

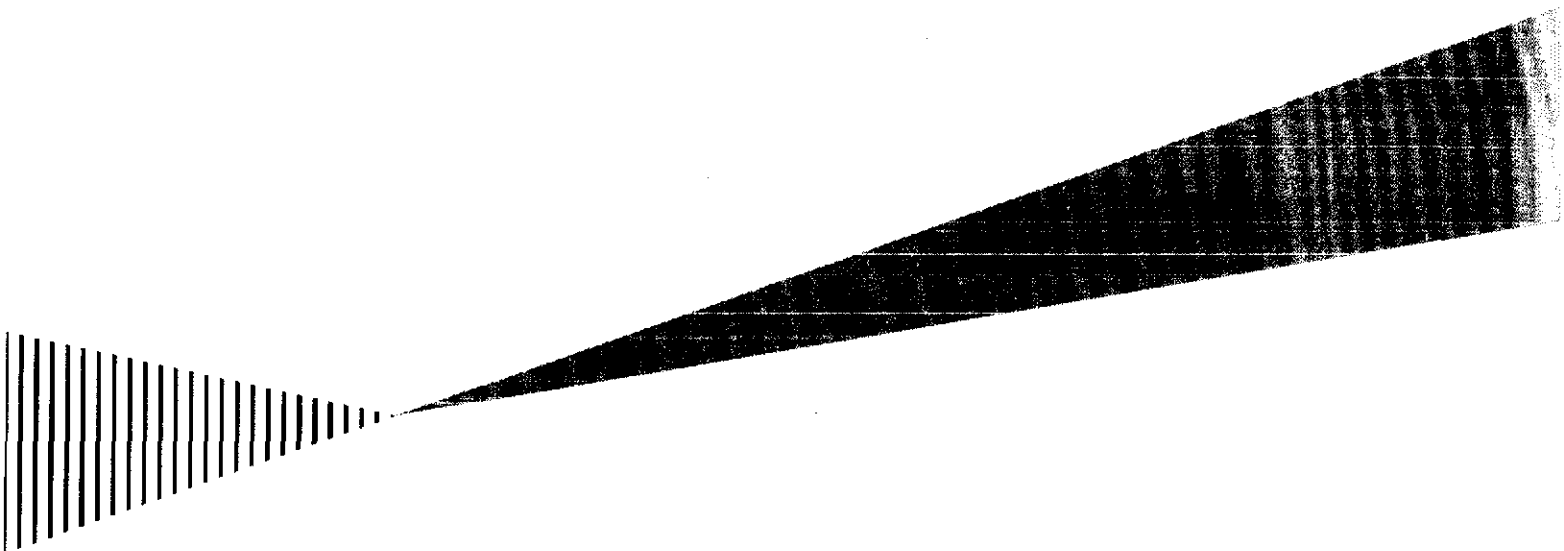


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STATUTORY-BASIS FINANCIAL STATEMENTS

Virginia Surety Company, Inc.
Years Ended December 31, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

Virginia Surety Company, Inc.
Statutory-Basis Financial Statements
Years Ended December 31, 2015 and 2014

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Report of Independent Auditors

The Board of Directors
Virginia Surety Company, Inc.

We have audited the accompanying statutory-basis financial statements of Virginia Surety Company, Inc., which comprise the balance sheets as of December 31, 2015 and 2014, and the related statements of income, changes in capital and surplus, and cash flow for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with accounting practices prescribed or permitted by the Illinois Department of Insurance. Management also is responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.



Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 2 to the financial statements, to meet the requirements of the state of Illinois, the financial statements have been prepared in conformity with accounting practices prescribed or permitted by the Illinois Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles are described in Note 2. The effects on the accompanying financial statements of these variances are not reasonably determinable but are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the effects of the matter described in the preceding paragraph, the statutory-basis financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of Virginia Surety Company, Inc. at December 31, 2015 and 2014, or the results of its operations or its cash flows for the years then ended.

Opinion on Statutory-Basis of Accounting

However, in our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the financial position of Virginia Surety Company, Inc. at December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended, in conformity with accounting practices prescribed or permitted by the Illinois Department of Insurance.

Ernst & Young LLP

May 26, 2016

Virginia Surety Company, Inc.

Balance Sheets – Statutory Basis
(Dollars in Thousands, Except Shares and Per Share Data)

	December 31	
	2015	2014
Admitted assets		
Cash and invested assets:		
Bonds	\$ 960,141	\$ 816,395
Common stocks – unaffiliated	1,605	2,566
Common stocks – affiliated	14,985	15,814
Short-term investments	37,418	35,159
Cash and cash equivalents	44,507	56,181
Receivables for securities	36	5
Total cash and invested assets	<u>1,058,692</u>	<u>926,120</u>
Agents’ balances and uncollected premiums	6,548	16,069
Receivable from parent, subsidiaries, and affiliates	3,529	4,565
Reinsurance balances recoverable	29,074	23,922
Accrued investment income	8,034	7,369
Net deferred tax asset	36,784	34,765
Funds advanced for payment of claims	331	6,446
Property, plant, and equipment	1,067	722
Other admitted assets	2,978	2,695
 Total admitted assets	 <u><u>\$ 1,147,037</u></u>	 <u><u>\$ 1,022,673</u></u>

	December 31	
	2015	2014
Liabilities and capital and surplus		
Liabilities:		
Reserves:		
Unearned premium	\$ 530,860	\$ 507,791
Losses and loss adjustment expense	56,409	73,331
Total reserves	587,269	581,122
Funds held and amounts payable to reinsurers	181,235	134,294
Amounts withheld or retained by the Company for account of others	24,592	21,566
Remittances not allocated	2,359	2,575
Provision for reinsurance	802	1,750
Payable to parent, subsidiaries, and affiliates	3,444	4,833
Other liabilities	16,557	17,037
Loss portfolio transfer	(32,857)	(41,293)
Total liabilities	783,401	721,884
Capital and surplus:		
Common stock, par value \$1 per share; authorized, issued, and outstanding -5,000,000 shares	5,000	5,000
Additional paid-in capital	180,895	145,895
Special surplus funds - retroactive reinsurance	32,857	41,293
Unassigned surplus	144,884	108,601
Total capital and surplus	363,636	300,789
Total liabilities and capital and surplus	\$ 1,147,037	\$ 1,022,673

See accompanying notes

For and on behalf of the board of directors, who authorized the issue of this financial report on the date of the signing

Director

Date

Director

Date

Virginia Surety Company, Inc.

Statements of Income – Statutory Basis
(Dollars in Thousands)

	Year Ended December 31	
	2015	2014
Premiums earned	\$ 266,922	\$ 301,294
Losses and loss adjustment expenses incurred	167,288	192,864
Commission expenses	31,796	28,755
Other underwriting expenses	49,240	39,914
Underwriting profit	18,598	39,761
Net investment income	33,030	32,747
Net realized investment gains (net of tax)	8,055	606
Loss portfolio transfer – reinsurance ceded	144	4,263
Retroactive reinsurance ceded	3	(124)
Income before income taxes	59,830	77,253
Income taxes	15,322	26,815
Net income	\$ 44,508	\$ 50,438

See accompanying notes.

Virginia Surety Company, Inc.

Statements of Changes in Capital and Surplus – Statutory Basis
(Dollars in Thousands)

	Common Stock	Additional Paid-In Capital	Special Surplus Fund	Unassigned Surplus	Total Capital and Surplus
Balance at January 1, 2014	\$ 5,000	\$ 145,895	\$ 54,635	\$ 103,683	\$ 309,213
Net income	–	–	4,263	46,175	50,438
Changes in:					
Net unrealized capital gain, net of tax	–	–	–	(2,873)	(2,873)
Provision for reinsurance	–	–	–	(1,146)	(1,146)
Cumulative translation adjustment account, net of tax	–	–	–	(10,108)	(10,108)
Net deferred tax assets	–	–	–	3,214	3,214
Non-admitted assets	–	–	–	(7,949)	(7,949)
Transfer to unassigned surplus – paid losses recovered in excess of total consideration paid on retroactive reinsurance transactions	–	–	(17,605)	17,605	–
Dividend to parent	–	–	–	(40,000)	(40,000)
Balance at December 31, 2014	5,000	145,895	41,293	108,601	300,789
Net income	–	–	144	44,364	44,508
Changes in:					
Net unrealized capital gain, net of tax	–	–	–	(3,869)	(3,869)
Provision for reinsurance	–	–	–	948	948
Cumulative translation adjustment account, net of tax	–	–	–	(15,256)	(15,256)
Net deferred tax assets	–	–	–	(1,068)	(1,068)
Non-admitted assets	–	–	–	2,584	2,584
Transfer to unassigned surplus – paid losses recovered in excess of total consideration paid on retroactive reinsurance transactions	–	–	(8,580)	8,580	–
Capital contribution	–	35,000	–	–	35,000
Balance at December 31, 2015	\$ 5,000	\$ 180,895	\$ 32,857	\$ 144,884	\$ 363,636

See accompanying notes.

Virginia Surety Company, Inc.

Statements of Cash Flow – Statutory Basis
(Dollars in Thousands)

	Year Ended December 31	
	2015	2014
Operating activities		
Premiums collected, net of reinsurance	\$ 347,198	\$ 339,868
Benefits and losses paid	(181,856)	(184,439)
Underwriting expenses paid	(70,609)	(75,167)
Net investment income received	37,677	41,647
Federal income taxes paid	(19,515)	(30,555)
Net cash provided by operating activities	112,895	91,354
Investing activities		
Sale, maturity, or repayment of investments	485,892	215,140
Purchase of investments	(637,227)	(269,300)
Net cash used in investing activities	(151,335)	(54,160)
Financing and miscellaneous activities		
Dividend to parent	–	(40,000)
Capital contribution	35,000	–
Net transfers to affiliates and other activities	(5,975)	(19,599)
Net cash provided by (used in) financing and miscellaneous activities	29,025	(59,599)
Net (decrease) increase in cash, cash equivalents, and short-term investments	(9,415)	(22,405)
Cash, cash equivalents, and short-term investments at beginning of year	91,340	113,745
Cash, cash equivalents, and short-term investments at end of year	\$ 81,925	\$ 91,340

See accompanying notes.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (Dollars in Thousands, Except Shares and Per Share Data)

December 31, 2015

1. Nature of Operations

Virginia Surety Company, Inc. (VSC or the Company) is a property and casualty insurance company domiciled in Illinois. The Company primarily writes contractual liability, mechanical repair, and appliance extended warranty coverages, as well as several other lines of business, throughout the United States and in certain foreign locations. The Company is currently licensed in all 50 states and the District of Columbia in the United States, and in Guam, Puerto Rico, and Canada.

On August 1, 2014, Wolverine Acquisitions, Inc., a corporation formed under the laws of the state of Delaware, acquired all of the outstanding equity of The Warranty Group, Inc., a Delaware corporation, through the merger of its wholly owned subsidiary, Wolverine Merger Sub, Inc., a Delaware corporation, with and into The Warranty Group, Inc., with The Warranty Group, Inc. as the surviving entity. Following the consummation of the merger, Wolverine Acquisitions, Inc., directly owns 100% of the issued and outstanding shares of the capital stock of The Warranty Group, Inc. and thereby indirectly owns 100% of the issued and outstanding shares of the capital stock of Virginia Surety Company, Inc. through its wholly owned subsidiary, TWG Holdings, Inc.

In North America, the majority of the Company's premiums are generated from contractual liability policies issued to affiliated obligor companies in connection with the sale of extended warranty contracts. These contractual liability policies can provide either full reimbursement of claims incurred under the extended warranty contracts or failure-to-perform coverage in the event the affiliated obligor company fails to provide benefits under the extended warranty contract for any reason.

Outside of North America, the Company also has direct and assumed premiums from extended warranty products sold in Korea, Argentina, Australia, New Zealand, and certain other foreign locations.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued) (Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying statutory-basis financial statements of the Company have been prepared in conformity with accounting practices prescribed or permitted by the Illinois Department of Insurance (the Department). Such practices differ from U.S. generally accepted accounting principles (GAAP). The more significant variances from GAAP are as follows:

Investments

Investments in bonds are reported at amortized cost using the scientific method or fair value. For GAAP, such fixed-maturity investments are designated at purchase as either held to maturity, trading, or available for sale. Available-for-sale investments are stated at fair value, with unrealized holding gains and losses reported in accumulated other comprehensive income (loss), net of deferred federal income taxes. Held-to-maturity securities are stated at amortized cost. Trading securities are stated at fair value, with unrealized holding gains and losses reported in the Company's statutory-basis statements of income as part of net realized gains (losses).

The amortized cost of fixed maturities, other than mortgage-backed and asset-backed securities, is adjusted for amortization of premiums and the accretion of discounts on a yield-basis method.

Fair value for statutory purposes is based on prices received either from the National Association of Insurance Commissioners (NAIC) Securities Valuation Office (SVO) or an independent third-party vendor. If fair value pricing is unavailable from these sources, the Company uses either broker-dealers or matrix pricing for reporting and disclosing fair values of investment securities.

All single-class and multi-class mortgage-backed/asset-backed securities, such as collateralized mortgage obligations (CMOs), are adjusted for the effects of changes in prepayment assumptions on the related accretion of the discount or amortization of premium of such securities using the retrospective method. If it is determined that a decline in fair value is other than temporary because the Company intends to sell the security or has

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies (continued)

assessed that it does not have the intent and ability to retain the investments in the security for a period of time sufficient to recover the amortized cost basis, the amortized cost basis is written down to fair value as a realized loss in the statutory-basis statements of income. If deemed to be other-than-temporarily impaired since the Company does not expect to recover the amortized cost basis even if it did not intend to sell the security and the Company has the intent and ability to hold the security, the amortized cost basis is written down to the present value of the future cash flows as a realized loss in the statutory-basis statements of income.

For GAAP purposes, all securities, purchased or retained, that represent beneficial interests in securitized assets, such as CMOs, mortgage-backed securities, and asset-backed securities, other than high-credit-quality securities, are adjusted using the prospective method when there is a change in the estimated future cash flows. If it is determined that a decline in fair value is other than temporary, the cost basis of the security is written down to the fair value. If high-credit-quality securities are adjusted, the retrospective method is used. For impaired fixed-maturity securities that the Company does not intend to sell, or if it is more likely than not that the Company will not have to sell such securities but expects that it will not fully recover the amortized cost basis, the credit component of the other-than-temporary impairment is recognized in other-than-temporary impairment losses and recognized in the statements of comprehensive income with the non-credit component of the other-than-temporary impairment recognized in other comprehensive income. Furthermore, unrealized losses entirely caused by non-credit-related factors related to fixed-maturity securities for which the Company expects to fully recover the amortized cost basis continue to be recognized in other comprehensive income.

Short-term investments include investments with remaining maturities of one year or less at the time of acquisition and are stated at amortized cost or fair value.

Subsidiaries

The accounts and operations of the Company's subsidiaries are not consolidated with the accounts and operations of the Company, as would be required under GAAP.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies (continued)

Policy Acquisition Costs

The costs of acquiring and renewing business are charged to expense when incurred. Under GAAP, certain costs of acquiring warranty business, principally commissions, premium tax, administration, underwriting, and sales expenses that vary with, and are directly related to, the successful acquisition of new business, are deferred and amortized as the related premiums and contract fees are earned.

Non-Admitted Assets

Certain assets designated as non-admitted, principally past-due affiliated receivable balances, past-due agents' balances, uncollected premiums, non-operating software and property and equipment, certain affiliated subsidiary investments, and other assets not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual* of the NAIC, are excluded from the accompanying statutory-basis balance sheets by a direct charge to unassigned surplus. These non-admitted assets totaled \$41,614 and \$44,198 at December 31, 2015 and 2014, respectively. Under GAAP, these amounts are carried as an asset, net of a valuation allowance, if necessary.

Reinsurance

A liability for reinsurance balances has been provided for unsecured unearned premiums and unpaid losses ceded to reinsurers unauthorized by license to assume such business in Illinois and for certain unsecured overdue reinsurance balances. Changes to those amounts are credited or charged directly to unassigned surplus. Under GAAP, an allowance for amounts deemed uncollectible would be established through a charge to income.

Reserves for losses and loss adjustment expenses and unearned premiums ceded to reinsurers have been reported as reductions of the related reserves rather than as assets, as would be required under GAAP.

Commissions allowed by reinsurers on business ceded are reported as income when incurred rather than being deferred and amortized with deferred policy acquisition costs, as required under GAAP. Any excess commission is deferred and recognized over the policy term, consistent with GAAP.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies (continued)

For reinsurance contracts that do not transfer insurance risk, the cash transactions between the ceding and assuming companies are reflected in the statutory-basis balance sheets as a deposit. Other income or loss is recognized when cash is transferred subsequent to the depletion of the deposit or through the elimination of any remaining deposit upon the completion of the contract. The amount of the deposit asset (or liability) is adjusted by calculating the effective yield of the deposit to reflect actual payments to date and any expected future payments, with a corresponding credit or charge to interest income or expense.

Deferred Income Taxes

The Company follows Statement of Statutory Accounting Principles (SSAP) No. 101, *Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10*, which establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes.

Deferred tax assets (DTAs) that are more likely than not expected to be realized are limited to: (1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse within two years of the balance sheet date for items characterized as ordinary in nature, and three years for items characterized as capital in nature; plus (2) the lesser of the remaining gross DTAs expected to be realized within the applicable period, as determined by the *Realization Threshold Limitation Table – RBC Reporting Entities*, or an amount that is no greater than the applicable percentage of statutory capital and surplus, excluding any net DTAs, electronic data processing (EDP) equipment and operating software, and any net positive goodwill; plus (3) the amount of remaining gross DTAs that can be offset against existing gross deferred tax liabilities (DTLs). The remaining DTAs are non-admitted. Under GAAP, the DTAs of the deferred tax assets are recognized to the extent realization of such benefits is more likely than not.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies (continued)

Tax Contingencies

The Company is following the guidance of SSAP No. 101 to account for tax loss contingencies. SSAP No. 101 refers to SSAP No. 5R as the authority for federal and foreign income tax loss contingencies except that when evaluating federal and foreign income tax contingencies, the term “probable,” as used in SSAP No. 5R, is replaced by the term “more likely than not” (a likelihood of more than 50%). Additionally, when evaluating federal and foreign income tax contingencies under SSAP No. 101, a reporting entity must assume it will be examined by the relevant taxing authority that has full knowledge of all relevant information when evaluating a tax loss contingency, and a 100% tax loss contingency must be recorded when the estimated tax loss contingency is greater than 50% of the tax benefits originally recognized. For GAAP, uncertain tax positions taken, or expected to be taken in a tax return, are measured and recognized utilizing the more likely-than-not threshold.

Statements of Cash Flow

Cash and short-term investments in the statutory-basis statements of cash flow represent cash balances and investments with initial maturities of one year or less. If, in the aggregate, the Company has a negative cash balance, it is reported as a negative asset and not as a liability. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with remaining maturities of three months or less when purchased, and negative cash balances are reported as liabilities. The statutory-basis statements of cash flow are presented in a prescribed regulatory format, rather than that required by Accounting Standards Codification Topic 230, *Statement of Cash Flows*.

The effects of the foregoing variances from GAAP on the accompanying statutory-basis financial statements have not been determined, but are presumed to be material.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies (continued)

Other significant accounting practices are as follows:

Investments

Bonds, common stocks, and short-term investments are stated at values prescribed by the NAIC, as follows:

Bonds not backed by other loans are reported at amortized cost using the scientific method or fair value. The cost of bonds is adjusted for amortization of premiums and accretion of discounts using the scientific-amortization method. Bonds rated NAIC 3 or lower are stated at the lower of the amortized cost or fair value. Fair values for statutory purposes are based on prices received from an independent third-party vendor. If fair value pricing is unavailable from this source, the Company uses either broker-dealers or matrix pricing for reporting and disclosing fair values of investment securities. Adjustments to reduce bonds to their fair value are reported as reductions in unassigned surplus, along with any adjustment for federal income taxes.

For asset-backed and mortgage-backed securities, the interest method includes anticipated prepayments. Prepayment assumptions are obtained from broker-dealer survey values, actual history, and expert forecasts. The retrospective-adjustment method is used to value all such securities.

Unaffiliated common stocks are reported at fair value as determined by the SVO, and the related unrealized capital gains and losses are reported in unassigned surplus, along with any adjustment for federal income taxes. Affiliated common stocks of non-insurance companies are reported using the GAAP equity method. Affiliated common stocks of insurance companies are reported using the statutory equity method.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies (continued)

As of December 31, 2015 and 2014, the Company's non-insurance subsidiaries (TWG Home Warranty Services, Inc. and The Warranty Group Colombia S.A.) did not obtain audits under GAAP, and, as a result, undistributed accumulated earnings attributable to the Company's investment in these subsidiaries was non-admitted, in accordance with SSAP No. 97, *Investments in Subsidiary, Controlled, and Affiliated Entities, a Replacement of SSAP No. 88* (SSAP No. 97). The Company's foreign insurance subsidiary (Virginia Surety Compania de Seguros) obtained foreign statutory audits in 2015 and 2014, allowing the Company to admit its investment in this subsidiary at December 31, 2015 and 2014, after making the appropriate adjustments, as defined in SSAP No. 97, paragraph 9.

Short-term investments include investments with remaining maturities of one year or less at the time of acquisition and are principally stated at amortized cost or fair value.

Realized investment gains and losses are determined on the specific-identification basis, and the related unrealized capital gains and losses are reported in unassigned surplus, along with any adjustment for federal income taxes.

Electronic Data Processing Equipment and Software

EDP equipment and software are recorded at cost, less accumulated depreciation. The admitted value of the Company's EDP equipment and operating software is limited to 3% of capital and surplus, excluding any net DTAs, EDP equipment and operating software, and any net positive goodwill. Depreciation on EDP and operating software is computed principally using the straight-line method over the lesser of the useful lives of the assets or three years. Non-operating software is depreciated using the straight-line method over the lesser of its useful life or five years. The net book value related to non-operating software is charged in full to unassigned surplus as a non-admitted asset. Accumulated depreciation at December 31, 2015 and 2014, was \$52,736 and \$47,648, respectively. Depreciation expense in 2015 and 2014 was \$5,096 and \$5,171, respectively.

Furniture and Equipment

Furniture and equipment are capitalized and depreciated on a straight-line basis over their useful lives. Accumulated depreciation at December 31, 2015 and 2014, was \$3,998 and \$3,839, respectively. Depreciation expense in 2015 and 2014 was \$172 and \$279, respectively.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued) *(Dollars in Thousands, Except Shares and Per Share Data)*

2. Summary of Significant Accounting Policies (continued)

Funds Held

The Company holds funds on behalf of unaffiliated companies in conjunction with certain reinsurance arrangements in order to securitize risks transferred as part of these reinsurance transactions. These balances are recorded as liabilities on the Company's statutory-basis balance sheets.

Premium Revenue Recognition

Unearned premium reserves on single-premium insurance related to warranty agreements are calculated to result in premiums being earned over the period at risk. The calculations are based on historical analyses of claim payment patterns over the duration of the policies in force, which, in some circumstances, supports the use of a pro rata method. All other non-warranty premium revenues are determined using a pro rata method.

Losses and Loss Adjustment Expense Reserves

Losses and loss adjustment expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred and unpaid through December 31. The Company does not discount losses and loss adjustment expense reserves. The reserves for unpaid losses and loss adjustment expenses are estimated using individual case-basis valuations and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes the reserves for losses and loss adjustment expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Reinsurance

Reinsurance premiums, commissions, losses, and loss adjustment expenses are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued) *(Dollars in Thousands, Except Shares and Per Share Data)*

2. Summary of Significant Accounting Policies (continued)

At December 31, 2015, the Company changed its reporting of a loss portfolio transfer (LPT) agreement with Old Republic Insurance Company (ORIC), which was effective on November 30, 2006. The LPT transaction was executed to transfer the existing Construction Program Group (CPG) traditional property and casualty business written directly by the Company to ORIC. No initial gain or loss was recorded as a result of the LPT transaction with ORIC. The impact of this restatement was a reclassification from unassigned surplus to special surplus funds of \$32,857 and \$41,293 at December 31, 2015 and 2014, respectively. In addition, any gains and/or losses related to this retroactive reinsurance transaction are separately reported in loss portfolio transfer – reinsurance ceded and are no longer reported as an underwriting deduction in the Company's statements of income. This change had no impact on the Company's net income, total surplus, or risk-based capital.

Foreign Currency Translation

Foreign revenues and expenses are translated at average monthly exchange rates. Foreign assets and liabilities are translated at the exchange rates at the balance sheet dates. Net foreign exchange gains and losses are charged or credited directly to unassigned surplus.

Federal Income Taxes

The Company's tax status is as a property casualty insurance company, and it is a member of the Wolverine InterCo, Inc. U.S. consolidated tax group. The method of tax allocation between the members of the consolidated tax group is subject to a written agreement approved by the Company's Board of Directors. The consolidated tax liability is generally allocated among the members of the group as if each member filed its own tax return. Benefits are recorded if a taxable loss can be used by the group.

Use of Estimates

The preparation of statutory-basis financial statements of insurance companies requires management to make estimates and assumptions that affect amounts reported in the statutory-basis financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known that could affect the amounts reported and disclosed herein.

Reclassifications

Certain amounts presented in the prior year's statutory-basis financial statements have been reclassified to conform to the current year's method of presentation.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

2. Summary of Significant Accounting Policies (continued)

Subsequent Events

Management of the Company has evaluated all events occurring after December 31, 2015, through May 26, 2016, the date the financial statements were available to be issued.

3. Investments

The statement value, gross unrealized gains and losses, and fair value of investments in bonds are summarized as follows:

	Statement Value	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2015				
U.S. Government and agencies	\$ 6,347	\$ 208	\$ (3)	\$ 6,552
States and political subdivisions	214,313	13,550	(116)	227,747
Foreign governments	67,951	1,323	(66)	69,208
Corporate bonds	262,364	1,374	(3,878)	259,860
Commercial mortgage-backed	137,374	306	(2,853)	134,827
Residential mortgage-backed	129,004	2,838	(652)	131,190
Asset-backed securities	142,788	28	(1,473)	141,343
Total bonds	<u>\$ 960,141</u>	<u>\$ 19,627</u>	<u>\$ (9,041)</u>	<u>\$ 970,727</u>
December 31, 2014				
U.S. Government and agencies	\$ 42,337	\$ 301	\$ (76)	\$ 42,562
States and political subdivisions	134,873	10,806	(7)	145,672
Foreign governments	82,479	1,694	(75)	84,098
Corporate bonds	230,749	12,307	(1,036)	242,020
Commercial mortgage-backed	63,018	1,026	(277)	63,767
Residential mortgage-backed	190,759	6,126	(164)	196,721
Asset-backed securities	72,180	144	(73)	72,251
Total bonds	<u>\$ 816,395</u>	<u>\$ 32,404</u>	<u>\$ (1,708)</u>	<u>\$ 847,091</u>

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

3. Investments (continued)

There are no significant industries or other concentrations of investments in bonds as of December 31, 2015 or 2014.

The Company records adjustments to reduce certain bonds rated NAIC 3 or higher to fair value when the fair value is lower than amortized cost. As of December 31, 2015, the Company recorded adjustments to reduce the statement value of bonds by \$328, with a corresponding reduction in unassigned surplus, net of taxes. As of December 31, 2014, the Company recorded adjustments to reduce the statement value of bonds by \$47, with a corresponding reduction in unassigned surplus, net of taxes.

The statement value and fair value of bonds at December 31, 2015, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Statement Value	Fair Value
Years to maturity:		
One or less	\$ 16,760	\$ 16,875
After one through five	152,933	156,628
After five through ten	243,198	248,207
After ten	138,084	141,657
Commercial mortgage-backed	137,374	134,827
Residential mortgage-backed	129,004	131,190
Asset-backed securities	142,788	141,343
	<u>\$ 960,141</u>	<u>\$ 970,727</u>

Proceeds from the sale of investments in bonds were \$368,676 and \$43,634 in 2015 and 2014, respectively. Gross gains of \$12,579 and gross losses of \$979 were realized on those sales in 2015. Gross gains of \$914 and gross losses of \$53 were realized on those sales in 2014.

At December 31, 2015 and 2014, the Company had restricted assets consisting of investments in bonds and short-term assets with an admitted statement value of \$48,494 and \$52,565, respectively. These assets represented 4.2% and 5.1%, respectively, of total admitted assets and were on deposit with various state insurance departments, Canadian insurance regulators, Guam, and Puerto Rico to satisfy regulatory requirements.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

3. Investments (continued)

At December 31, 2015 and 2014, bonds with a carrying value of \$90,181 and \$97,959, respectively, were denominated in currencies other than the U.S. dollar.

The cost, gross unrealized gains and losses, and fair value of investments in common stocks (unaffiliated and affiliated) are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2015				
Common stocks – unaffiliated	\$ 2,069	\$ 231	\$ (695)	\$ 1,605
Common stocks – affiliated	25,009	2,541	(9,707)	17,843
Total	<u>\$ 27,078</u>	<u>\$ 2,772</u>	<u>\$ (10,402)</u>	<u>\$ 19,448</u>
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2014				
Common stocks – unaffiliated	\$ 3,103	\$ 101	\$ (638)	\$ 2,566
Common stocks – affiliated	25,009	3,539	(6,781)	21,767
Total	<u>\$ 28,112</u>	<u>\$ 3,640</u>	<u>\$ (7,419)</u>	<u>\$ 24,333</u>

The fair values of the Company's affiliated common stocks that are non-admitted are \$2,858 and \$5,953 at December 31, 2015 and 2014, respectively.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

3. Investments (continued)

The following is a summary of the sources of net investment income for the years ended December 31:

	<u>2015</u>	<u>2014</u>
Bonds	\$ 27,752	\$ 25,844
Common stocks (unaffiliated)	87	439
Cash and short-term investments	6,386	7,862
Investment, interest, and other expenses	(1,195)	(1,398)
Total	<u>\$ 33,030</u>	<u>\$ 32,747</u>

A significant judgment in the valuation of investments is the determination of when an other-than-temporary decline in value has occurred. The Company follows a consistent and systematic process for impairing securities that sustain other-than-temporary declines in value. The decision to impair a security incorporates both quantitative criteria and qualitative information. The impairment review process considers a number of factors, including, but not limited to: (a) the length of time and the extent to which a security's fair value has been less than statement value, (b) the financial condition and near-term prospects of the issuer, (c) the intent and ability of the Company to retain its investment for a period of time to allow for any anticipated recovery in value, (d) whether the debtor is current on interest and principal payments, and (e) general market conditions and industry- or sector-specific factors. For securities deemed to be other-than-temporarily impaired, the security is adjusted to its fair value, and the resulting losses are recognized in net realized gains or losses in the statutory-basis statements of income. No other-than-temporary impairment losses were recorded by the Company for 2015 or 2014.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

3. Investments (continued)

The following table analyzes the Company's unaffiliated investment positions with unrealized losses segmented by type and period of continuous unrealized loss.

	Less Than 12 Months		Greater Than 12 Months		Total		
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Number of Securities
December 31, 2015							
Bonds:							
U.S. Government and agency States and political subdivisions	\$ 541	\$ (3)	\$ –	\$ –	\$ 541	\$ (3)	1
Foreign governments	5,432	(116)	–	–	5,432	(116)	6
Corporate bonds	4,601	(66)	–	–	4,601	(66)	6
Commercial mortgage-backed	173,452	(3,878)	–	–	173,452	(3,878)	69
Residential mortgage-backed	97,054	(2,731)	4,944	(122)	101,998	(2,853)	27
Asset-backed securities	35,024	(516)	4,276	(136)	39,300	(652)	21
	128,683	(1,473)	145	–	128,828	(1,473)	56
Total bonds	444,787	(8,783)	9,365	(258)	454,152	(9,041)	186
Equity securities:							
Common stock – unaffiliated	1,605	(695)	–	–	1,605	(695)	4
	\$ 446,392	\$ (9,478)	\$ 9,365	\$ (258)	\$ 455,757	\$ (9,736)	190
December 31, 2014							
Bonds:							
U.S. Government and agency States and political subdivisions	\$ 20,206	\$ (69)	\$ 544	\$ (7)	\$ 20,750	\$ (76)	4
Foreign governments	4,217	(7)	–	–	4,217	(7)	3
Corporate bonds	12,122	(34)	4,699	(41)	16,821	(75)	12
Commercial mortgage-backed	42,709	(850)	13,955	(186)	56,664	(1,036)	36
Residential mortgage-backed	16,656	(61)	9,388	(216)	26,044	(277)	9
Asset-backed securities	11,761	(28)	9,702	(136)	21,463	(164)	8
	42,006	(73)	–	–	42,006	(73)	18
Total bonds	149,677	(1,122)	38,288	(586)	187,965	(1,708)	90
Equity securities:							
Common stock – unaffiliated	2,046	(638)	–	–	2,046	(638)	4
	\$ 151,723	\$ (1,760)	\$ 38,288	\$ (586)	\$ 190,011	\$ (2,346)	94

The Company's bond portfolio is sensitive to interest rate fluctuations, which affect the fair value of individual securities. All unrealized losses reported above related to the Company's investment in bonds were caused by the effect of a rising interest rate environment on certain securities with stated interest rates currently below market rates. The Company has the ability and intent to hold these securities until their full cost can be recovered. Unrealized losses on equity securities result from normal market fluctuations and are considered temporary. Therefore, the Company does not believe these unrealized losses on bonds or equity securities represent an other-than-temporary impairment as of December 31, 2015 or 2014.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued) *(Dollars in Thousands, Except Shares and Per Share Data)*

4. Fair Value of Financial Instruments

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in the fair value statutory accounting guidance as defined in SSAP No. 100, *Fair Value Measurements*. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable market inputs (Level 3). The three levels of the hierarchy are as follows:

- Level 1 – includes financial instruments whose fair value is determined based on observable unadjusted quoted market prices for identical financial assets or liabilities in active markets that the Company has the ability to access at the measurement date. This is the most reliable fair value measurement and includes, for example, active exchange-traded securities.
- Level 2 – includes financial instruments whose fair value is determined based upon various inputs, including, but not limited to, quoted market prices for similar assets in active markets; quoted market prices for identical assets in inactive markets; inputs other than quoted market prices that are observable for the asset, such as interest rates or yield curves; or other inputs derived principally from other observable market information. When quoted market prices in active markets are not available, fair values are derived through matrix pricing, which is a mathematical technique used principally to value debt securities by relying on the securities' relationship to other benchmark-quoted securities and not by relying exclusively on quoted market prices for specific securities.
- Level 3 – includes financial instruments whose fair value is determined from techniques in which one or more of the significant inputs, such as assumptions about risk, are unobservable. Because Level 3 fair values contain unobservable market inputs, judgment must be used to determine fair values. Level 3 fair values represent the best estimate of an amount that could be realized in a current market exchange absent actual market exchanges.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

4. Fair Value of Financial Instruments (continued)

The following methods and assumptions were used by the Company in estimating the fair value of financial instruments in the accompanying statutory-basis financial statements and notes thereto:

Cash, Cash Equivalents, Short-Term Investments, and Receivables: The carrying amounts reported in the accompanying statutory-basis balance sheets for these financial instruments approximate their fair values.

Investment Securities: Fair values for statutory purposes are based on prices received from an independent third-party vendor. If fair value pricing is unavailable from this source, the Company uses either broker-dealers or matrix pricing for reporting and disclosing fair values of investment securities.

For fixed-maturity securities not actively traded, fair values are estimated using values obtained from independent pricing services or, in the case of private placements, they are estimated by discounting the expected future cash flows using current market rates applicable to the coupon rate, credit, and maturity of the investments.

Liabilities for Insurance Contracts: The fair values of the Company's liabilities for insurance contracts, other than investment-type contracts, are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk such that the Company's exposure to changing interest rates is minimized through matching investment maturities with the amounts due under the insurance contracts.

Additional data with respect to the fair values of the Company's investments is disclosed in Note 3.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

4. Fair Value of Financial Instruments (continued)

The table below summarizes the Company's investments reported at fair value in the accompanying statutory-basis financial statements at December 31.

	Total	Level 1	Level 2	Level 3
December 31, 2015				
Bonds:				
States and political subdivisions	\$ 979	\$ –	\$ 979	\$ –
Residential mortgage-backed	1,632	–	1,632	–
Total bonds	<u>\$ 2,611</u>	<u>\$ –</u>	<u>\$ 2,611</u>	<u>\$ –</u>
Equity securities:				
Money market funds	\$ 281	\$ 281	\$ –	\$ –
Mutual funds	1,324	1,324	–	–
Total equity securities	<u>\$ 1,605</u>	<u>\$ 1,605</u>	<u>\$ –</u>	<u>\$ –</u>
	Total	Level 1	Level 2	Level 3
December 31, 2014				
Bonds:				
States and political subdivisions	\$ 1,175	\$ –	\$ 1,175	\$ –
Corporate bonds	218	–	218	–
Total bonds	<u>\$ 1,393</u>	<u>\$ –</u>	<u>\$ 1,393</u>	<u>\$ –</u>
Equity securities:				
Money market funds	\$ 584	\$ 584	\$ –	\$ –
Mutual funds	1,982	1,982	–	–
Total equity securities	<u>\$ 2,566</u>	<u>\$ 2,566</u>	<u>\$ –</u>	<u>\$ –</u>

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

4. Fair Value of Financial Instruments (continued)

The carrying value and fair value of the Company's financial instruments not carried at fair value are presented below. The estimated fair value is determined on a recurring basis for all financial instruments not carried at fair value.

Type of Financial Instrument	Aggregate Fair Value	Admitted Assets	Level 1	Level 2	Level 3	Not Practicable (Carrying Value)
December 31, 2015						
Bonds:						
U.S. Government and agencies	\$ 6,552	\$ 6,347	\$ —	\$ 6,552	\$ —	\$ —
States and political subdivisions	226,768	213,334	—	226,768	—	—
Foreign governments	69,208	67,951	—	69,208	—	—
Corporate bonds	259,860	262,364	—	259,860	—	—
Commercial mortgage-backed securities	134,827	137,374	—	134,827	—	—
Residential mortgage-backed securities	129,558	127,372	—	129,558	—	—
Asset-backed securities	141,343	142,788	—	141,343	—	—
December 31, 2014						
Bonds:						
U.S. Government and agencies	\$ 42,562	\$ 42,337	\$ —	\$ 42,562	\$ —	\$ —
States and political subdivisions	144,497	133,698	—	144,497	—	—
Foreign governments	84,098	82,479	—	84,098	—	—
Corporate bonds	241,802	230,531	—	241,802	—	—
Commercial mortgage-backed securities	63,767	63,018	—	63,767	—	—
Residential mortgage-backed securities	196,721	190,759	—	196,721	—	—
Asset-backed securities	72,251	72,180	—	72,251	—	—

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes

For the year ended December 31, 2015, the Company was included in a consolidated federal income tax return with the following affiliated entities:

Automotive Warranty Services, Inc.	Resource Training, Inc.
Automotive Warranty Services of Florida, Inc.	Rockford Holding, Inc.
Consumer Program Administrators, Inc.	Rockford Life Insurance Company
Dealer Performance, Inc.	Service Protection, Inc.
FFG Corporation	Service Saver, Inc.
First Extended Service Corporation	ServicePlan of Florida, Inc.
First Extended Service Corporation of Florida	ServicePlan, Inc.
First Extended, Inc.	The Warranty Group, Inc.
National Product Care Company	TWG Holdings, Inc.
North America Warranty, Inc.	TWG Home Warranty Services, Inc.
Product Care, Inc.	TWG Innovative Solutions, Inc.
Resource Acquisition Corporation	TWG Warranty Group, Inc.
Resource Automotive, Inc.	TWG Warranty Services, Inc.
Resource Dealer Group, Inc.	Wolverine Acquisitions, Inc.
Resource Life Insurance Company	Wolverine InterCo, Inc.

For the periods ended December 31, 2014 and August 1, 2014, the Company was included in consolidated federal income tax returns. However, the Company was not affiliated with Wolverine Acquisitions, Inc. and Wolverine InterCo, Inc. prior to August 2, 2014. Additionally, prior to January 1, 2015, the Company was not affiliated with Rockford Holding, Inc. and Rockford Life Insurance Company.

The method of tax allocation between the companies is subject to a written agreement that was approved by the Company's Board of Directors. The consolidated tax liability is generally allocated among the members of the group as if each member filed its own tax return. Benefits are recorded as if a taxable loss can be used by the group.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

The components of the net admitted DTAs and DTLs recognized in the Company's statutory-basis balance sheets are as follows:

	2015		
	Ordinary	Capital	Total
Gross and adjusted DTAs	\$ 51,444	\$ –	\$ 51,444
DTAs non-admitted	(4,802)	–	(4,802)
Net admitted DTAs	46,642	–	46,642
DTLs	(9,167)	(691)	(9,858)
Net admitted DTAs (DTLs)	\$ 37,475	\$ (691)	\$ 36,784

	2014		
	Ordinary	Capital	Total
Gross and adjusted DTAs	\$ 47,855	\$ –	\$ 47,855
DTAs non-admitted	(4,234)	–	(4,234)
Net admitted DTAs	43,621	–	43,621
DTLs	(8,477)	(379)	(8,856)
Net admitted DTAs (DTLs)	\$ 35,144	\$ (379)	\$ 34,765

	Change		
	Ordinary	Capital	Total
Gross and adjusted DTAs	\$ 3,589	\$ –	\$ 3,589
DTAs non-admitted	(568)	–	(568)
Net admitted DTAs	3,021	–	3,021
DTLs	(690)	(312)	(1,002)
Net admitted DTAs	\$ 2,331	\$ (312)	\$ 2,019

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

The amount of each result or component of the admission calculation, by tax character, of paragraphs 11a, 11bi, 11bii, and 11c at December 31 follows:

	2015		
	Ordinary	Capital	Total
Federal income taxes paid in prior years recoverable through loss carrybacks (11a)	\$ 28,839	\$ –	\$ 28,839
Adjusted gross DTAs expected to be realized (excluding the amount of DTAs from 11a, above) after application of the threshold limitation (lesser of 11bi and 11bii, below)	7,945	–	7,945
Adjusted gross DTAs expected to be realized after the balance sheet date (11bi) or	7,945	–	7,945
Adjusted gross DTAs allowed per limitation threshold (11bii)	N/A	N/A	49,057
Adjusted gross DTAs (excluding the amount of DTAs from 11a and 11b, above) offset by DTLs (11c)	9,858	–	9,858
DTAs admitted as a result of application of SSAP No. 101 (total of 11a, 11b, and 11c)	46,642	–	46,642

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

	2014		
	Ordinary	Capital	Total
Federal income taxes paid in prior years recoverable through loss carrybacks (11a)	\$ 27,409	\$ –	\$ 27,409
Adjusted gross DTAs expected to be realized (excluding the amount of DTAs from 11a, above) after application of the threshold limitation (lesser of 11bi and 11bii, below)	7,356	–	7,356
Adjusted gross DTAs expected to be realized after the balance sheet date (11bi) or	7,356	–	7,356
Adjusted gross DTAs allowed per limitation threshold (11bii)	N/A	N/A	40,161
Adjusted gross DTAs (excluding the amount of DTAs from 11a and 11b, above) offset by DTLs (11c)	8,856	–	8,856
DTAs admitted as a result of application of SSAP No. 101 (total of 11a, 11b, and 11c)	43,621	–	43,621

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

	Ordinary	Change Capital	Total
Federal income taxes paid in prior years recoverable through loss carrybacks (11a)	\$ 1,430	\$ –	\$ 1,430
Adjusted gross DTAs expected to be realized (excluding the amount of DTAs from 11a, above) after application of the threshold limitation (lesser of 11bi and 11bii, below)	589	–	589
Adjusted gross DTAs expected to be realized after the balance sheet date (11bi) or	589	–	589
Adjusted gross DTAs allowed per limitation threshold (11bii)	N/A	N/A	8,896
Adjusted gross DTAs (excluding the amount of DTAs from 11a and 11b, above) offset by DTLs (11c)	1,002	–	1,002
DTAs admitted as a result of application of SSAP No. 101 (total of 11a, 11b, and 11c)	3,021	–	3,021
		2015	2014
Ratio percentage used to determine recovery period and threshold limitation amount		457%	427%
Amount of adjusted capital and surplus used to determine recovery period and threshold limitation in paragraph 11bii		\$ 326,852	\$ 266,024

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

The following is the provision for the current incurred tax expense for the years ended December 31:

	2015	2014	Change
Federal	\$ 13,476	\$ 24,309	\$ (10,833)
Foreign	1,846	2,506	(660)
	<u>15,322</u>	<u>26,815</u>	<u>(11,493)</u>
Federal income tax on capital gains	4,337	419	3,918
Federal and foreign income taxes incurred	<u>\$ 19,659</u>	<u>\$ 27,234</u>	<u>\$ (7,575)</u>

The tax effects of temporary differences that give rise to significant portions of the DTAs and DTLs at December 31 are as follows:

	2015		
	Ordinary	Capital	Total
DTAs:			
Unearned premium reserves	\$ 37,164	\$ –	\$ 37,164
Unpaid loss reserve discounting	163	–	163
Non-admitted assets	11,884	–	11,884
Other (including items <5% of total tax assets)	2,233	–	2,233
	<u>51,444</u>	<u>–</u>	<u>51,444</u>
Non-admitted assets	(4,802)	–	(4,802)
Admitted DTAs	46,642	–	46,642
DTLs:			
Investments	–	(691)	(691)
Unrealized foreign exchange gains	–	–	–
Property, plant, and equipment basis differences	(9,018)	–	(9,018)
Other	(149)	–	(149)
Total DTLs	<u>(9,167)</u>	<u>(691)</u>	<u>(9,858)</u>
Net DTAs (DTLs)	<u>\$ 37,475</u>	<u>\$ (691)</u>	<u>\$ 36,784</u>

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

	2014		
	Ordinary	Capital	Total
DTAs:			
Unearned premium reserves	\$ 35,559	\$ –	\$ 35,559
Unpaid loss reserve discounting	236	–	236
Non-admitted assets	11,903	–	11,903
Other (including items <5% of total tax assets)	157	–	157
	47,855	–	47,855
Non-admitted assets	(4,234)	–	(4,234)
Admitted DTAs	43,621	–	43,621
DTLs:			
Investments	–	(379)	(379)
Unrealized foreign exchange gains	(1,830)	–	(1,830)
Property, plant, and equipment basis differences	(6,443)	–	(6,443)
Other	(204)	–	(204)
Total DTLs	(8,477)	(379)	(8,856)
Net DTAs (DTLs)	\$ 35,144	\$ (379)	\$ 34,765

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

	<u>Ordinary</u>	<u>Change Capital</u>	<u>Total</u>
DTAs:			
Unearned premium reserves	\$ 1,605	\$ –	\$ 1,605
Unpaid loss reserve discounting	(73)	–	(73)
Non-admitted assets	(19)	–	(19)
Other (including items <5% of total tax assets)	2,076	–	2,076
	3,589	–	3,589
Non-admitted assets	(568)	–	(568)
Admitted DTAs	3,021	–	3,021
DTLs:			
Investments	–	(312)	(312)
Unrealized foreign exchange gains	1,830	–	1,830
Property, plant, and equipment basis differences	(2,575)	–	(2,575)
Other	55	–	55
Total DTLs	(690)	(312)	(1,002)
Net DTAs	\$ 2,331	\$ (312)	\$ 2,019

The change in net deferred income taxes is composed of the following (exclusive of non-admitted DTAs):

	<u>December 2015</u>	<u>2014</u>	<u>Change</u>
Total DTAs	\$ 51,444	\$ 47,855	\$ 3,589
Total DTLs	(9,858)	(8,856)	(1,002)
Net DTAs	\$ 41,586	\$ 38,999	2,587
Tax effect of cumulative translation adjustment			(3,509)
Tax effect of unrealized gains			(146)
Change in net deferred income tax			\$ (1,068)

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

5. Federal Income Taxes (continued)

Non-admitted DTAs increased by \$568 and \$3,864 for 2015 and 2014, respectively.

The provision for federal taxes is different from that which would be obtained by applying the statutory federal income tax rate to income from operations before federal income taxes.

The significant items causing this difference for the years ended December 31 are as follows:

	<u>2015</u>	<u>2014</u>
Provision calculated at statutory rate	\$ 22,459	\$ 27,185
Tax-exempt interest and dividends	(1,863)	(1,332)
Other permanent differences	14	47
Change in deferred taxes on non-admitted assets	20	(1,863)
Adjustment of prior year taxes	81	(25)
Tax differential on foreign earnings	1,846	2,506
Foreign tax credit	(1,830)	(2,498)
Total	<u>\$ 20,727</u>	<u>\$ 24,020</u>

The components of change in DTAs and DTLs and the current income tax benefit (expense) are as follows:

	<u>2015</u>	<u>2014</u>
Net change in deferred income taxes	\$ 1,068	\$ (3,214)
Current income tax expense	19,659	27,234
Total statutory income tax expense	<u>\$ 20,727</u>	<u>\$ 24,020</u>

The Company incurred federal income taxes available for recoupment in the event that the Company incurs future net losses totaling \$18,422 and \$24,490 for 2015 and 2014, respectively.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued) *(Dollars in Thousands, Except Shares and Per Share Data)*

5. Federal Income Taxes (continued)

The Company has not recognized a DTL for the undistributed earnings of its 100% foreign subsidiaries that arose in 2015 and prior years because the Company does not expect those unremitted earnings to reverse and become taxable to the Company in the foreseeable future. A DTL will be recognized when the Company expects that it will recover those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. As of December 31, 2015 and 2014, the undistributed earnings of these subsidiaries were approximately \$21,800 and \$14,000, respectively.

Effective August 2, 2014, the Company became part of the Wolverine InterCo, Inc. consolidated tax return group. Prior to August 2, 2014, the Company was part of The Warranty Group, Inc. (TWG) consolidated tax return group. During 2016, Wolverine InterCo, Inc.'s consolidated tax return group will be subject to U.S. federal examination by tax authorities for the period August 2, 2014 through December 31, 2014. TWG's consolidated tax return group is currently not subject to examination for the period January 1, 2014 through August 1, 2014, and the tax years ended December 31, 2013 and 2012; however, the statute of limitations is still open. Tax years prior to 2012 are closed.

The Company did not recognize a liability for unrecognized tax benefits and does not expect the unrecognized tax position to change significantly over the next 12 months.

There was no impact on the determination of adjusted gross DTAs and the determination of net admitted DTAs as a result of tax planning strategies for 2015 and 2014.

6. Reinsurance

Certain premiums and losses are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks and maintain its exposure to loss within its capital resources.

The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations. Certain of these agreements provide excess loss coverage and are subject to contingent commission adjustments.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

6. Reinsurance (continued)

The effects of reinsurance on premiums written and earned for the years ended December 31 are as follows:

	2015		2014	
	Written	Earned	Written	Earned
Direct premiums	\$ 775,846	\$ 558,562	\$ 672,873	\$ 506,057
Assumed premiums:				
Affiliate	75,720	54,158	73,872	45,287
Non-affiliate	26,229	35,636	52,243	68,433
Ceded premiums	(578,224)	(381,434)	(469,337)	(318,483)
Net premiums	<u>\$ 299,571</u>	<u>\$ 266,922</u>	<u>\$ 329,651</u>	<u>\$ 301,294</u>

The Company's ceded reinsurance arrangements reduced certain other items in the accompanying statutory-basis financial statements as follows:

	2015	2014
Losses and loss adjustment expenses incurred	\$ 278,938	\$ 234,531
Loss and loss adjustment expense reserves*	222,069	248,732
Unearned premium reserves*	1,043,147	846,639

*At year-end.

On November 30, 2006, three LPT transactions were completed to facilitate the acquisition of TWG by Onex Corporation. Two of the loss portfolio transfers resulted in the Company ceding all assets and liabilities related to the other traditional property and casualty business to FFG Insurance Company (FFG) and ORIC. A condition of these two LPT transactions was an indemnification issued by Aon Corporation (TWG's former parent) to TWG for any future development on reserves or non-performance of the underlying reinsurers. The third LPT transaction resulted in the Company assuming from FFG all assets and liabilities related to certain extended warranty contracts.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

6. Reinsurance (continued)

On September 13, 2006, the LPT agreement, whereby FFG transferred its warranty business to the Company, was accepted and placed on file pursuant to Section 131.20a of the Illinois Insurance Code. On October 31, 2006, the LPT agreement, whereby the Company transferred certain of its traditional non-warranty property and casualty business to FFG, was accepted and placed on file pursuant to section 131.20a of the Illinois Insurance Code. The LPT transaction with FFG related to the traditional non-warranty property and casualty business was accounted for on a prospective basis since the Company and FFG were affiliates at the time the transactions occurred. No gain or loss was recorded as a result of the LPT transactions with FFG.

As discussed in Note 2, a separate LPT transaction was executed at November 30, 2006, to transfer the existing CPG traditional property and casualty business written directly by the Company to ORIC. This transaction was accounted for on a retroactive basis since ORIC was not affiliated with the Company. No initial gain or loss was recorded as a result of the LPT transaction with ORIC.

On August 7, 2009, Aon sold FFG to National Indemnity Company (NICO), a subsidiary of Berkshire Hathaway, Inc. As a condition of the sale, NICO assumed the indemnification previously issued by Aon related to the LPT transactions with FFG and ORIC. In connection with NICO's acquisition of FFG from Aon, NICO entered into a novation agreement with VSC and Aon effective August 7, 2009.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

6. Reinsurance (continued)

The following table summarizes the property and casualty LPT transaction with ORIC accounted for as retroactive reinsurance:

	<u>2015</u>	<u>2014</u>
Loss reserves transferred:		
Initial loss reserves ceded	\$ 227,267	\$ 227,267
Adjustment – prior years	162,729	158,466
Adjustment – current year	144	4,263
Total loss reserves transferred	<u>\$ 390,140</u>	<u>\$ 389,996</u>
Consideration paid:		
Initial consideration	\$ (227,267)	\$ (227,267)
Adjustment – prior years	–	–
Adjustment – current year	–	–
Total consideration paid	<u>\$ (227,267)</u>	<u>\$ (227,267)</u>
Paid losses recovered:		
Prior years	\$ 348,703	\$ 331,098
Current year	8,580	17,605
Total paid losses recovered	<u>\$ 357,283</u>	<u>\$ 348,703</u>
Retroactive reinsurance reserves ceded	<u>\$ 32,857</u>	<u>\$ 41,293</u>
Special surplus from retroactive reinsurance:		
Initial surplus (gain) loss	\$ –	\$ –
Adjustment – prior years	(41,293)	(54,635)
Adjustment – current year	8,436	13,342
Current year restricted surplus	<u>\$ (32,857)</u>	<u>\$ (41,293)</u>
Cumulative total transferred to unassigned surplus	<u>\$ (130,016)</u>	<u>\$ (121,436)</u>

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

6. Reinsurance (continued)

Unsecured reinsurance recoverables that exceed 3% of the Company's capital and surplus at December 31, 2015, are summarized as follows:

Name of reinsurer	
Westport Insurance Corporation	\$ 51,984
Endurance Reinsurance Corp of America	16,860
Odyssey America Reins Co.	12,682
Aspen Insurance UK Ltd.	12,409

The Company has been indemnified for future development on losses and loss adjustment expenses and any uncollectible reinsurance balances recoverable from those reinsurers above, which are subject to the LPT transactions.

The maximum amount of return commission that would have been due reinsurers had all of the Company's ceded reinsurance been canceled was \$15,967 and \$12,953 at December 31, 2015 and 2014, respectively. Had the Company canceled its assumed reinsurance, \$1,150 and \$1,122 in ceding commissions would have been recoverable as of December 31, 2015 and 2014, respectively.

All reinsurance contracts with adjustable features (e.g., retrospectively rated premiums and contingent, sliding scale, and profit commissions) have been analyzed, and any required adjustments have been properly recorded.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

7. Losses and Loss Adjustment Expenses

The following table provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses (LAE), net of reinsurance recoverables, for 2015 and 2014:

	P&C	Warranty and Other	Total
2015			
Reserves for losses and LAE, at beginning of year	\$ 41,293	\$ 32,038	\$ 73,331
Add provision for claims occurring in:			
Current year	–	167,382	167,382
Prior years	144	(238)	(94)
Net incurred losses during the current year	144	167,144	167,288
Deduct payments for claims occurring in:			
Current year	–	151,178	151,178
Prior years	8,580	24,452	33,032
Net claim payments during the current year	8,580	175,630	184,210
Reserve for losses and LAE, at end of year	\$ 32,857	\$ 23,552	\$ 56,409
	P&C	Warranty and Other	Total
2014			
Reserves for losses and LAE, at beginning of year	\$ 54,635	\$ 34,925	\$ 89,560
Add provision for claims occurring in:			
Current year	–	191,472	191,472
Prior years	4,263	(2,871)	1,392
Net incurred losses during the current year	4,263	188,601	192,864
Deduct payments for claims occurring in:			
Current year	–	163,778	163,778
Prior years	17,605	27,710	45,315
Net claim payments during the current year	17,605	191,488	209,093
Reserve for losses and LAE, at end of year	\$ 41,293	\$ 32,038	\$ 73,331

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

7. Losses and Loss Adjustment Expenses (continued)

Since the reserves for net losses and loss adjustment expenses include estimates developed from various actuarial methods, the Company's actual losses incurred may be more or less than the Company's previously developed estimates. Certain of the Company's arrangements with producers of warranty contracts include profit-sharing provisions whereby the redundancy or deficiency in reserves noted in the above table would be paid, or reduce payments to the producer, in the form of a profit commission.

The Company's P&C business is ceded to various third-party reinsurers, and the changes in claim development do not affect the Company's financial position. Redundancies and deficiencies in the P&C block of business are subject to a loss portfolio transfer and are guaranteed by a third party. Development on these reserves has no impact on income.

8. Related-Party Transactions

The Company has entered into administrative services agreements with its affiliated companies. Pursuant to these agreements, various administrative, management, and support services are provided to or provided by the Company. The expenses related to these administrative, management, and support services are allocated to or allocated by the Company in amounts equal to the direct and indirect costs and expenses incurred in providing these services. Direct costs include expenses such as salaries, benefits, communications, advertising, consulting services, maintenance, rent, utilities, and supplies, which are directly attributable to the operations of the Company. Allocated costs include expenses such as salaries, benefit claims and enrollment processing, billing, accounting, underwriting, product development, and budgeting, which support the operations of the Company. These costs are allocated based on various utilization statistics.

During 2015 and 2014, net amounts allocated to the Company pursuant to the intercompany services agreement with TWG was \$36,974 and \$34,381, respectively. In addition, during 2015 and 2014, the Company's branches in Australia and New Zealand were allocated \$2,523 and \$3,001, respectively, for marketing and administrative services provided by The Warranty Group Australasia Pty Ltd. The allocated expenses are included in other underwriting expenses and loss and loss adjustment expenses incurred in the statutory-basis statements of income.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

(Dollars in Thousands, Except Shares and Per Share Data)

8. Related-Party Transactions (continued)

At December 31, 2015 and 2014, the Company reported \$3,529 and \$4,565, respectively, due from its parent, subsidiaries, and affiliates and \$3,444 and \$4,833 due to its parent, subsidiaries, and affiliates, respectively. Amounts non-admitted due from affiliates as of December 31, 2015 and 2014, were \$2,384 and \$8,678, respectively.

The Company insures losses associated with certain of the warranty agreements written by its affiliated companies. Additionally, the Company has issued contractual liability policies and failure-to-perform endorsements to affiliated companies.

9. Capital and Surplus

The Company has 5,000,000 shares of \$1 par value common stock authorized, issued, and outstanding. The Company has no preferred stock authorized, issued, or outstanding.

During 2015, the Company received a \$35,000 capital contribution from its parent in order to maintain excess capital to support future growth while maintaining the Company's financial strength rating. The Company is subject to certain minimum surplus requirements of the Illinois Insurance Code. Additionally, insurance companies are subject to certain risk-based capital (RBC) requirements as specified by the NAIC. Under those requirements, the required amount of capital and surplus of an insurance company is determined based on the various risk factors related to it. The Company met the RBC requirements at December 31, 2015.

The payment of dividends by the Company to its parent is limited and can only be made from earned profits, unless prior approval is received from the Department. Under the insurance regulations of the state of Illinois, the maximum amount of dividends that the Company may pay to its parent during any 12-month period without the prior approval of the Department is limited to the greater of 10% of the most recent year-end capital and surplus or the net income of the most recently completed year, as reported in the Company's annual statement. Approximately \$44,508 is available for dividend payments in 2016 without prior written approval of the Department. The Company paid ordinary dividends of \$0 and \$40,000 in 2015 and 2014, respectively.

At December 31, 2015 and 2014, the Company had special surplus of \$32,857 and \$41,293, respectively, resulting from retroactive reinsurance contracts. For the years ended December 31, 2015 and 2014, the changes in special surplus were related to changes in retroactive reinsurance ceded on the LPT transaction with ORIC.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued) *(Dollars in Thousands, Except Shares and Per Share Data)*

10. Employee Benefits

TWG sponsors a defined-contribution 401(k) savings plan for its employees. The savings plan is a voluntary contributory plan under which employees may elect to defer compensation for federal income tax purposes under Section 401(k) of the Internal Revenue Code of 1986. Annually, employees may contribute up to 50% of their eligible annual compensation, as defined in the savings plan, subject to maximum amounts established by the Internal Revenue Code. Prior to January 1, 2014, TWG matched up to 75% of the first 6% of eligible compensation that a participant contributed to the savings plan after the completion of 1,000 hours and one year of service. Effective January 1, 2014, the savings plan was amended to eliminate the service requirement in order to be eligible to receive TWG's matching contributions. An employee's interest in TWG's matching contributions vests at a rate of 20% per plan year. The matching contributions to the savings plan allocated to the Company were \$568 and \$483 during 2015 and 2014, respectively.

11. Third-Party Administrators

The Company utilizes third-party administrators primarily for premium collection and claims payment processing of certain business. These third-party administrators do not perform any underwriting or risk-taking functions related to the insurance business of the Company.

The Company utilizes third-party administrators in its operations. Premiums written by those third-party administrators that exceeded 5% of the Company's statutory-basis capital and surplus were \$344,824 and \$278,987 in 2015 and 2014, respectively.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued) (Dollars in Thousands, Except Shares and Per Share Data)

11. Third-Party Administrators (continued)

The Company has the following aggregate amount of direct premiums written through third-party administrators.

Third-Party Administrator	FEI Number	Exclusive Contract	Type of Business Written	Type of Authority Granted	Direct Written Premium
Safe-Guard Products International, Inc. Two Concourse Pkwy., Suite 500 Atlanta, GA 30328	58-2014424	No	Warranty related	P, C	\$ 200,391
Total Warranty Services 505 South Flagler Drive, Suite 700 West Palm Beach, FL 33401	27-2498538	No	Warranty related	P, C	51,354
Express Systems, Inc. 25541 Commerce Drive, Suite 100 Lake Forest, CA 92630	33-0620692	No	Warranty related	P, C	39,197
American Guardian 4450 Weaver Parkway, Suite 200 Warrenville, IL 60555	36-4236704	No	Warranty related	P, C	26,706
Motorcycle Management Consulting Services 126 East Dyer Road, Suite A Santa Ana, CA 92707	33-0203958	No	Warranty related	P, C	27,176

Type of Authority Granted

C – Claims Payment
P – Premium Collection

12. Uninsured Plans

Uninsured plans consist primarily of claims processed on behalf of certain credit card and personal computer companies where the Company has determined that there is no insurance risk transfer. The total claim payment volume for uninsured plan contracts for the years ended December 31, 2015 and 2014, was \$1,456 and \$7,412, respectively.

Virginia Surety Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)
(Dollars in Thousands, Except Shares and Per Share Data)

12. Uninsured Plans (continued)

The net gain from operations from uninsured plans for the years ended December 31 was as follows:

	<u>2015</u>	<u>2014</u>
Gross administrative fees earned	1,457	4,176
Gross expenses incurred (claims and administrative)	133	252
Total net gain from uninsured plans	<u>\$ 1,324</u>	<u>\$ 3,924</u>

13. Commitments and Contingencies

The Company and its subsidiaries are subject to various claims and lawsuits that arise in the ordinary course of business. The damages that may be claimed are substantial, including, in many instances, claims for punitive or extraordinary damages. Accruals for these items have been provided, to the extent that losses are deemed probable and are estimable. The Company's insurance subsidiaries are, from time to time, subject to a variety of regulatory audits or actions relating to current and past business operations and practices. The Company does not believe any pending regulatory matters will have a material adverse effect on the Company's statutory-basis financial condition, results of operations, or cash flows.

Although the ultimate outcome of these matters cannot be ascertained and liabilities in indeterminate amounts may be imposed on the Company or its subsidiaries, on the basis of the present information and availability of insurance coverages, it is the opinion of management that the disposition or ultimate determination of such claims will not have a material adverse effect on the statutory-basis financial position of the Company. However, it is possible that future results of operations or cash flows for any particular quarterly or annual period could be materially affected by an unfavorable resolution of these matters.

Supplementary Information – Statutory Basis



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Report of Independent Auditors on Supplementary Information

The Board of Directors
Virginia Surety Company, Inc.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplemental investment and reinsurance disclosures are presented to comply with the National Association of Insurance Commissioners' *Annual Statement Instructions* and the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* and for purposes of additional analysis, and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the statutory-basis financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the statutory-basis financial statements as a whole.

This report is intended solely for the information and use of Virginia Surety Company, Inc. and state insurance departments to whose jurisdiction Virginia Surety Company, Inc. is subject, and it is not intended to be, and should not be, used by anyone other than these specified parties.

Ernst & Young LLP

May 26, 2016

Virginia Surety Company, Inc.

Investment Risks Interrogatories – Statutory Basis
(Dollars in Thousands)

December 31, 2015

1. The Company's total admitted assets as reported in the annual statement are \$1,147,037 for the year ended December 31, 2015.
2. Following are the ten largest exposures to a single issuer, borrower, or investment, by investment category, excluding: (i) U.S. Government, U.S. Government agency securities, and those U.S. Government money market funds listed in the Appendix to the SVO's *Purposes and Procedures Manual*, as exempt; (ii) property occupied by the Company; and (iii) policy loans.

Issuer	Investment Category	Amount	Percentage of Total Admitted Assets
Federal Home Loan Mortgage Corporation	Bonds	\$ 54,533	4.75%
Federal National Mortgage Association, Inc.	Bonds	46,487	4.05
Blackrock Liquidity Funds	MM Fund	36,641	3.19
JP Morgan Chase & Co.	Bonds, Cash	25,306	2.20
Government of Canada	Bonds	18,377	1.60
HSBC Bank	CD, Cash, Bonds, MM Fund	16,099	1.40
Virginia Surety Compania de Seguros	Common Stock – Parent, Subs, Affiliates	15,007	1.31
Citigroup, Inc.	Bonds	10,041	0.88
Government of Malaysia	Bonds	10,040	0.88
Goldman Sachs Group, Inc.	Bonds	9,635	0.84

3. The Company's total admitted assets held in bonds and short-term investments by NAIC rating at December 31, 2015, were:

Bonds and Short-Term Investments

NAIC Rating	Amount	Percentage of Total Admitted Assets
NAIC 1	\$ 829,964	72.36%
NAIC 2	168,708	14.71
NAIC 6	1,917	0.17
	<u>\$ 1,000,589</u>	

Virginia Surety Company, Inc.

Investment Risks Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

4. As of December 31, 2015, the Company's total admitted assets held in foreign investments were \$255,107, excluding Canadian investments and currency exposure of \$46,957 (regardless of whether there is any foreign currency exposure), of which \$102,409 of the foreign-currency-denominated investments supports \$42,220 of the foreign currency-denominated insurance liabilities in these same foreign currencies.

5. The aggregate foreign investment exposure categorized by the NAIC's sovereign rating is:

	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
Countries rated NAIC 1	\$ 216,720	18.89%
Countries rated NAIC 3 or below	38,387	3.35

6. The two largest foreign investment exposures by country, if applicable, categorized by the country's NAIC sovereign rating are as follows:

	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
Countries rated NAIC 1:		
Country: Cayman Islands	\$ 130,119	11.34%
Country: Australia	21,844	1.90
Countries rated NAIC 3 or below:		
Country: Argentina	38,387	3.35

Virginia Surety Company, Inc.

Investment Risks Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

7. The aggregate unhedged foreign currency exposure was \$102,409, or 8.93% of the total admitted assets.
8. The aggregate unhedged foreign currency exposure categorized by NAIC sovereign rating follows:

	Amount	Percentage of Total Admitted Assets
Countries rated NAIC 1	\$ 64,022	5.59%
Countries rated NAIC 3 or below	38,387	3.35

9. The two largest unhedged foreign currency exposures by country, categorized by the country's NAIC sovereign rating are:

	Amount	Percentage of Total Admitted Assets
Countries rated NAIC 1:		
Country: Australia	\$ 21,844	1.90%
Country: South Korea	13,730	1.20
Countries rated NAIC 3 or below:		
Country: Argentina	38,387	3.35

Virginia Surety Company, Inc.

Investment Risks Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

10. The ten largest non-sovereign (i.e., non-governmental) foreign issues are:

	Amount	Percentage of Total Admitted Assets
HSBC Bank	\$ 15,016	1.31%
Virginia Surety Compania De Seguros	15,007	1.31
OZLM_15-12A	8,533	0.74
CIFC_15-2A	8,506	0.74
TICP_15-1A	8,492	0.74
SYMP_12-10AR	8,233	0.72
ACAS_15-1A	7,981	0.70
CGMS_15-2A	7,962	0.69
CENT CLO LP CECLO_13-19A	7,561	0.66
VENTR_14-17A	7,494	0.65

11. The Company's total admitted assets held in Canadian investments and unhedged Canadian currency exposure, including Canadian-currency-denominated investments of \$46,957 supporting Canadian-currency-denominated insurance liabilities at December 31, 2015, are:

	Amount	Percentage of Total Admitted Assets
Canadian-currency-denominated investments	\$ 44,323	3.86%
Canadian-denominated insurance liabilities	28,192	2.46
Unhedged Canadian currency exposure	44,323	3.86

12. The aggregate amount and percentages of the Company's total admitted assets held in investments with contractual sales restrictions (defined as investments having restrictions that prevent investments from being sold within 90 days) are: none.

Virginia Surety Company, Inc.

Investment Risks Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

13. The Company's assets held in equity interest are less than 2.5% of the Company's total admitted assets.
14. Assets held in non-affiliated, private-placed equities are less than 2.5% of the Company's total admitted assets.
15. Assets held in general partnership interest are less than 2.5% of the Company's total admitted assets.
16. Mortgage loans reported in Schedule B are less than 2.5% of the Company's total admitted assets.
17. Aggregate mortgage loans having the following loan-to-value ratios, as determined from the most current appraisal as of the annual statement date are: none.
18. The five largest investments in one parcel or group of contiguous parcels of real estate reported in Schedule A are less than 2.5% of the Company's total admitted assets.
19. Assets held in mezzanine real estate loans are less than 2.5% of the Company's total admitted assets.
20. The Company did not have any admitted assets as of December 31, 2015, or during 2015, subject to the following types of agreements: securities lending, repurchase agreements, reverse repurchase agreements, dollar repurchase agreements, and dollar reverse repurchase agreements.
21. The Company did not own any assets with warrants not attached to other financial instruments, options, caps, and floors as of December 31, 2015, or during 2015.
22. The Company did not own any assets with potential exposure for collars, swaps, and forwards as of December 31, 2015, or during 2015.
23. The Company did not own any assets with potential exposure (defined as the amount determined in accordance with the NAIC's *Annual Statement Instructions*) for futures contracts as of December 31, 2015, or during 2015.

Virginia Surety Company, Inc.

Reinsurance Interrogatories – Statutory Basis
(Dollars in Thousands)

December 31, 2015

1. Has the reporting entity reinsured any risk with any other entity under a quota-share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota-share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit, or any similar provisions)? Yes ☒ No ☐
2. If yes, indicate the number of reinsurance contracts containing such provisions: 12
3. If yes, does the amount of reinsurance credit taken reflect the reduction in quota-share coverage caused by any applicable limiting provisions? Yes ☒ No ☐
4. Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which, during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus in regard to policyholders or reported calendar-year-written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus in regard to policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contracts contain one or more of the following features or other features that would have similar results: Yes ☒ No ☐
 - (a) A contract term longer than two years and the contract is non-cancelable by the reporting entity during the contract term
 - (b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer
 - (c) Aggregate stop-loss reinsurance coverage

Virginia Surety Company, Inc.

Reinsurance Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

December 31, 2015

- (d) A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions that are only triggered by a decline in the credit status of the other party
 - (e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period)
 - (f) Payment schedule, accumulating retentions from multiple years, or any features inherently designed to delay the timing of the reimbursement to the ceding entity
5. Has the reporting entity, during the period covered by the statement, ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus in regard to policyholders or reported calendar-year-written premium ceded or year-end loss and loss expense reserves greater than 5% of prior year-end surplus in regard to policyholders, excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with: (i) one or more unaffiliated policyholders of the reporting entity or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:
- (a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents 50% or more of the entire direct and assumed premium written by the reinsurer based on its most recently available statutory-basis financial statements

Yes [X] No []

Virginia Surety Company, Inc.

Reinsurance Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

December 31, 2015

- (b) Twenty-five percent or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract
6. If yes to 4 or 5, please provide the following information:
- (a) The aggregate statutory-basis financial statement impact gross of all such ceded reinsurance contracts on the statutory-basis balance sheet and statutory-basis statement of income
- (b) A summary of the reinsurance contract terms and indicate whether they apply to the contracts meeting the criteria in 4 or 5.
- (c) A brief discussion of management's principal objectives in entering into the reinsurance contract, including the economic purpose to be achieved.

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
1) Asset Insurance Company, Ltd.^(B)			
Assets	\$ 1,147,037	\$ 99,386	\$ 1,246,423
Liabilities	783,401	99,386	882,787
Capital and surplus	363,636	14,831	378,467
Underwriting profit	18,598	14,831	33,429
Management's objective	Cede risk to reinsurance captive		

Virginia Surety Company, Inc.

Reinsurance Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

December 31, 2015

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
2) Chicago Standard Insurance Co. Ltd.^(B)			
Assets	\$ 1,147,037	\$ 23,053	\$ 1,170,090
Liabilities	783,401	23,053	806,454
Capital and surplus	363,636	3,439	367,075
Underwriting profit	18,598	3,439	22,037
Management's objective	Cede risk to unaffiliated reinsurance captive		

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
3) Concord Atlantic Reinsurance Ltd.^(B)			
Assets	\$ 1,147,037	\$ 26,061	\$ 1,173,098
Liabilities	783,401	26,061	809,462
Capital and surplus	363,636	6,595	370,231
Underwriting profit	18,598	6,595	25,193
Management's objective	Cede risk to unaffiliated reinsurance captive		

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
4) Express Performance Ltd.^(A)			
Assets	\$ 1,147,037	\$ 61,583	\$ 1,208,620
Liabilities	783,401	61,583	844,984
Capital and surplus	363,636	13,327	376,963
Underwriting profit	18,598	13,327	31,925
Management's objective	Cede risk to unaffiliated reinsurance captive		

Virginia Surety Company, Inc.

Reinsurance Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

December 31, 2015

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
5) Glendale Reinsurance Company^(B)			
Assets	\$ 1,147,037	\$ 84,163	\$ 1,231,200
Liabilities	783,401	84,163	867,564
Capital and surplus	363,636	15,053	378,689
Underwriting profit	18,598	15,053	33,651
Management's objective	Cede risk to unaffiliated reinsurance captive		

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
6) Kenwood Insurance Company^(B)			
Assets	\$ 1,147,037	\$ 142,296	\$ 1,289,333
Liabilities	783,401	142,296	925,697
Capital and surplus	363,636	22,136	385,772
Underwriting profit	18,598	22,136	40,734
Management's objective	Cede risk to unaffiliated reinsurance captive		

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
7) Lariat Insurance Company Ltd.^(B)			
Assets	\$ 1,147,037	\$ 37,874	\$ 1,184,911
Liabilities	783,401	37,874	821,275
Capital and surplus	363,636	6,964	370,600
Underwriting profit	18,598	6,964	25,562
Management's objective	Cede risk to unaffiliated reinsurance captive		

Virginia Surety Company, Inc.

Reinsurance Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

December 31, 2015

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
8) Safe-Guard Reinsurance Co. Ltd.^(A)			
Assets	\$ 1,147,037	\$ 260,519	\$ 1,407,556
Liabilities	783,401	260,519	1,043,920
Capital and surplus	363,636	(12,217)	351,419
Underwriting profit	18,598	(12,217)	6,381
Management's objective	Cede risk to unaffiliated reinsurance captive		

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
9) St. Charles Insurance Company^(A)			
Assets	\$ 1,147,037	\$ 30,659	\$ 1,177,696
Liabilities	783,401	30,659	814,060
Capital and surplus	363,636	7,053	370,689
Underwriting profit	18,598	7,053	25,651
Management's objective	Cede risk to unaffiliated reinsurance captive		

Reinsurer	As Reported	Reinsurance Effect	Restated Without Reinsurance
10) Universal Reinsurance Company Ltd.^(A)			
Assets	\$ 1,147,037	\$ 32,899	\$ 1,179,936
Liabilities	783,401	32,899	816,300
Capital and surplus	363,636	8,503	372,139
Underwriting profit	18,598	8,503	27,101
Management's objective	Cede risk to unaffiliated reinsurance captive		

The reinsurance effect in this interrogatory on surplus is shown as the underwriting profit (loss) for the year ended December 31, 2015, as it is assumed that any prior surplus would have been distributed to policyholders.

Virginia Surety Company, Inc.

Reinsurance Interrogatories – Statutory Basis (continued)
(Dollars in Thousands)

December 31, 2015

Reinsurance Contract Terms Key

- (A) 100% quota share, included due to >50% of reinsurer's premiums come from the Company.
- (B) 100% quota share (25% funds held) of business to reinsurer, loss corridor 120% to 165% or 180%, included due to >50% of reinsurer's premiums come from the Company.
7. Except for transactions meeting the requirements of paragraph 31 of SSAP No. 62R, *Property and Casualty Reinsurance*, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the statutory-basis financial statement, and either:
- Yes ☐ No ☒
- (a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP)?
- (b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP?
8. If yes to 7, explain why the contract is treated differently for GAAP and SAP.
- Yes ☐ No ☐ N/A ☒

Virginia Surety Company, Inc.

Summary Investment Schedule – Statutory Basis
(Dollars in Thousands)

December 31, 2015

Investment Categories	Gross Investment Holdings*		Admitted Assets as Reported in the Annual Statements	
	Amount	Percentage of Gross Investment Holdings	Amount	Percentage of Gross Investment Holdings
Bonds:				
U.S. Treasury securities	\$ 6,347	0.6%	\$ 6,347	0.6%
U.S. Government agency obligations (excluding mortgage-backed securities):				
Issued by U.S.-Government-sponsored agencies				
Non-U.S. Government (including Canada, excluding mortgage-backed securities)	67,951	6.4	67,951	6.4
Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
States, territories, and possessions general obligations	19,443	1.9	19,443	1.9
Political subdivisions of states, territories, and possessions and political subdivisions general obligations	32,935	3.1	32,935	3.1
Revenue and assessment obligations	161,935	15.3	161,935	15.3
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities issued or guaranteed by GNMA	20,393	1.9	20,393	1.9
FNMA, and FHLMC	41,334	3.9	41,334	3.9
Pass-through securities – all other	1,875	0.2	1,875	0.2
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC, or VA	63,771	6.0	63,771	6.0
Issued by non-U.S. government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies				
All other	139,005	13.1	139,005	13.1
Other debt and other fixed-income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans and hybrid securities)	229,917	21.7	229,917	21.7
Unaffiliated non-U.S. securities (including Canada)	175,235	16.6	175,235	16.6
Equity interests:				
Investment in common stock of affiliate	14,985	1.4	14,985	1.4
Investments in mutual funds	1,605	0.2	1,605	0.2
Receivables for securities	36	—	36	—
Cash, cash equivalents, and short-term investments	81,925	7.7	81,925	7.7
Total invested assets	\$ 1,058,692	100.0%	\$ 1,058,692	100.0%

*Gross investment holdings as valued in compliance with the NAIC's *Accounting Practices and Procedures Manual*.

Virginia Surety Company, Inc.

Note to Supplementary Information – Statutory Basis

December 31, 2015

Note – Basis of Presentation

The accompanying supplemental reinsurance interrogatories and supplemental investment schedules present selected statutory-basis financial data as of December 31, 2015, and for the year then ended, for the purpose of complying with the National Association of Insurance Commissioners' *Annual Statement Instructions* and the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* and agree to, or are included in, the amounts reported in the Company's 2015 Statutory Annual Statement as filed with the Illinois Department of Insurance.

Captions or amounts that are not applicable have been omitted.

EY | Assurance | Tax | Transactions | Advisory

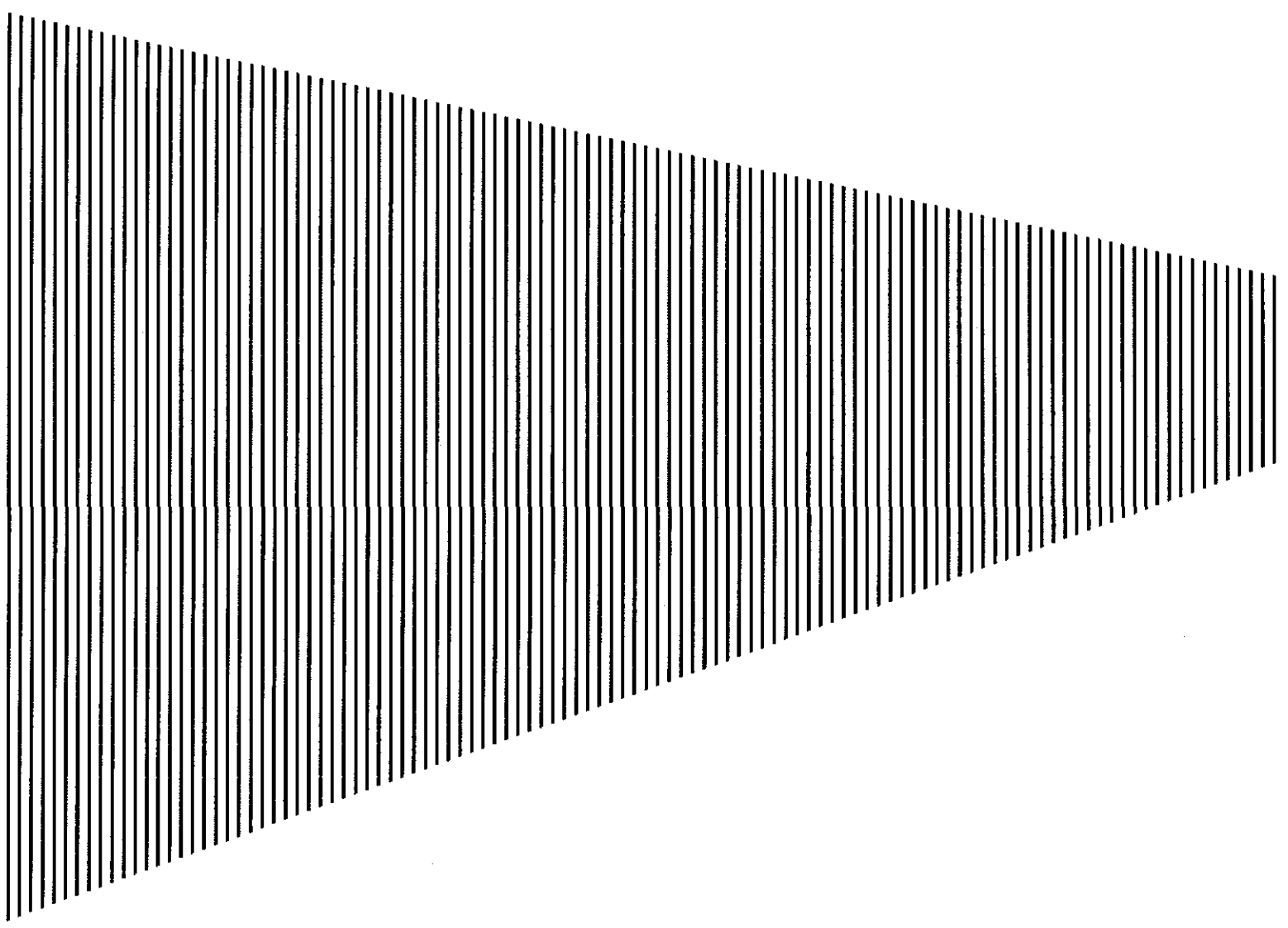
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Section 78 Report: Appointed Actuary's Review of Actuarial Information in respect of the Audited December 2015 Financial Statements

This return is in respect of Virginia Surety Company Incorporated (VSC).

This return is prepared under section 78 of the Insurance (Prudential Supervision) Act 2010 in respect of section 77 of the Act which requires that each licensed insurer within New Zealand must ensure that the actuarial information contained in, or used in the preparation of, the financial statements of the insurer and any group financial statement are reviewed by the appointed actuary.

This return has been prepared by James Pettifer (FIAA), Appointed Actuary of VSC NZ and is reliant on the work done and reporting completed by Richard Vaughan, the Appointed Actuary for VSC. This is the first time such return has been prepared for VSC.

I am an employee of The Warranty Group Australasia, which shares a parent company with VSC NZ. Other than my employment relationship with VSC NZ, I have no financial or ownership interest in VSC NZ.

As part of the Statement of Actuarial Opinion provided by Richard Vaughan, the actuarial information contained in the audited December 2015 financial statements has been reviewed to confirm that the actuarial information provided has been used appropriately in those statements. There has been no material impacts on the accounts between the date of the financial statements and the date of this report.

VSC has supplied Richard with the information and explanations necessary to undertake this review.

It is VSC's established policy to seek the advice of the appointed actuary in respect of all actuarial information and to adopt that advice in its financial statements.

The following actuarial items have been reviewed and reflect the scope and limitation of this review:

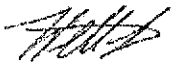
- Premium Revenue
- Gross Claims Incurred
- Outstanding Claims
- Unearned Premiums

In my opinion, there was no other information that required actuarial review for the purposes of this return.

In summary, I can confirm that:

- Richard has obtained all information and explanations required to review VSC's financial statements;
- Richard is comfortable with the actuarial-related numbers used in these reports; and
- VSC is solvent under Illinois solvency requirements.

Signed:



(James Pettifer, FIAA)

Date: 29th April 2016



VIRGINIA SURETY COMPANY INC – NEW ZEALAND BRANCH

ANNUAL FINANCIAL REPORT

**FOR THE YEAR ENDED
31 DECEMBER 2015**

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DIRECTOR'S REPORT

The Director presents the annual report together with the audited Financial Statements for the year ended 31 December 2015.

No disclosure has been made pursuant to Section 211(1) (a) and (e) to (j) of the *Companies Act 1993* following a unanimous decision by the shareholders in accordance with Section 211 (3) of the Act.

RESULTS

The profit for the year after income tax was \$142,057 (2014: \$536,727).

DIVIDEND

The Director recommends that no dividend be paid (2014: \$Nil).

AUDITORS

In terms of the *Companies Act 1993*, Ernst & Young are to continue in office as the Branch's auditors.

ACTIVITIES

The principal activities during the year were those of insurance underwriting and investment.

DIRECTORS INTERESTS IN TRANSACTIONS

Directors have no interests to declare in the transactions of the year ended 31 December 2015.


REVIEW OF OPERATIONS

The gain for the financial year reflects the maturity of its existing earnings profile and claim experience.

SUBSEQUENT EVENTS

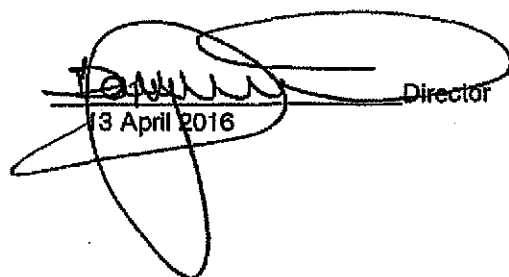
There were no events since 31st December 2015 which have significantly affected, or may significantly affect, the operations of the branch in future financial years, the results of those operations, or the state of affairs of the company in future financial years.

ON BEHALF OF THE BOARD



Director

13 April 2016



Director

13 April 2016



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Independent Auditor's Report

To the Shareholders of Virginia Surety Company Inc. (New Zealand Branch)

Report on the Financial Statements

We have audited the financial statements of the New Zealand branch of Virginia Surety Company Inc. on pages 5 to 24, which comprise the statement of financial position of the New Zealand branch of Virginia Surety Company Inc. as at 31 December 2015, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

This report is made solely to the company's shareholders, as a body. Our audit has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the New Zealand branch of the company and the company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

Directors' Responsibility for the Financial Statements

The directors are responsible on behalf of the company for the preparation and fair presentation of the financial statements in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). These auditing standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we have considered the internal control relevant to the New Zealand branch of the company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the New Zealand branch of the company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

We believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

Other than in our capacity as auditor we have no relationship with, or interest in, the New Zealand branch of the company.

Partners and employees of our firm may deal with the New Zealand branch of the company on normal terms within the ordinary course of trading activities of the business of the New Zealand branch of the company.

Opinion

In our opinion, the financial statements on pages 5 to 24 present fairly, in all material respects, the financial position of the New Zealand branch of the company as at 31 December 2015 and its financial performance and cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

Ernst & Young
13 May 2016
Melbourne

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VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2015

	Notes	2015 \$	2014 \$
REVENUE			
Premium revenue		3,991,376	3,573,875
Decrease/(Increase) in unearned premium reserve		(791,969)	(194,650)
		<u>3,199,407</u>	<u>3,379,225</u>
EXPENSES			
Gross claims incurred	5	880,579	1,166,678
Acquisition costs	15	1,429,808	1,160,730
		<u>2,310,387</u>	<u>2,327,408</u>
Investment income	8	175,213	217,974
(Loss)/gain on investments		53,920	49,388
		<u>229,133</u>	<u>267,362</u>
Other operating and administration expenses	7	(860,559)	(720,486)
Profit/(Loss) before income tax		<u>257,594</u>	<u>598,693</u>
Income tax (expense) / benefit	9	(115,537)	(61,966)
Profit/(Loss) after income tax		<u>142,057</u>	<u>536,727</u>
Total comprehensive income		<u>142,057</u>	<u>536,727</u>
Operating profit for the year attributable to:			
Non-controlling interest		-	-
Owners of the parent		142,057	536,727
Operating Profit after tax		142,057	536,727
Total comprehensive income is attributable to:			
Non-controlling interest		-	-
Owners of the parent		142,057	536,727
Operating Profit after tax		142,057	536,727

The attached notes on pages 9 to 24 form part of and should be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.

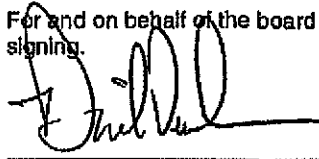
VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2015

	Notes	2015 \$	2014 \$
ASSETS			
Current assets			
Cash and cash equivalents	10	2,090,156	1,169,782
Trade and other receivables	11	203,514	908,210
Deferred acquisition costs	15	4,628,443	3,538,735
Current tax asset	9	95,031	48,340
Total current assets		7,017,144	5,665,067
Non-current assets			
Investments	12	4,660,933	4,872,074
Deferred tax assets	9	67,383	11,341
Total non-current assets		4,728,316	4,883,415
TOTAL ASSETS		11,745,460	10,548,482
LIABILITIES			
Current liabilities			
Trade and other payables		714,024	70,507
Outstanding claims	14	206,648	181,533
Unearned premiums	17	7,948,467	7,156,502
Current tax liabilities	9	-	405,676
Total current liabilities		8,869,139	7,814,218
TOTAL LIABILITIES		8,869,139	7,814,218
NET ASSETS		2,876,321	2,734,264
TOTAL EQUITY		2,876,321	2,734,264

For and on behalf of the board of directors, who authorised the issue of this financial report on the date of signing.


Director

13 April 2016


Director

13 April 2016

The attached notes on pages 9 to 24 form part of and should to be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2015

	2015	2014
	\$	\$
Total Equity as at 1 January	2,734,264	2,197,537
Profit /(loss) for the year	142,057	536,727
Total comprehensive income/(loss)	<u>142,057</u>	<u>536,727</u>
Total Equity as at 31 December	<u>2,876,321</u>	<u>2,734,264</u>

The attached notes on pages 9 to 24 form part of and should be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2015

	Note	2015 \$	2014 \$
Cash flows from operating activities			
Receipts from customers		3,211,502	2,462,366
Payments to suppliers and employees		(3,119,927)	(3,072,001)
Interest received		242,958	252,713
Net cash flows provided by/(used in) operating activities	10	334,533	(356,922)
Cash flows from investing activities			
Purchase of investment assets		211,141	(1,466,492)
Payment received from investment		-	1,500,000
Net cash flows used in investing activities		211,141	33,508
Cash flows from financing activities			
Repayments to related parties		374,700	(67,262)
Net cash flows from financing activities		374,700	(67,262)
Net decrease in cash and cash equivalents		920,374	(390,676)
Cash and cash equivalents at beginning of period		1,169,782	1,560,458
Cash and cash equivalents at end of period		2,090,156	1,169,782

The attached notes on pages 9 to 24 form part of and should be read in conjunction with these financial statements, together with the Auditors' Report on page 3 and 4.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

1. CORPORATE INFORMATION

These financial statements have been prepared for the New Zealand branch of the Virginia Surety Company Inc., which is incorporated in the United States of America.

Corporate Information

Virginia Surety Company Inc for the year ended 31 December 2015, incorporated in the United States of America, is the Branch's immediate parent company.

The registered office of Virginia Surety Company Inc New Zealand branch (the Branch) for the year ended 31 December 2015 is

359 Lincoln Road,
Christchurch,
New Zealand, 8024

TPG Capital, incorporated in U.S, is the Branch's ultimate holding company.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Insurance Contract

All of the insurance products offered or utilised by the Branch meet the definition of insurance contracts under the New Zealand equivalents to International Financial Reporting Standards, and are accounted for and reported in accordance with these standards.

These products do not contain embedded derivatives or deposits that are required to be unbundled.

Basis of Preparation

The financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand (NZ GAAP) and the requirements of the *Companies Act 1993* and the *FMC Act 2014* on a historical cost basis. For the purposes of complying with NZ GAAP the entity is a for-profit entity.

The financial report has been prepared on an accrual basis of accounting including the historical cost convention and the going concern assumption. Notwithstanding the current liability deficiency, the directors have concluded the company can continue as a going concern as the creditor, being the parent company, has agreed not to call upon amounts owed for a period of 12 months.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The financial statements are presented in New Zealand dollars.

The following particular accounting policies have been applied:

a) Revenue

Premium revenue for insurance comprises amounts charged to policyholders. The earned portion of premium received and receivable, including unclosed business, is recognised as revenue. The pattern of recognition of income over the policy or indemnity periods is based on time, which closely approximates the pattern of risks underwritten. Unearned premium is determined by apportioning the premiums written over the period of risk from the date of attachment of risk. Interest on investment income is accounted for on an accrual basis.

b) Unearned Premium

Provisions in respect of the proportion of premiums relating to risk in future periods of account are calculated on the straight-line basis over the period of risk.

c) Deferred Acquisition Expenses

Acquisition expenses, principally comprising commissions and fees incurred on insurance contracts, are deferred and expensed over the period in which the related premiums are earned. Deferred acquisition costs are measured at the lower of cost and recoverable amount.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period and are treated as a change in an accounting estimate.

An impairment review is performed at each reporting date or more frequently when an indication of impairment arises. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the statement of comprehensive income. Deferred acquisition expenses are also considered in the liability adequacy test for each reporting period.

d) Outstanding Claims

The Outstanding Claims provision comprises the estimated costs of claims incurred including indirect claims settlement costs, whether reported or not, and claims not settled at balance date. Reported claims have been assessed in the light of the information available at balance date and after taking account of present value of the expected future payments. The provision for claims incurred but not reported has been assessed having regard for the Branch's claim performance. The expected future payments include claims handling costs which are to be incurred in settling the insured claims.

e) Taxation

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

e) Taxation (continued)

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the asset and liability giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Branch expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax is recognised as an expense or income in the statement of comprehensive income, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity.

f) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except:

- where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

g) Investments

Financial assets at fair value through profit and loss:

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the statement of profit or loss.

h) Foreign Currency Translation

(i) Functional and presentation currency

Both the functional and presentation currency of Virginia Surety Company Inc – New Zealand Branch is New Zealand dollars (\$).

(ii) Transactions & balances

Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the reporting date.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

h) Foreign Currency Translation (continued)

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

i) Claims

Reported claims have been assessed in the light of the information available at balance date and after taking account of expected trends in future settlements.

j) Trade and other receivables

Trade receivables, which generally have 30 day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less an allowance for impairment.

Collectability of trade receivables is reviewed on an ongoing basis at an operating unit level. Individual debts that are known to be uncollectible are written off when identified. An impairment provision is recognised when there is objective evidence that the Group will not be able to collect the receivable. Financial difficulties of the debtor, default payments or debts more than 30 days overdue are considered objective evidence of impairment. The amount of the impairment loss is the receivable carrying amount compared to the present value of estimated future cash flows discounted at the original effective interest rate.

k) Trade and other payables

Trade and other payables are carried at amortised cost and due to their short-term nature they are not discounted. They represent liabilities for goods and services provided to the Branch prior to the end of the financial year that are unpaid and arise when the Branch becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are usually paid within 30 days of recognition.

l) Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

m) Impairment of assets

At each reporting date, the Branch reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Branch estimates the recoverable amount of the cash-generating unit to which the asset belongs.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

m) Impairment of assets (continued)

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

n) New Accounting Standards and Interpretations

Changes in accounting policy and disclosures

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The branch has adopted the following new and amended New Zealand Equivalents to International Financial Reporting Standards and interpretations as of 1 January 2015.

- *Amendments to NZ IAS 19 Defined Benefit Plans: Employee Contributions*

The adoption of the standards and interpretations detailed above are not deemed to have an impact on the financial statements or performance of the branch. The branch has not elected to early adopt any new standards or interpretations that are issued but not yet effective.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

o) Significant Accounting Judgements, Estimates & Assumption

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts in the financial statements. Management continually evaluates its judgements and estimates in relation to assets, liabilities, contingent liabilities, revenue and expenses. Management bases its judgements and estimates on historical experience and on other various factors it believes to be reasonable under the circumstances, the result of which form the basis of the carrying values of assets and liabilities that are not readily apparent from other sources.

(i) Valuation of outstanding claims provision

For insurance contracts, estimates have to be made both for the expected ultimate cost of claims reported at the reporting date and for the expected ultimate cost of claims incurred but not yet reported at the reporting date (IBNR). It can take a significant period of time before the ultimate claims form the majority of the liability in the statement of financial position. The IBNR included assumptions such as claims frequency, cancellations and average claim size.

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques, including Paid Chain Ladder, Inflation-Adjusted Payments Per Claims Incurred and Bornheutter-Ferguson method.

The main assumption underlying these techniques is that a Group's past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analysed by accident years, but can also be further analysed by geographical area, as well as by significant business lines and claim types. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development.

In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based. Additional qualitative judgement is used to assess the extent to which past trends may not apply in future, (e.g., to reflect one-off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy features and claims handling procedures) in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

Similar judgements, estimates and assumptions are employed in the assessment of adequacy of provisions for unearned premium. Judgement is also required in determining whether the pattern of insurance service provided by a contract requires amortisation of unearned premium on a basis other than time apportionment.

The carrying value at the reporting date of expected future claims liabilities is \$206,648 (2014: \$181,533).

Claims provisions are expected to be settled within one year. The amount of expected future payments does not differ materially from the present value; therefore the claims provision has not been discounted.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

3. RISK MANAGEMENT

(a) Risk management framework

The financial condition and operation of the branch is affected by a number of key risks including insurance risk, credit risk, market risk and liquidity risk.

The branch has developed, implemented and maintained a Risk Management Strategy (RMS) and Reinsurance Risk Management Strategy (ReMS). The RMS and ReMS identify the branch's policies and procedures, processes and controls that comprise its risk management and control systems. The RMS and ReMS have been approved by the Audit and Compliance Committee and provided to APRA.

(b) Insurance risk

Insurance Risk is defined as the risk of loss due to the actual experience being different than that assumed when an insurance product was designed and priced.

VSC's local underwriter is responsible for pricing the risk. When the value is above the underwriter's delegated authority it is referred to the US Underwriting Group for review and approval.

These files provide guidance on the willingness to accept risk and such issues as geographic and monetary limits.

The following processes are undertaken:

- Continuous assessment of product characteristics to ensure that pricing and outcomes remain consistent with the assumptions used in product design.
- Systems of claims categorisation and loss measurement by risk category.
- Effective correction strategies for underpricing of risk.
- Anticipation of factors leading to changes in claims incidence and claims costs.

Unless approved by the local Underwriter or confirmation is received from the US Underwriting Group, no business will be accepted nor new classes of business introduced.

In accordance with the Reinsurance Policy no liability which exceeds the maximum retention levels shall be approved by the Executive Management Committee.

The Underwriting Committee meets on a monthly basis to review and monitor portfolio performance.

On a monthly basis all product programs are reviewed by the underwriter and presented to the Underwriting Committee who review them, in particular the loss ratio.

(c) Credit risk

Credit risk refers to the risk that a customer or counterparty to a financial instrument fails to meet its contractual obligations resulting in financial loss to the branch and arises principally from the branch's premium receivables and investments.

VSC's exposure to credit risk is concentrated in the following key activities:

Investments: These activities involve the investment of a significant proportion of assets in fixed interest and bonds. VSC's investment policy ensures that it only invests in assets that are of investment grade A- or above and that no more than 5% is invested in the one asset.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

(c) Credit risk (continued)

Business partner risk: Intermediaries and business partners, act on behalf of VSC in insurance sales, premium collection and remittance to VSC. To counteract counterparty risk, VSC receives monthly remittance from their business partners. If this is not received on time, investigative action is undertaken.

Intermediaries and business partners are subject to a variety of statutory regulatory controls in addition to controls within VSC management framework. Financial Institutions in general are subject to a range of regulatory control processes. Agents tend to be less subject to statutory regulatory control with greater emphasis on monitoring and supervision on the part of VSC.

The Branch does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The maximum exposure to credit risk is the amounts shown in the statement of financial condition and notes. The maximum credit risk to the Branch is the carrying value of the assets. The Branch does not have any concentration of credit exposure.

(d) Market risk

Market risk is the risk that changes in market prices, such as changes in interest rates and foreign exchange, will affect the branch's interest income, claims expense or the value of its holdings in financial instruments.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Branch's exposure to the risk of changes in market interest rates relates primarily to the Branch's short term deposit with floating interest rates.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015****(d) Market risk (continued)**

The following table demonstrates the sensitivity to a reasonably possible change in interest rates on that portion of deposits affected. With all other variables held constant, the branch's profit before tax is affected through the impact on floating rate deposit as follows.

	Increase/decrease in basis points	Effect on profit before tax \$
2015		
Short Term Deposits	+100	-
Short Term Deposits	+200	-
Short Term Deposits	-100	-
Short Term Deposits	-200	-
2014		
Short Term Deposits	+100	-
Short Term Deposits	+200	-
Short Term Deposits	-100	-
Short Term Deposits	-200	-

Foreign currency risk:

The branch has minimal exposure to foreign currency risk as all investments are undertaken in New Zealand dollars. The Branch does not undertake any transactions denominated in foreign currencies and so exposures in foreign currency do not arise. The foreign currency exposure at the year end was nil.

(e) Liquidity risk

Liquidity risk can be defined as the risk that the branch will not be able to meet its payment obligations as they fall due without excessive cost.

Ultimate responsibility for liquidity risk management rests with the board of directors, who have built an appropriate liquidity risk management framework for the management of the Branch's short, medium and long term funding and liquidity management requirements.

The Branch manages liquidity risk by maintaining adequate reserves and banking facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

4. RELATED PARTY TRANSACTIONS

The following table provides the total amount of transactions that were entered into with related parties for the relevant financial year (for information regarding outstanding balances for trade and other receivables, refer to Note 11):

		Sales to Related Parties	Purchases from Related Parties	Expenses Charged by Related Parties
		\$	\$	\$
<i>Fellow subsidiaries :</i>				
The Warranty Group				
Australasia Pty Ltd	2015	-	-	(435,870)
- expenses paid for on				
behalf of fellow subsidiary	2014	-	-	(473,193)
The Warranty Group				
Australasia Pty Ltd	2015	-	-	(898,727)
- marketing &				
administration fees	2014	-	-	(943,429)

During the year, The Warranty Group Australasia Pty Ltd, paid expenses of \$435,870 (2014: \$473,193) on behalf of the New Zealand Branch of Virginia Surety Company Inc. These expenses were recharged to the branch at year end.

During the year, the Australia branch of Virginia Surety Company Inc paid claims of \$nil (2014: \$410) on behalf of the New Zealand branch. These claim paid were recharged to the New Zealand branch.

Unless otherwise stated, related parties are fellow subsidiaries of the ultimate parent company.

Terms and conditions of transactions with related parties

Sales to and purchases from related parties are made in arm's length transactions both at normal market prices and on normal commercial terms.

Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

5. CLAIMS INCURRED

Current year claims relate to risks borne in the current financial year. Prior year claims relate to a reassessment of the risks borne in all previous financial periods.

	2015	2014
	\$	\$
Current year	819,317	1,105,416
Prior years	61,262	61,262
Total incurred claims	<u>880,579</u>	<u>1,166,678</u>

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015****6. AUDITORS' REMUNERATION**

The auditor of the Branch is Ernst & Young.

Auditors' fees payable for the audit of the financial report of the company as at 31st December 2015 amounted to \$30,030 (2014: \$24,841).

Auditors' fees charged for the year comprises:

	2015 \$	2014 \$
Auditor Remuneration:		
Audit fee	24,714	20,450
Tax compliance	32,384	56,125
	<u>57,098</u>	<u>76,575</u>

7. OTHER OPERATING AND ADMINISTRATION EXPENSES

Other Operating and administration expenses comprises:

	2015 \$	2014 \$
Salaries & benefits	(32,369)	29,730
Other operating and administrative expenses recharged to the branch	498,849	473,264
Office & communication	59,405	73,856
Travel & entertainment	37,431	47,193
Bank charges	637	763
Bad debts	209,042	2,137
Legal fees	750	16,968
Auditors & consultants fees	57,098	76,575
Other expenses	29,716	-
	<u>860,559</u>	<u>720,486</u>

8. INVESTMENT INCOME

	2015 \$	2014 \$
Investment income comprises:		
Interest on government stock	168,349	170,325
Other interest	6,864	47,649
	<u>175,213</u>	<u>217,974</u>

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

9. CURRENT YEAR'S TAXATION

	2015	2014
	\$	\$
<u>Taxation expense comprises:</u>		
Profit before taxation	257,594	598,693
Current tax expense @ 28%	<u>(72,126)</u>	<u>(167,634)</u>
Non-deductible expenses for tax purposes	(511)	(641)
Adjustments recognised in the current period in relation to the current tax of prior periods	(42,900)	2,530
Utilisation of previously unrecognised tax losses	<u>-</u>	<u>103,779</u>
Total tax (expense) / benefit	<u>(115,537)</u>	<u>(61,966)</u>
<u>Current tax assets and liabilities</u>		
Tax receivable	<u>95,031</u>	<u>48,340</u>
Current tax asset	<u>95,031</u>	<u>48,340</u>
Tax payable	<u>-</u>	<u>405,676</u>
Current tax liability	<u>-</u>	<u>405,676</u>
<u>Deferred tax balances</u>		
Provision for doubtful debts	58,528	185
Deferred acquisition costs	-	-
Carry forward tax losses	-	-
Other	8,855	11,156
Net deferred tax (liability)/asset	<u>67,383</u>	<u>11,341</u>

10. CASH AND CASH EQUIVALENTS

	2015	2014
	\$	\$
Cash at bank and in hand	2,090,156	1,169,782
Reconciliation to Cash Flow Statement		
For the purpose of the Cash Flow statement, cash and cash equivalents comprise the following at 31 December:		
Cash at bank and in hand	2,090,156	1,169,782

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

10. CASH AND CASH EQUIVALENTS (Continued)

Reconciliation of net profit after tax to net cash flows from operations

	2015 \$	2014 \$
Net profit	142,057	536,727
Adjustments for:		
Increase/(Decrease) in allowance for doubtful debts	208,368	-
Changes in Assets and Liabilities:		
(Increase) / Decrease in trade and other receivables	107,803	(73,685)
(Increase) / Decrease in Investment Assets	13,825	(14,649)
Increase / (Decrease) in outstanding claim	25,115	39,914
Increase / (Decrease) in trade and other payables	643,517	(55,087)
(Increase) / Decrease in deferred tax asset	(56,042)	1,144
Increase / (Decrease) in current taxes	(452,367)	53,032
(Decrease) / Increase in unearned premium	791,965	194,651
(Increase) / Decrease in deferred acquisition cost	(1,089,708)	(1,038,969)
Net cash flows provided by/ (used in) operating activities	334,533	(356,922)

11. TRADE AND OTHER RECEIVABLES

	2015 \$	2014 \$
Investment income receivable	35,530	49,355
Premium debtors	377,014	476,367
Provision for doubtful debts	(209,030)	(662)
Prepayments	-	8,450
Related party receivable	-	374,700
	203,514	908,210

Related party receivable:

All intercompany balances are with The Warranty Group Australasia Pty Ltd and are due and payable on demand. No interest rates apply to the outstanding amounts.

12. INVESTMENTS

	2015 \$	2014 \$
<u>Non current</u>		
Government stock	4,660,933	4,872,074
Total investments	4,660,933	4,872,074

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015****13. FINANCIAL ASSETS AND LIABILITIES****Categories of financial assets and liabilities**

	2015	2014
	\$	\$
Cash and cash equivalents	2,090,156	1,169,782
Investments	4,660,933	4,872,074
Loans and receivables	203,514	908,210
Liabilities at amortised cost	(714,024)	(70,507)

Financial assets carried at fair value through profit or loss have been designated as such upon initial recognition.

The carrying value of all financial assets and liabilities approximate to their fair value.

14. CLAIMS PROVISIONS**Composition of claims provision**

	2015	2014
	\$	\$
Central estimate of expected future payments for claims reported including:		
Indirect claims settlement costs	206,648	181,533
Gross provision	<u>206,648</u>	<u>181,533</u>

The percentage risk margin adopted in determining the outstanding claims liability is nil.

Claims provisions are expected to be settled within one year. The amount of expected future payments does not differ materially from the present value; therefore, the claims provision has not been discounted.

CLAIMS RESERVE

	2015	2014
	\$	\$
At beginning of year	181,533	141,619
Claims incurred	880,579	1,166,678
Claims settled	(855,464)	(1,126,764)
At end of year	<u>206,648</u>	<u>181,533</u>

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

15. DEFERRED ACQUISITION COSTS

	2015 \$	2014 \$
At beginning of year	3,538,735	2,499,766
Costs Incurred	2,519,516	2,199,699
Recognised in statement of comprehensive income	(1,429,808)	(1,160,730)
At end of year	<u>4,628,443</u>	<u>3,538,735</u>

16. ASSETS BACKING GENERAL INSURANCE LIABILITIES

In determining which assets back general insurance liabilities, a comparison between the asset values and the amount needed to meet claims liabilities and solvency requirements was carried out.

17. LIABILITY ADEQUACY TEST

The liability adequacy test carried out on the insurance portfolio in the current year in accordance with NZ IFRS 4 identified a surplus of \$1,323,198 (2014: \$1,207,018).

	2015 \$	2014 \$
<u>Insurance Portfolio</u>		
Gross unearned premium reserve	7,948,467	7,156,502
Reinsurance	-	-
Net unearned premium	7,948,467	7,156,502
Ultimate net loss ratio	25.1%	33.7%
Risk claims (0% discount) central estimate	(1,996,826)	(2,410,749)
Claims handling costs	-	-
Risk margin	-	-
Expected future claims	(1,996,826)	(2,410,749)
Deferred acquisition costs		
Commission expense	(3,356,434)	(2,317,369)
Administration	(1,272,009)	(1,221,366)
Total deferred acquisition costs	(4,628,443)	(3,538,735)
Level of surplus / (deficiency)	<u>1,323,198</u>	<u>1,207,018</u>

The liability adequacy test carried out on the insurance portfolio in the current year, as well as the liability adequacy test carried out in the prior year, identified surpluses, therefore there was no write down of any asset balances.

18. INSURER FINANCIAL STRENGTH RATING AND SOLVENCY DISCLOSURE

Virginia Surety Company Inc has a financial strength rating of A- issued by A M Best (2014: A-) and the following solvency information:

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

18. INSURER FINANCIAL STRENGTH RATING AND SOLVENCY DISCLOSURE (CONTINUED)

	2015	2014
	\$	\$
Actual solvency capital	363,636,160	300,789,108
Minimum solvency capital	71,595,223	62,777,781
Solvency margin	292,040,937	238,511,327
Solvency ratio	5.08	4.83

19. EQUITY RETAINED FOR THE PURPOSES OF FINANCIAL SOUNDNESS

The branch retains a level of equity and retained reserves which enable it to maintain an adequate solvency margin for ongoing ability to pay clients. These financial statements relate to a branch of an overseas company. Its assets are available to support the liabilities of the company outside of New Zealand.

20. SUBSEQUENT EVENTS

The company's largest customer, DSE (NZ) Limited, went into administration and receivership on 4 January 2016. Invitations were called for expressions of interest for a sale of the business as a going concern, however, no acceptable offers were received and on 25 February 2016 the receivers and managers announced that all stores would be closed. Given this new information, the branch increased its reported allowance for doubtful debts by \$208,000. No other matter or circumstance has arisen since the end of the financial year which has significantly affected, or may significantly affect, the operations of the branch in future financial years, the results of those operations, or the state of affairs of the branch in future financial years.

Section 78 Report: Appointed Actuary's Review of Actuarial Information in respect of the Audited December 2015 Financial Statements

This return is in respect of Virginia Surety Company Incorporated – New Zealand Branch (VSC NZ).

This return is prepared under section 78 of the Insurance (Prudential Supervision) Act 2010 in respect of section 77 of the Act which requires that each licensed insurer within New Zealand must ensure that the actuarial information contained in, or used in the preparation of, the financial statements of the insurer and any group financial statement are reviewed by the appointed actuary.

This return has been prepared by James Pettifer (FIAA), Appointed Actuary of VSC NZ. This is the third time such return has been prepared for VSC NZ.

I am an employee of The Warranty Group Australasia, which shares a parent company with VSC NZ. Other than my employment relationship with VSC NZ, I have no financial or ownership interest in VSC NZ.

I have reviewed the actuarial information contained in the audited December 2015 financial statements signed on 13th April 2016 to confirm that the actuarial information provided has been used appropriately in those statements. There has been no material impacts on the accounts between the date of the financial statements and the date of this report.

VSC NZ has supplied me with all the information and explanations necessary to allow me to undertake this review.

It is VSC NZ's established policy to seek the advice of the appointed actuary in respect of all actuarial information and to adopt that advice in its financial statements.

The following actuarial items have been reviewed and reflect the scope and limitation of this review:

- Premium Revenue
- Gross Claims Incurred
- Outstanding Claims
- Unearned Premiums

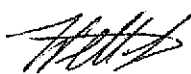
In my opinion, there was no other information that required actuarial review for the purposes of this return.

In summary, I can confirm that:

- I have obtained all information and explanations required to review VSC NZ's financial statements;
- I have reviewed the actuarial-related numbers in the Statement of Comprehensive Income and Statement of Financial Position signed on 13th April 2016 and I am comfortable with the actuarial-related numbers used in these reports; and
- I am not able to comment on the solvency margin of VSC NZ as at 31st December 2015 from an actuarial perspective due to exemption from compliance with the Solvency Standard for Non-life Insurance Business under Section 59 of the Insurance Prudential Supervision Act 2010 from the RBNZ.

For further detail on the items listed above, please refer to the detailed Section 78 Report for New Zealand.

Signed:



(James Pettifer, FIAA)

Date: 26th May 2016