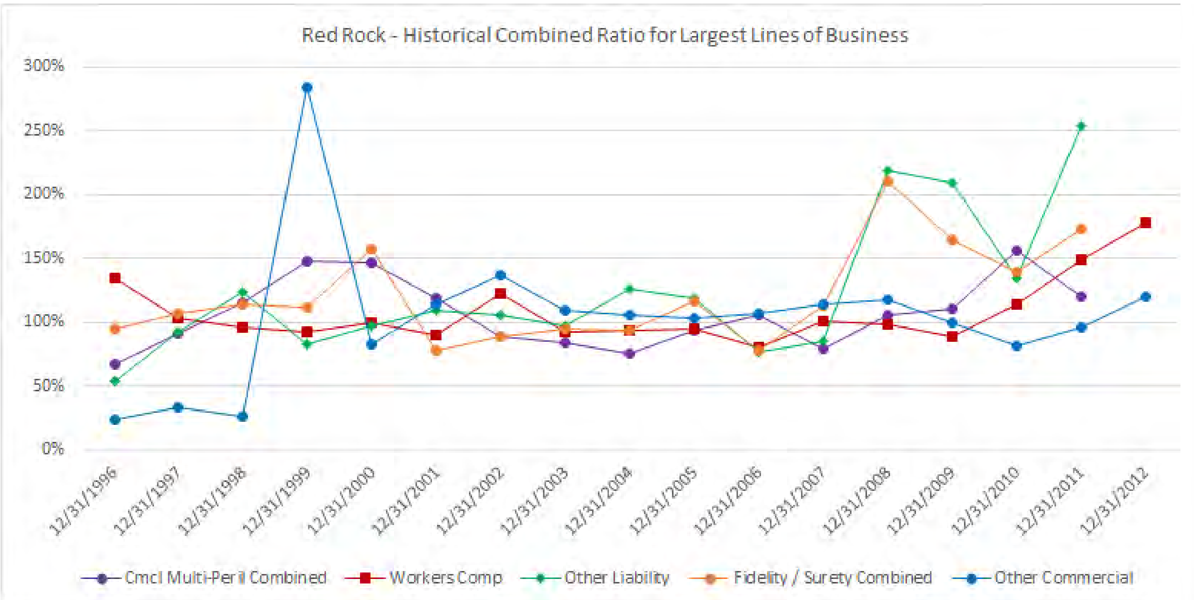
Note: "C&S" in the table above refers to Capital and Surplus

The Company experienced approximately $15M of adverse loss development on prior accident years during 2011, nearly half of which was attributable to WC. Professional liability lines of business also experienced adverse development. In addition, the Company's underwriting expense ratio was in excess of 40 percent, higher than industry norms. When coupled with its recorded accident year 2011 net loss and loss adjustment expense ratio of 78.5 percent as of December 31, 2011, this made current year business unprofitable as well. Finally, the Company wrote off its net deferred tax asset as of December 31, 2011 as a result of its re-evaluation of potential future net income. This caused an approximate $4M reduction in statutory surplus between year-end 2010 and 2011.

A review of BancInsure's historical combined ratios shows increasingly poor results after 2007, with ratios far exceeding 100 percent (figure 7).

Figure 7

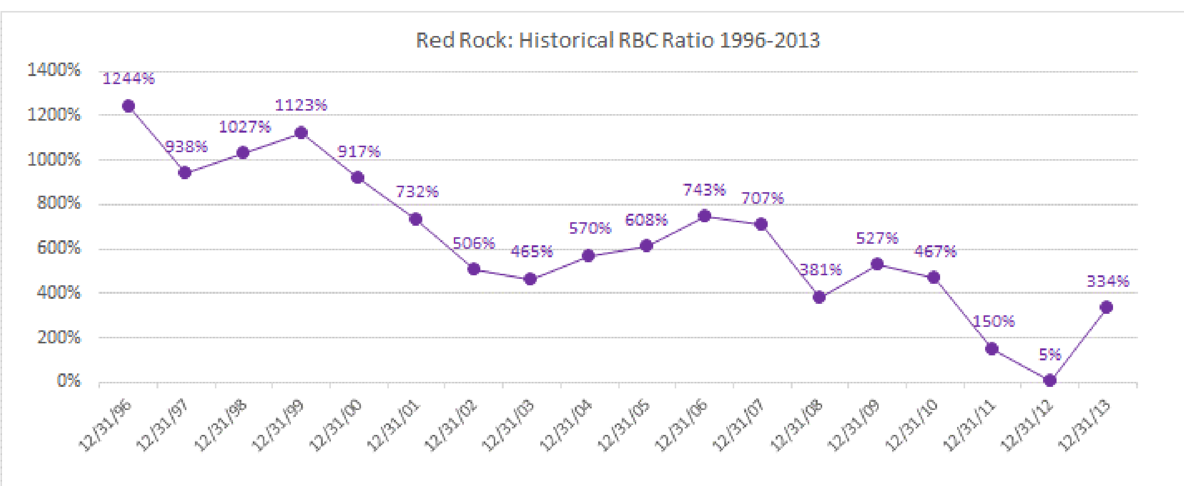
RED ROCK (BANCINSURE) HISTORICAL COMBINED RATIO



BancInsure's risk-based capital (RBC) ratio was healthy in the 1990s, and then began to decrease slowly until year-end 2003, when it began to recover to a high of 743 percent by year-end 2006. After 2006, there were fluctuations in RBC ratio, though the general trend was downward. By year-end 2011, with an RBC ratio of 150 percent the company was required to file a capital plan with the Oklahoma Insurance Department.

Figure 8

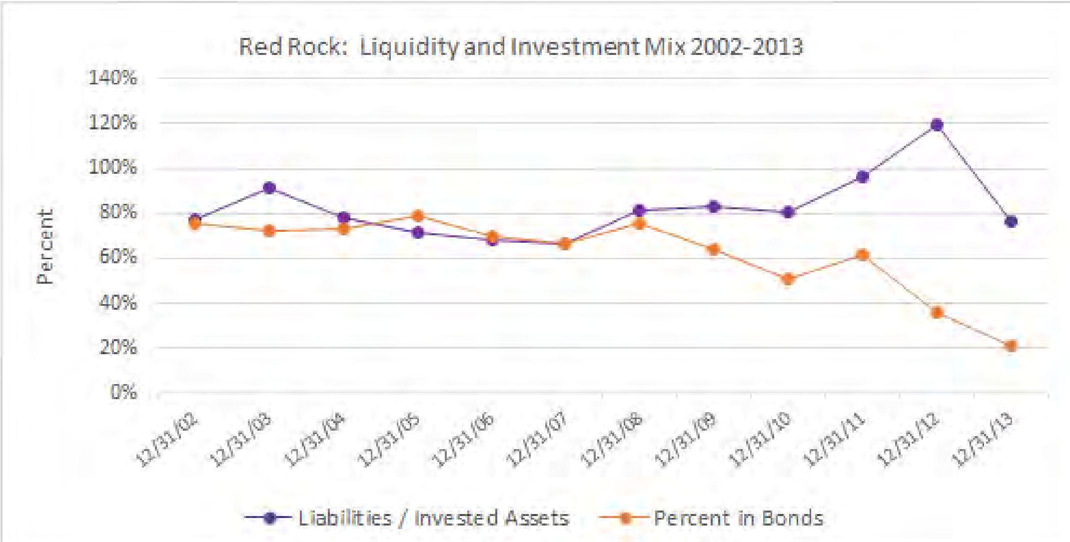
RED ROCK (BANCINSURE) HISTORICAL RBC RATIO



From an invested asset standpoint, the Company's percent investment in bonds began to decrease after 2007 (figure 9). Further, consistent with the aforementioned deterioration in surplus, the ratio of liabilities to assets began to spike in 2011.

Figure 9

RED ROCK (BANCINSURE) HISTORICAL RESERVE LEVERAGE AND INVESTMENT MIX



According to the Company's 2011 management discussion and analysis (MD&A), results of operations were noted as follows:

"During 2011, BancInsure experienced worsening in certain lines of business focused on financial institutions and experienced significant worsening in one workers' compensation program. These factors coupled with the weather-related catastrophe losses led to the net losses that worsened as the year progressed and culminated with the unexpected actuarial results as of December that resulted in large IBNR increases. Exacerbating the worsening loss ratio was the shrinking premium volume due to the lower A. M. Best rating. The Company experienced the worst case scenario which meant the company would be challenged to find profits in the future years."

Also from the 2011 MD&A:

"As a result, BancInsure's Board of Directors and management endeavored to divest of market share in search of gains and a new insurance carrier for the Company's valued customers."

Company Ratings-

The Company's history of rating by agency is shown below:

Figure 10

RED ROCK (BANCINSURE) RATING AGENCY HISTORY (SNL FINANCIAL)

Credit Ratings Details

	S&P	Fitch Ratings	AM Best	Demotech
Financial Strength	Remove *9/30/2003*	Remove *3/23/2009*	F Downgrade *11/16/2016*	Remove *8/2/2014*
	BBB (WR) *9/8/2003*	BBBq Affirm *7/31/2008*	E *1/14/2015*	A Initiate *6/30/2014*
	BBB (WN) *7/15/2003*	BBBq Affirm *7/19/2007*	Remove *3/22/2012*	-
	BBB (WR) Downgrade *1/15/2003*	BBBq Affirm *8/15/2006*	B (ON) Downgrade *1/13/2012*	-
	A- (WN) *11/8/2002*	BBBq SNL Start	B++ (ON) Downgrade *8/2/2011*	-
	A- Downgrade *11/21/2001*	-	A- (ON) Affirm *5/14/2010*	-

Ratings Watch Action Legend: (WP) Watch Positive, (WN) Watch Negative, (WU) Watch Uncertain, (WR) Watch Removed, (OP) Outlook Positive, (ON) Outlook Negative, (OS) Outlook Stable, (OD) Outlook Developing.

While most of its business was dependent upon an A- rating or better, the 2011 downgrade by A. M. Best, along with the unfavorable experience, initiated divestiture of segments of its business to other insurers. On February 14, 2012, AmTrust Financial Services, Inc. purchased the renewal rights to BancInsure's in-force insurance policies.

BancInsure became subject to administrative proceedings by the Oklahoma Insurance Department in 2012 when the department concluded that the Company was in a hazardous financial condition as defined by law. The formal order was served January 11, 2013.

The proceedings were put on hold in late 2012 when Foster Jennings, Inc. (a NY-based financial services holding company) offered to acquire BancInsure from BMSI Holdings Inc. Foster Jennings' purchase price of $1 was coupled with a promise to make a significant capital investment.

The purchase came with the announcement that the newly named Red Rock Insurance Company would re-enter the insurance marketplace with a new business strategy focusing on non-financial customers.

The Oklahoma Insurance Department continued involvement and oversight after the conditional purchase agreement with Foster Jennings.

Subsequent to the capital infusion, the assets were determined to be unacceptable by the Oklahoma Insurance Department. According to Oklahoma Insurance Commissioner John Doak, "After several failed attempts to satisfy the insurance department's capital requirements, a formal determination was made that the company was in hazardous financial condition." The Oklahoma Insurance Department "imposed supervision and ultimately filed for and obtained an order of receivership and liquidation."

Section II—Phase I Comparison

Based on the data available prior to insolvency, we summarized Red Rock's risk profile and compared it to the analysis performed in Phase I. The following charts include a percentile distribution from the insolvent and WC industry samples as well as the risk thresholds ("TH") determined in Phase 1 and the Company data point. Low, medium, and high risk thresholds are denoted by the dotted line. The legend further indicates directional order.

Figure 11

RED ROCK (BANCINSURE) RISK PROFILE AND PHASE I COMPARISON

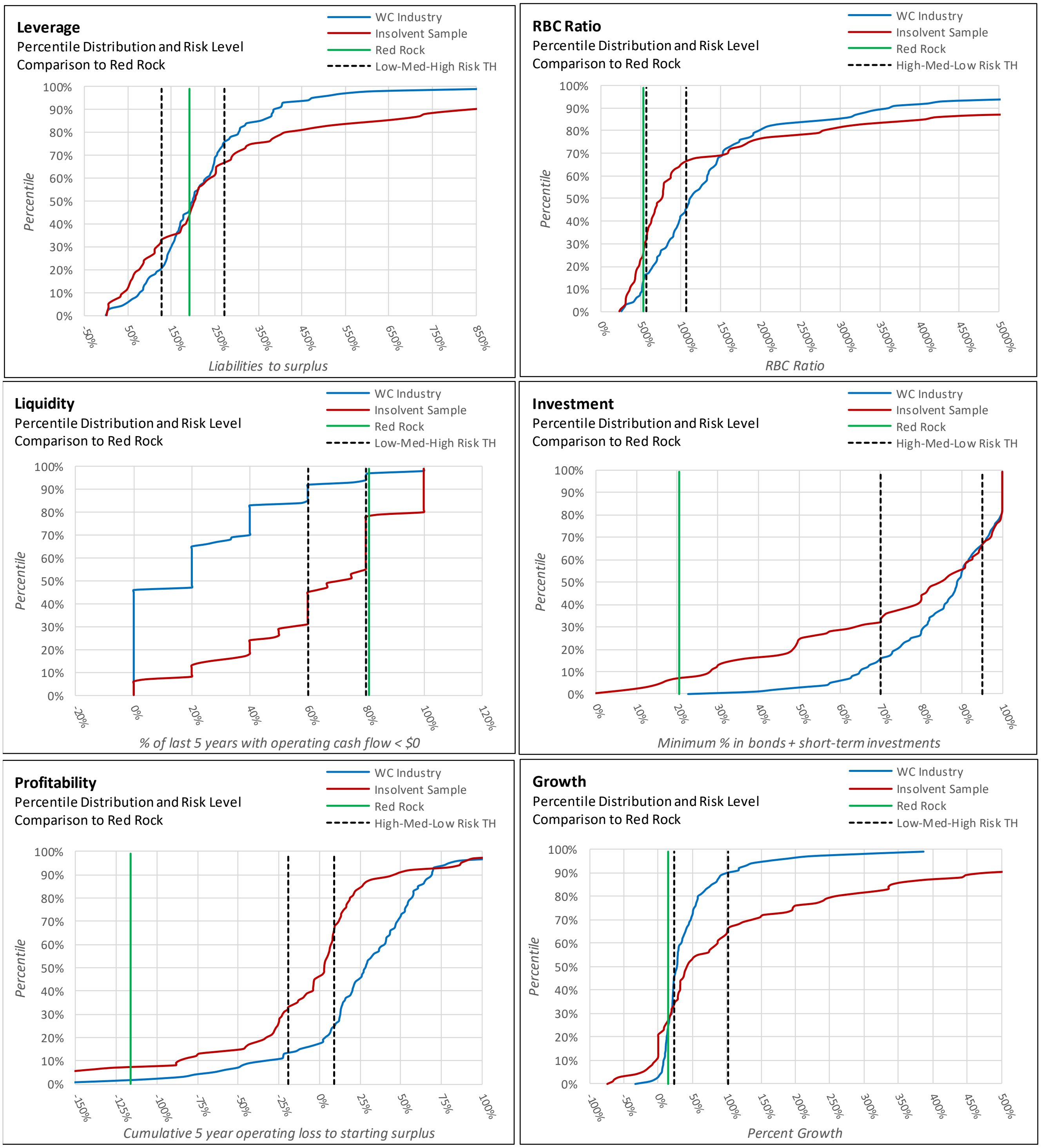
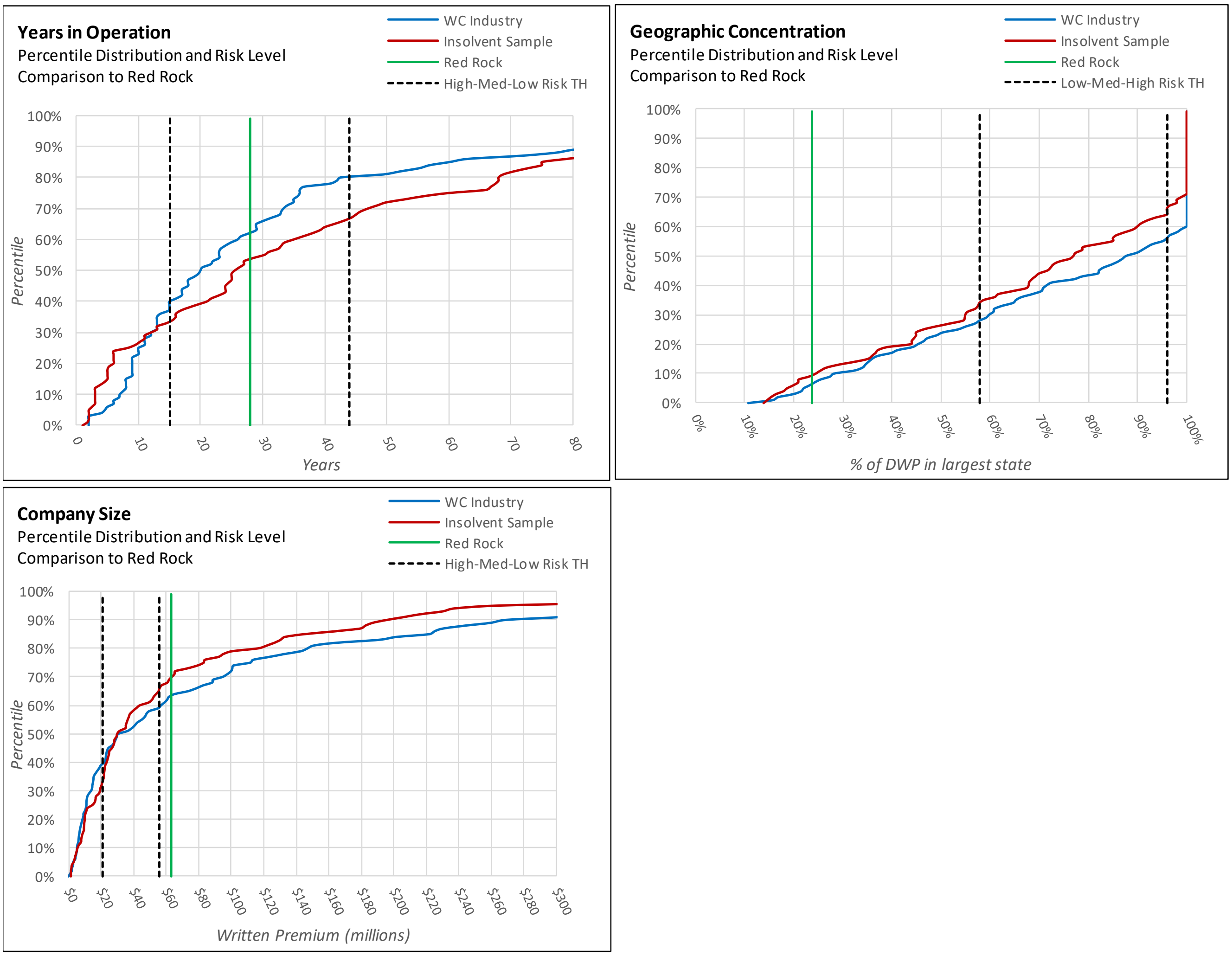


Figure 11 (cont.)



The following is a summary of observations related to figure 13:

- Overall, from the results of the Phase 1 research, the most indicative risk factors for the WC cohort appeared to be Premium Growth, Profitability, Liquidity, Investment, and Leverage.
- When compared to the insolvent sample and the industry sample (WC cohort) in the charts above, Red Rock ranked within a higher risk threshold for all financial risk factors except premium growth and leverage.
- Red Rock showed very high risk in profitability, liquidity, and investment, falling above the 90th percentile in each shows high risk indications for the Profitability, Investment, and RBC risk factors. This may suggest that these three factors were leading indicators prior Red Rock's insolvency.
- Red Rock also ranked on the cusp of medium-to-high in liquidity risk. For liquidity, there is a greater disparity between the industry and insolvent sample. While Red Rock is higher than the industry, it fell in line with the insolvent sample. This suggests that indicators of liquidity risk may have been less of a leading indicator for Red Rock's insolvency.
- The Company's diverse geographic concentration puts it in a low-risk percentile for this factor. However, the diverse state mix is likely superseded by its narrow niche market.
- With relatively moderate premium growth, Red Rock falls in the low- (close-to-medium) range for this factor. However, many years prior to the Company's insolvency (beginning in 2003), the Company significantly increased its WC premium volume, moving away from its previous focus areas of D&O and

fidelity coverage. While the growth factor alone was not indicative of high risk, the line of business (WC) which drove the growth may have greater implications given its long-tailed nature.

Section III—Analysis of Key Findings

Some of the key observations from the Red Rock insolvency are as follows:

a) **WC Premium Growth —**Premium growth, specifically within WC, may have contributed to the downward course of events that led to Red Rock's insolvency. Red Rock noted in its filings that unexpected WC losses could be attributed to individual programs.

b) **MGA's/Program Managers -** Underwriting business through unaffiliated program managers can create significant risks, as was the case for this company.

c) **Ongoing Profitability and Liquidity Concerns**—The Company was unprofitable every year from 2008 to 2012. Cash flow was negative in 2008, 2009, 2011, and 2012.

   Various concerns were highlighted by the Appointed Actuary in the Risk of Material Adverse Deviation section of the 2010 and 2011 Statements of Actuarial Opinion (SAO).

   Risk factors noted in the 2010 SAO included: (1) the exposure to large, fortuitous losses within its policy limits; (2) the sensitivity of the Company's results to general economic conditions. The 2011 SAO included (1) above, as well as (2) the recent expansion in the workers' compensation line; (3) the sensitivity of the Company's results to general economic conditions; (4) changes in claims handling; (5) the Company's ceded reserves-to-surplus ratio; and (6) the relative position of the carried reserves. Also noted in the 2011 SAO, a reduction to the Company's capital by the materiality standard selected in the SAO would shift the Company's risk-based capital position from "Company Action Level" to "Regulatory Action Level."

   The 2011 SAO included additional detail on each of the risk factors noted above. The extent of detail provided is a potential signal of the magnitude of difficulties faced by the Company. Regulators and actuaries may wish to consider whether actuarial standards should encourage such an approach for companies that could be in a financially hazardous condition, whether or not this is evident from the financial statement. If the Appointed Actuary determines that loss reserves are potentially understated by a material amount, even if that amount is reasonable, such disclosures could assist regulators in identifying companies at risk earlier than they otherwise might from the financial statements alone.