Independent CPA Audit

CONTRACTORS BONDING AND INSURANCE COMPANY

Statutory Financial Statements and Schedules

December 31, 2013 and 2012

(With Independent Auditors' Report Thereon)

KPMG

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Independent Auditors' Report

The Audit Committee of the Board of Directors of RLI Corp.
The Board of Directors of Contractors Bonding and Insurance Company:

Report on the Financial Statements

We have audited the accompanying financial statements of Contractors Bonding and Insurance Company, which comprise the statutory statements of admitted assets, liabilities, and capital and surplus as of December 31, 2013 and 2012, and the related statutory statements of income and changes in capital and surplus, and cash flow for the years then ended, and the related notes to the statutory financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' 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 of America. Those standards require that we 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 the auditors' 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.

KPMG

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

As described in note 1 to the financial statements, the financial statements are prepared by Contractors Bonding and Insurance Company using statutory accounting practices prescribed or permitted by the Washington State Office of the Insurance Commissioner, which is a basis of accounting other than U.S. generally accepted accounting principles. Accordingly, the financial statements are not intended to be presented in accordance with U.S. generally accepted accounting principles.

The effects on the financial statements of the variances between the statutory accounting practices and U.S. generally accepted accounting principles also are described in note 1.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the variances between statutory accounting principles and U.S. generally accepted accounting principles discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statements referred to above do not present fairly, in accordance with U.S. generally accepted accounting principles, the financial position of Contractors Bonding and Insurance Company as of December 31, 2013 and 2012, or the results of its operations or its cash flows for the years then ended.

Opinion on Statutory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and capital and surplus of Contractors Bonding and Insurance Company as of December 31, 2013 and 2012, and the results of its operations and its cash flow for the years then ended, in accordance with statutory accounting practices prescribed or permitted by the Washington State Office of the Insurance Commissioner described in note 1.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information included in the schedule of supplemental investment risk interrogatories, the summary investment schedule, and the supplemental schedule of reinsurance interrogatories is presented for purposes of additional analysis and is not a required part of the financial statements but is supplementary information required by the Washington State Office of the Insurance Commissioner. 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 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 of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

KPMG LLP

Chicago, Illinois
May 2, 2014

CONTRACTORS BONDING AND INSURANCE COMPANY

Statutory Statements of Admitted Assets, Liabilities, and Capital and Surplus

December 31, 2013 and 2012

(In thousands)

Admitted Assets		2013	2012
Bonds, at amortized cost (Fair value – $173.9 million and $158.1 million in 2013 and 2012, respectively)	$	179,152	154,603
Cash, cash equivalents and short-term investments		1,579	18,211
Total cash and invested assets		180,731	172,814
Uncollected premiums and agents' balances		9,911	8,640
Reinsurance recoverable on paid losses and loss adjustment expenses		—	119
Deferred tax asset		2,956	3,285
Electronic data processing equipment, at cost less accumulated straight-line depreciation of $2.9 million and $4.6 million in 2013 and 2012, respectively		—	27
Investment income due and accrued		1,716	1,495
Receivable from affiliates		124	2,975
Receivables for securities		—	400
Other assets		96	961
Total admitted assets	$	195,534	190,716
Liabilities and Capital and Surplus			
Unpaid losses and loss adjustment expenses	$	45,924	48,773
Accrued expenses		213	51
Unearned premiums		27,511	26,663
Advance premiums		567	696
Ceded reinsurance premiums payable		182	1,757
Amounts withheld		8,982	10,647
Current federal income tax payable		301	416
Commissions payable, contingent commissions, and other similar charges		322	281
Other liabilities		40	—
Total liabilities		84,042	89,284
Capital and surplus:			
Capital stock, $10 par value. Authorized 1,000,000 shares; issued and outstanding 300,000 shares		3,000	3,000
Paid-in contributed capital		2,510	2,510
Unassigned surplus		105,982	95,922
Total capital and surplus		111,492	101,432
Total liabilities and capital and surplus	$	195,534	190,716

See accompanying notes to statutory financial statements.

CONTRACTORS BONDING AND INSURANCE COMPANY

Statutory Statements of Income and Changes in Capital and Surplus

Years ended December 31, 2013 and 2012

(In thousands)

		2013	2012
Premiums earned	$	49,193	49,459
Losses and underwriting expenses incurred:			
Losses and loss adjustment expenses		10,827	8,669
Other underwriting expenses		28,631	28,708
Total losses and underwriting expenses incurred		39,458	37,377
Net underwriting gain		9,735	12,082
Net investment income		3,854	3,801
Net realized capital gains (losses), net of tax of $(28) and $14 for 2013 and 2012, respectively		(52)	26
Total investment income		3,802	3,827
Other income		397	438
Income before federal income taxes, net of tax on realized gains (losses)		13,934	16,347
Federal income tax expense		3,915	2,239
Net income		10,019	14,108
Capital and surplus at beginning of year		101,432	90,363
Change in unrealized (losses) gains on investments (net of tax)		(10)	—
Change in net deferred income tax		(454)	(3,286)
Change in nonadmitted assets		505	247
Capital and surplus at end of year	$	111,492	101,432

See accompanying notes to statutory financial statements.

CONTRACTORS BONDING AND INSURANCE COMPANY

Statutory Statements of Cash Flow

Years ended December 31, 2013 and 2012

(In thousands)

		2013	2012
Operating activities:			
Premiums collected, net of reinsurance	$	47,162	48,960
Investment income, net of investment expense		6,112	4,862
Other income		397	438
Benefits and loss related payments		(8,319)	(7,290)
Commissions and other expenses paid		(33,624)	(44,151)
Federal income tax benefit received (expense paid)		(4,002)	3,718
Miscellaneous cash applications		400	(400)
Net cash flow from operations		8,126	6,137
Investing activities:			
Cash provided from investments sold, matured, or repaid:			
Bonds		40,136	145,456
Cost of investments acquired:			
Bonds		(67,245)	(158,578)
Net cash flow from investing activities		(27,109)	(13,122)
Financing activities and miscellaneous sources:			
Other cash provided (applied)		2,351	(5,827)
Net cash flow from financing activities and miscellaneous sources		2,351	(5,827)
Net change in cash and short-term investments		(16,632)	(12,812)
Cash and short-term investments at beginning of year		18,211	31,023
Cash and short-term investments at end of year	$	1,579	18,211

See accompanying notes to statutory financial statements.

(1) Background and Significant Accounting Policies

(a) Organization

Contractors Bonding and Insurance Company (the Company or CBIC) is domiciled in the state of Washington. CBIC is a wholly owned subsidiary of Data and Staff Service Company (DSS). DSS is a wholly owned subsidiary of RLI Insurance Company (RLI), which is a wholly owned subsidiary of RLI Corp. The Company specializes in providing admitted surety bonds and related niche property and casualty insurance products throughout the United States, with a focus on the Pacific Northwest.

(b) Basis of Presentation

The accompanying statutory financial statements have been prepared in conformity with accounting practices prescribed or permitted by the Washington State Office of the Insurance Commissioner (the Office). The National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* (NAIC SAP) has been adopted as a component of prescribed or permitted practices by the Office. The Office has adopted all of the prescribed accounting practices as stated in the NAIC SAP and the Company has no permitted accounting practices. Statutory accounting practices differ in certain respects from U.S. generally accepted accounting principles (GAAP). The most significant differences include the following:

(1) Acquisition costs related to premiums written are expensed as incurred, rather than deferred to the extent recoverable and charged to operations ratably over the period covered by the related insurance policies as prescribed by GAAP.

(2) Investments in bonds are not classified as to the Company's intention to trade, hold to maturity, or make available for sale. Investments in bonds are generally carried at amortized cost rather than fair value. Accordingly, unrealized changes in fair value attributable to bonds are not reflected in the statutory statements of income and changes in capital and surplus.

(3) Certain assets are designated as nonadmitted assets and are charged to surplus, as opposed to being carried at amounts recoverable for GAAP purposes.

(4) The realizability of deferred tax assets is evaluated utilizing a "more likely than not" standard. A valuation allowance is established for deferred tax assets deemed not realizable using this standard. Under statutory accounting principles, the realizability of deferred tax assets is determined utilizing an admissibility test whereby gross deferred tax assets are reduced by a statutory valuation allowance if it is more likely than not that some portion or all of the gross deferred tax assets will not be realized. Thereafter, a net deferred tax asset, for the tax effect of temporary differences between financial reporting and the tax basis of assets and liabilities, is only reported as an admitted asset to the extent of the sum of the following items: 1) federal income taxes paid in prior years that can be recovered through loss carrybacks from temporary differences that reverse during a time frame corresponding with IRS tax loss carryback provisions, not to exceed three years; 2) gross deferred tax assets expected to be realized within three years (if certain risk-based capital levels are met), but limited to 15% of adjusted surplus; and 3) the amount of gross deferred tax assets that can be offset against gross deferred

tax liabilities. Additionally, changes in the balances of deferred tax assets and liabilities result in increases or decreases in tax expense under GAAP, whereas under statutory accounting principles, these changes directly impact surplus.

(5) A liability is established, which is not required under GAAP, by a direct charge to unassigned surplus for unsecured reinsurance recoverables from unauthorized reinsurers and certain past due amounts from authorized reinsurers, rather than just providing for the estimated amounts deemed uncollectible.

(6) The liability for unpaid losses and loss adjustment expenses (LAE) is reported net of reinsurance recoverables, and unearned premiums are reported net of prepaid reinsurance premiums, rather than presenting these amounts gross of the effects of reinsurance ceded for GAAP.

(7) The statutory statement of cash flow differs in certain respects from the presentation required by GAAP, including the presentation of the changes in cash and short-term investments instead of cash and cash equivalents. Short-term investments include securities with original maturities of one year or less at the time of acquisition.

(8) The statutory financial statements are prepared in a form using language and groupings substantially the same as the annual statements filed with the NAIC and state regulatory authorities, which differ from the presentation and disclosures of financial statements presented under GAAP.

(9) Comprehensive income, which is required under GAAP, is not determined for statutory reporting purposes.

For the years ended December 31, 2013 and 2012, the Company had GAAP net income of \$9.7 million and \$10.2 million, respectively. The Company's GAAP shareholder's equity amounted to \$113.3 million and \$109.3 million at December 31, 2013 and 2012, respectively.

Significant statutory accounting policies are as follows:

(c) Investments

Bonds are generally carried at amortized cost with the discount or premium on bonds amortized using the scientific method. Bonds with a NAIC designation of 3-6 are carried at the lower of amortized cost or fair value. Investment income is recorded as earned and consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on bonds acquired and the addition of discount accrual. Short-term investments are carried at cost, which approximates fair value, and are considered cash equivalents in the statutory financial statements. Realized investment gains and losses are determined at the trade date on the basis of the specific-identification method.

The Company reviews the values of its investments in bonds on a quarterly basis for other-than-temporary impairment losses. Investments that have a fair value that is less than amortized cost are evaluated for other-than-temporary impairment. The Company's methodology of assessing other-than-temporary impairments is based on security-specific facts and circumstances as of the date of the reporting period. Management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and short-term prospects of the issuer including any specific events that may influence the operations of the issuer, and whether or not the Company had the intent to sell or if it is more likely than not that the Company will be required to sell prior to recovery of the bonds with interest-related impairments in evaluating other-than-temporary impairment. If this review suggests that a decline in fair value is other than temporary, the carrying value in the investment is reduced to its fair value through an adjustment to earnings.

(d) Revenue Recognition

Premiums, net of reinsurance, are earned and recognized as revenue ratably in relation to the risk covered over the period of the underlying policies. Unearned premiums, which are reflected net of reinsurance, represent the pro rata portion of premiums written, which are applicable to the unexpired terms of the policies in force. Premium deficiency reserves (PDR) are recognized when it is probable that the expected future costs will exceed anticipated future premiums and reinsurance recoveries on existing contracts. Anticipated investment income is not considered in the calculation of any PDR. For purposes of calculating a PDR, contracts are grouped in a manner consistent with the method of acquiring, servicing and measuring the profitability of such contracts. A premium deficiency reserve was not necessary as of December 31, 2013 and December 31, 2012.

(e) Acquisition Costs

The costs of acquiring insurance premiums (principally commissions and premium taxes) are charged to current operations as incurred.

(f) Liability for Unpaid Losses and Loss Adjustment Expenses

The estimated liability for unpaid losses and LAE includes a provision for reported and unpaid losses as well as estimates of losses incurred but not reported (IBNR), net of amounts covered by reinsurance. The estimates are based on certain actuarial and other assumptions related to the ultimate cost to settle such claims. Such assumptions are subject to occasional changes due to evolving economic, social, and political conditions. All estimates are periodically reviewed and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments are reflected in the results of operations in the period in which they are determined. As these amounts are determined based upon estimates, the ultimate liability may be more or less than such estimates. Based on the current assumptions used in estimating reserves, management believes that the Company's overall reserve levels at December 31, 2013 make a reasonable provision to meet its future obligations.

(g) *Federal Income Taxes*

The Company files a consolidated federal income tax return with its parent and affiliates. The provision for federal income taxes is based on current taxable income. The method of allocation between the companies is subject to written agreement and approved by the Company's board of directors. Allocation is based on the ratio of that portion of the separate company taxable income each member bears to the total taxable income of the group. Intercompany tax balances are settled within 30 days of filing the consolidated income tax return.

Current year federal income tax expense is based on financial reporting income or loss adjusted for certain permanent and temporary differences. The temporary differences are the result of dissimilar financial reporting and tax basis accounting methods. A net deferred tax asset, net of any requisite valuation allowance, representing the tax effect of temporary differences between financial reporting and the tax basis of assets and liabilities is only reported as an admitted asset to the extent that it will be realized subject to the provisions of SSAP No. 101, *Income Taxes – A Replacement of SSAP No. 10R and SSAP No. 10 (SSAP No. 101)*. The change in net deferred tax asset or liability is reflected directly in unassigned surplus.

The Company records liabilities for potential tax contingencies only when it is probable the position will not be sustainable upon audit by taxing authorities. These liabilities are reevaluated routinely and are adjusted appropriately based upon changes in facts or law. Penalties and interest, in the event they are incurred, are included in tax expense. The amount of uncertain tax items is not significant as of December 31, 2013 or 2012.

(h) *Provision for Reinsurance*

A statutory reinsurance liability must be established for unsecured amounts ceded to unauthorized reinsurers and certain amounts of past due recoverables from authorized reinsurers. This amount is recorded through a direct charge to unassigned surplus.

(i) *Nonadmitted Assets*

Certain assets (principally direct premiums 90 days past due, office furniture and equipment, EDP equipment, and deferred tax assets in excess of specified thresholds) are designated as nonadmitted assets and charged to unassigned surplus.

(j) *Allowance for Uncollectible Reinsurance*

The Company continuously monitors the financial condition of its reinsurers. As part of the Company's monitoring efforts, the Company reviews the reinsurers' annual financial statements and, to the extent applicable, Securities and Exchange Commission filings. The Company also reviews insurance industry developments that may impact the financial condition of its reinsurers. The Company analyzes the credit risk associated with its reinsurance balances recoverable by monitoring the A.M. Best and Standard & Poor's (S&P) ratings of its reinsurers. In addition, the Company subjects its reinsurance recoverables to detailed recoverability tests, including one based on average default by S&P rating. Based upon the Company's review and testing, its policy is to charge to earnings, in the form of an allowance, an estimate of unrecoverable amounts from reinsurers. This allowance is reviewed on an ongoing basis to ensure that the amount makes a reasonable provision for reinsurance balances that the Company may be unable to recover.

(k) ***Depreciation and Amortization***

Currently, all depreciation and amortization is calculated using the straight-line method. The useful lives are as follows: 3 years for computers and external operating software and 5 to 40 years for tenant improvements and real estate. Depreciation and amortization expense for the Company totaled $0.3 million and $0.4 million for 2013 and 2012, respectively.

(l) ***Risks and Uncertainties***

Certain risks and uncertainties are inherent to the Company's day-to-day operations and to the process of preparing its statutory financial statements. The more significant of those risks and uncertainties, as well as the Company's methods for attempting to mitigate, quantify, and minimize such risks and uncertainties, are presented below and throughout the notes to the statutory financial statements.

Catastrophe Exposures

The Company insures commercial accounts concentrated on the United States West Coast, outside of California, and has some exposure to catastrophic events, primarily wind. Exposure reports by exposure type and zip code are periodically generated and analyzed. The Company limits its risk to such catastrophes through the purchase of reinsurance.

Reinsurance

The Company purchases reinsurance from a number of financially strong reinsurers. Reinsurance does not discharge the Company from its primary liability to policyholders, and to the extent that a reinsurer is unable to meet its obligations, the Company would be liable. The Company continuously monitors the financial condition of prospective and existing reinsurers. The Company secures collateral from unauthorized reinsurers and provides an allowance for reinsurance balances deemed uncollectible, as discussed previously.

Investment Risk

The Company's investment portfolio is subject to market, credit, and interest rate risks. The bond portfolio is affected by interest rate changes and movements in credit spreads. The Company attempts to mitigate its interest rate and credit risks by constructing a well-diversified portfolio with high-quality securities with varied maturities. Downturns in the financial markets could have a negative effect on the Company's portfolio, but it attempts to mitigate this risk through asset allocation and security selection.

Liquidity Risk

Liquidity is essential to the Company's business and a key component of its concept of asset-liability matching. The Company's liquidity may be impaired by an inability to collect premium receivable or reinsurance recoverable balances in a timely manner, an inability to sell assets or redeem its investments, unforeseen outflows of cash or large claim payments, or an inability to access debt or equity capital markets. This situation may arise due to circumstances that the Company may be unable to control, such as a general market disruption or an operational problem that affects third parties or the Company, or even by the perception among market participants that the Company, or other market participants, is experiencing greater liquidity risk. The Company's ability to access capital is a function of the ultimate parent, RLI Corp., and as such, it is dependent upon RLI Corp.'s ability to access such capital. The Company's financial and credit ratings are important to its liquidity. A reduction in the Company's ratings could adversely affect its liquidity and competitive position, by increasing its borrowing costs or limiting its access to the capital markets.

Use of Estimates

The preparation of statutory financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the statutory financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from those estimates. The most significant of these amounts is the liability for unpaid losses and LAE. Management continually updates its estimates as additional data becomes available and adjusts the statutory financial statements as deemed necessary. Other estimates, such as the recoverability of reinsurance balances, are constantly monitored, evaluated, and adjusted. Although recorded estimates are supported by actuarial computations and other data, the estimates are ultimately based on management's expectations of future events. It is reasonably possible that expectations associated with these accounts can change in the near term (i.e., one year) and that the effect of these changes could be material to the statutory financial statements.

External Factors

The Company is regulated by the Washington State Office of the Insurance Commissioner, as well as states in which it does business. Such regulations, among other things, limit the amount of dividends, impose restrictions on the amount and types of investments, and regulate rates insurers may charge for various coverages. The Company is also subject to insolvency and guaranty fund assessments for various programs designed to ensure policyholder indemnification. The Company generally accrues an assessment during the period in which it becomes probable that a liability has been incurred from an insolvency and the amount of the related assessment can be reasonably estimated.

The NAIC has developed Property/Casualty Risk-Based Capital (RBC) standards that relate an insurer's reported statutory capital and surplus to the risks inherent in its overall operations. The RBC formula uses the statutory annual statement to calculate the minimum indicated capital level to support asset (investment and credit) risk and underwriting (loss reserves, premiums written, and unearned premium) risk. The NAIC model law calls for various levels of regulatory action based on the magnitude of an indicated RBC capital deficiency, if any. The Company regularly monitors its internal capital requirements and the NAIC's RBC developments. As of December 31, 2013, the Company determined that its capital levels are well in excess of the minimum capital requirements for all RBC action levels and that the Company's capital levels are sufficient to support the level of risk inherent in its operations.

(m) Fair Value

Bonds are generally carried at amortized cost based upon NAIC designations. Due to the relatively short-term nature of cash, short-term investments, accounts receivable, and accounts payable, the carrying value of each is a reasonable estimate of fair value. The Company's approach to determining the fair values of bonds is disclosed in notes 2 and 3.

(2) Fair Value Measurement

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties (exit price), that is other than in a forced or liquidation sale. The fair value of a liability is the amount at which that liability could be settled in a current transaction between willing parties, that is, other than in a forced or liquidation sale.

Fair values are based on quoted market prices when available. In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using observable information that management believes market participants would use to determine a current transaction price. This process involves some level of management estimation and judgment, which becomes significant with increasingly complex instruments.

The Company's financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy which gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

Pricing Level 1 is applied to valuations based on readily available, unadjusted quoted prices in active markets for identical assets. These valuations are based on quoted prices that are readily and regularly available in an active market.

Pricing Level 2 is applied to valuations based upon quoted prices for similar assets in active markets, quoted prices for identical or similar assets in inactive markets; or valuations based on models where the significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities) or can be corroborated by observable market data.

Pricing Level 3 is applied to valuations that are derived from techniques in which one or more of the significant inputs are unobservable.

Financial Assets and Liabilities Measured at Fair Value

Certain financial assets are measured at fair value, including bonds with a NAIC designation of 3-6, which are carried at the lower of amortized cost or fair value. The Company does not have any bonds with a NAIC designation of 3-6 or any other assets or liabilities that are measured at fair value as of December 31, 2013 or 2012.

The following table presents the NAIC fair values and admitted NAIC carrying values of all assets that are financial instruments. The NAIC fair values are categorized into the three-level fair value hierarchy as of December 31, 2013 and 2012.

Type of financial instrument		Aggregate fair value	Admitted assets	(Level 1)	(Level 2)	(Level 3)
2013:						
Cash	$	1,579	1,579	1,579	—	—
Bonds		173,937	179,152	—	173,937	—
2012:						
Cash	$	18,211	18,211	18,211	—	—
Bonds		158,095	154,603	—	158,095	—

For fair value measurements shown as Level 1, the Company's pricing vendor uses quoted market prices that are readily observable in active markets on market exchanges. For fair value measurements shown as Level 2, valuations are determined by the Company's pricing vendor based on quoted prices for similar assets in active markets, quoted prices for identical or similar assets in inactive markets, or valuation models where the significant inputs are observable.

(3) Investments

The Company's bond portfolio consists of investments in U.S. treasury, government-sponsored agency, corporate, municipal and mortgage-backed securities. All bonds in the investment portfolio continue to pay the expected coupon payments under the contractual terms of the securities, and the Company believes it is probable that it will receive all contractual or estimated cash flows based on its analysis of factors disclosed in note 1(c).

The statement value and estimated fair value of bonds at December 31, 2013 and 2012, respectively, are reflected below. The fair values for bonds are based on quoted market prices, where available. For bonds not actively traded, fair values are estimated using values obtained from independent pricing services.

		2013			
		Statement value	Gross unrealized gains	Gross unrealized losses	Estimated fair value
			(In thousands)		
U.S. government	$	5,022	4	—	5,026
States, political subdivisions, and special revenues		99,050	400	(3,191)	96,259
Corporate		51,454	217	(1,202)	50,469
Mgte/ABS/CMO*		23,626	7	(1,450)	22,183
Totals	$	179,152	628	(5,843)	173,937

* Mortgage-backed, asset-backed and collateralized mortgage obligations

		2012			
		Statement value	Gross unrealized gains	Gross unrealized losses	Estimated fair value
			(In thousands)		
U.S. government	$	5,019	3	—	5,022
States, political subdivisions, and special revenues		94,460	2,299	(3)	96,756
Corporate		52,441	1,197	(4)	53,634
Mgte/ABS/CMO*		2,683	—	—	2,683
Totals	$	154,603	3,499	(7)	158,095

* Mortgage-backed, asset-backed and collateralized mortgage obligations

The following tables illustrate the total value of securities that were in an unrealized loss position as of December 31, 2013 and 2012, respectively:

		2013		
		Less than 12 months	**12 months or greater**	**Total**
			(In thousands)	
U.S. government:				
Fair value	$	—	—	—
Cost or amortized cost		—	—	—
Unrealized loss	$	—	—	—
States, political subdivisions, and special revenues:				
Fair value	$	74,330	—	74,330
Cost or amortized cost		77,521	—	77,521
Unrealized loss	$	(3,191)	—	(3,191)
Corporate:				
Fair value	$	33,522	—	33,522
Cost or amortized cost		34,724	—	34,724
Unrealized loss	$	(1,202)	—	(1,202)
Mtge/ABS/CMO*:				
Fair value	$	21,386	—	21,386
Cost or amortized cost		22,836	—	22,836
Unrealized loss	$	(1,450)	—	(1,450)
Total:				
Fair value	$	129,238	—	129,238
Cost or amortized cost		135,081	—	135,081
Unrealized loss	$	(5,843)	—	(5,843)

* Mortgage-backed, asset-backed and collateralized mortgage obligations.

	2012 Less than 12 months	2012 12 months or greater (In thousands)	2012 Total
U.S. government:			
Fair value	$ —	—	—
Cost or amortized cost	—	—	—
Unrealized loss	$ —	—	—
States, political subdivisions, and special revenues:	$		
Fair value	3,981	—	3,981
Cost or amortized cost	3,984	—	3,984
Unrealized loss	$ (3)	—	(3)
Corporate:			
Fair value	$ 5,975	—	5,975
Cost or amortized cost	5,979	—	5,979
Unrealized loss	$ (4)	—	(4)
Mtge/ABS/CMO*:			
Fair value	$ —	—	—
Cost or amortized cost	—	—	—
Unrealized loss	$ —	—	—
Total:			
Fair value	$ 9,956	—	9,956
Cost or amortized cost	9,963	—	9,963
Unrealized loss	$ (7)	—	(7)

* Mortgage-backed, asset-backed and collateralized mortgage obligations.

As of December 31, 2013 and 2012, 83 and six bonds, respectively, had unrealized losses. These bonds represent a total fair value of $129.2 million and $10.0 million, respectively, and a total unrealized loss of $5.8 million and $7,000, respectively, as of December 31, 2013 and 2012. None of these bonds were in an unrealized loss position of more than 20% for more than six consecutive months. The Company does not intend to sell these securities, and has the intent and ability to hold these investments until a recovery in value, which may be maturity. In addition, the Company continually monitors the credit quality of its bonds to assess if it is probable that it will receive its contractual or estimated cash flows in the form of principal and interest. The Company considers price declines of securities in its other-than-temporary impairment analysis where such price declines provide evidence of declining credit quality, and distinguishes between price changes caused by credit deterioration, as opposed to rising interest rates.

Key factors that are considered in the evaluation of credit quality include, but are not limited to:

- Changes in technology that may impair the earnings potential of the investment,
- The discontinuance of a segment of the business that may affect the future earnings potential,
- Reduction or elimination of dividends,
- Specific concerns related to the issuer's industry or geographic area of operation,
- Significant or recurring operating losses, poor cash flows, and/or deteriorating liquidity ratios, and
- Downgrades in credit quality by a major rating agency.

The Company concluded that the securities in an unrealized loss position are not other-than-temporarily impaired. Therefore, the Company recognized no impairment losses in 2013 or 2012.

The statement value and estimated fair value of bonds at December 31, 2013 by contractual maturity are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

		Statement value	Estimated fair value
		(In thousands)	
Due in one year or less	$	5,022	5,027
Due after one year through five years		13,308	13,380
Due after five years through 10 years		79,450	77,844
Due after 10 years		57,746	55,503
MBS/ABS/CMO		23,626	22,183
	$	179,152	173,937

Proceeds from sale of bonds during 2013 were $30.9 million, compared to no proceeds from sale of bonds during 2012. Proceeds from maturities/calls of bonds during 2013 and 2012 were $9.2 million and $145.5 million, respectively.

The components of realized gains and losses on investments are as follows:

		2013	2012
		(In thousands)	
Bonds:			
Gains	$	158	42
Losses		(238)	(2)
Realized gains on bonds		(80)	40
Less income tax expense (benefit)		(28)	14
Net realized gains (losses) on investments	$	(52)	26

The Company does not engage in any subprime residential mortgage lending. In addition, the Company has no exposure to subprime lending relating to its investment portfolio or insurance coverages.

At December 31, 2013 and 2012, investments with a statement value of $5.0 million were on deposit with governmental authorities or banks to comply with insurance laws.

The composition of net investment income is as follows:

		2013	2012
		(In thousands)	
Bonds	$	4,111	3,935
Other		—	5
		4,111	3,940
Less investment expenses		(257)	(139)
Net investment income	$	3,854	3,801

(4) Related-Party Transactions

As described below and elsewhere in the notes to the statutory financial statements, the Company has engaged in transactions with its parent and affiliates during the normal course of business:

(a) The Company paid no dividends to its parent in 2013 or 2012.

(b) During the normal course of business, the Company is allocated various expenses resulting from services performed on its behalf by RLI. Expenses are allocated using a cost based approach.

(c) At December 31, 2013 and 2012, the Company reported $0.1 million and $3.0 million as net amounts due from affiliates, respectively. Any intercompany balance resulting from services performed or costs allocated in accordance with the terms of the intercompany services agreement are settled within 30 calendar days following the end of the calendar quarter in which the intercompany balance was created.

(5) Capital and Surplus

Dividend payments from the Company to its parent are restricted by state insurance laws as to the amount that may be paid without prior approval from the regulatory authorities of Washington. The maximum dividend distribution in a rolling 12-month period is limited by Washington law to the greater of 10% of policyholder surplus as of December 31 of the preceding year or the net income of the Company for the 12-month period ending December 31 of the preceding year. Any dividend distribution in excess of the ordinary dividend limits is deemed extraordinary and requires prior approval from the Office. Because the limitations are based upon a rolling 12-month period, the presence, amount and impact of these restrictions vary over time.

Unassigned surplus includes $0 in net unrealized gains on investments for 2013. Unassigned surplus has been reduced by $1.4 million and $1.9 million relating to nonadmitted assets as of December 31, 2013 and 2012, respectively.

(6) Reinsurance

In the normal course of business, the Company cedes insurance exposures with other insurance companies, pools, and associations through various treaties and in certain instances by negotiation of individual risks. Generally, policies are reinsured with other insurance companies to limit the Company's risk on any individual loss to $3.4 million.

The following are summaries of the impact of the Company's reinsurance program on the statutory financial statements:

	2013			
	Direct	Assumed	Ceded	Net
		(In thousands)		
Premiums written	$ 55,423	—	5,382	50,041
Premiums earned	55,064	—	5,871	49,193
Losses and loss adjustment expenses incurred	9,406	—	(1,421)	10,827
Unearned premiums	27,843	—	332	27,511
Unpaid losses and loss adjustment expenses	53,352	—	7,428	45,924

	2012			
	Direct	Assumed	Ceded	Net
	(In thousands)			
Premiums written	$ 54,917	—	6,233	48,684
Premiums earned	55,944	—	6,485	49,459
Losses and loss adjustment expenses incurred	2,317	—	(6,352)	8,669
Unearned premiums	27,483	—	820	26,663
Unpaid losses and loss adjustment expenses	58,002	—	9,229	48,773

At December 31, 2013, net balances recoverable from reinsurers (comprising unearned premiums and losses and LAE paid and unpaid, including IBNR amounts) having unsecured portions exceeding 3% of the Company's total capital and surplus were as follows:

Name of reinsurer	Amount (In thousands)
Munich Re America	$ 5,563

The losses, LAE, and unearned premiums for business ceded to other insurers are recoverable and realizable to the extent that the assuming reinsurers fulfill their commitments. The Company has the ability to initiate arbitration or otherwise instituted legal actions where appropriate on certain outstanding recoverable balances. No such actions have been taken in at least the past five years.

The total return commission, which would have been due reinsurers if all reinsurance was canceled with the return of unearned premium, would be less than $0.1 million and $0 as of December 31, 2013 and 2012, respectively. The amount of return commission, predicated on loss experience as a result of existing contracts, was $0.7 million and $0 as of December 31, 2013 and 2012, respectively.

As of December 31, 2013 and 2012, the Company had no allowance for uncollectible reinsurance, as there have been no issues with collectibility.

(7) Unpaid Losses and Loss Adjustment Expenses

The following table is a reconciliation of the Company's liability for unpaid losses and LAE for the years ended December 31, 2013 and 2012. Loss and LAE reserves represent the Company's best estimate of ultimate payments for losses and related settlement expenses from claims that have been reported but not paid, and those losses that have occurred but have not yet been reported to the Company. Loss reserves do not represent an exact calculation of liability, but instead represent the Company's estimates, generally utilizing individual claim estimates, actuarial expertise and estimation techniques at a given accounting date. The loss reserve estimates are expectations of what ultimate settlement and administration of claims will cost upon final resolution. These estimates are based on facts and circumstances then known to the Company, review of historical settlement patterns, estimates of trends in claims frequency and severity, projections of loss costs, expected interpretations of legal theories of liability and many other factors. In establishing reserves, the Company also takes into account estimated recoveries from reinsurance, salvage and subrogation. The reserves are reviewed regularly by the Company's actuaries.

		2013	2012
		(In thousands)	
Net unpaid losses and loss adjustment expenses, net of reinsurance recoverable of $9,229 and $18,701, as of January 1	$	48,773	54,150
Incurred losses and loss adjustment expenses related to:			
Current accident year losses		21,233	20,593
Prior accident years losses		(10,406)	(11,924)
Total incurred		10,827	8,669
Paid loss and loss adjustment expense payments related to:			
Current accident year losses		(3,914)	(3,667)
Prior accident years losses		(9,762)	(10,379)
Total paid		(13,676)	(14,046)
Net unpaid losses and loss adjustment expenses, net of reinsurance recoverable of $7,428 and $9,229, as of December 31	$	45,924	48,773

Reserve Development

The Company utilizes a regular reserve analysis process. During this process, the Company identified deviations from initial reserve estimates for various lines of business. The deviations developed during the reserve analysis were used to modify the Company's ultimate loss estimates. The recognition of the changes in initial reserve estimates occurred over time as claims were reported, initial case reserves were established, initial reserves were reviewed in light of additional information, and ultimate payments were made on the collective set of claims incurred as of that evaluation date. The new information on the ultimate settlement value of claims is regularly updated until all claims in a defined set of claims are settled. As a relatively small insurer, the Company's experience will ordinarily exhibit fluctuations from period to period. While the Company attempts to identify and react to systematic changes in the loss environment, it also must consider the volume of experience directly available, and interpret any particular period's indications with a realistic technical understanding of the reliability of those observations.

A discussion of significant components of reserve development for the two most recent calendar years follows:

2013: As of December 31, 2012, loss and LAE reserves were $48.8 million. During 2013, $9.8 million was paid for incurred losses and LAE attributable to insured events of prior years. Reserves remaining for prior years are now $28.6 million as a result of re-estimation of unpaid claims and claims adjustment expenses. Therefore, there has been $10.4 million of favorable prior year development since last year-end. The decrease is the result of the Company's ongoing analysis of recent loss development trends and reserve risks. Original estimates are increased or decreased as additional information becomes known regarding individual claims. The majority of the favorable development came from the commercial multi-peril liability line of business, particularly accident years 2006-2012, with the remainder coming from the surety line of business, primarily accident year 2012. Commercial multi-peril liability continues to benefit from favorable loss trends, with actual losses reported being less than expected losses, especially in the older accident years. For all lines of business combined, no accident year showed significant unfavorable development.

2012: As of December 31, 2011, loss and LAE reserves were \$54.2 million. During 2012, \$10.4 million was paid for incurred losses and LAE attributable to insured events of prior years. Reserves remaining for prior years are now \$31.9 million as a result of re-estimation of unpaid claims and claims adjustment expenses. Therefore, there has been \$11.9 million of favorable prior year development since last year-end. The decrease is the result of the Company's ongoing analysis of recent loss development trends and reserve risks. Original estimates are increased or decreased as additional information becomes known regarding individual claims. Approximately half of the favorable development came from surety, primarily accident years 2010 and 2011. The contract surety and miscellaneous surety products showed favorable development in both the 2011 and 2010 accident years with miscellaneous surety accounting for slightly more favorable development than contract surety. The remainder of the favorable development came from commercial multi-peril, primarily accident years 2006, 2008, and 2010. There was unfavorable development for commercial multi-peril for the 2011 accident year, primarily from general liability coverages.

(8) Federal Income Taxes

The net deferred tax assets (DTA) at December 31, 2013 and the change from prior year are comprised of the following components:

	2013 Total	2013 Capital	2013 Ordinary	2012 Total	2012 Capital	2012 Ordinary	Change
				(In thousands)			
Total of gross deferred tax assets	$ 3,343	—	3,343	3,773	—	3,773	(430)
Valuation allowance adjustment	—	—	—	—	—	—	—
Adjusted gross deferred tax assets	3,343	—	3,343	3,773	—	3,773	(430)
Total gross deferred tax liabilities	57	—	57	23	—	23	34
Net deferred tax assets (liabilities)	3,286	—	3,286	3,750	—	3,750	(464)
Total deferred tax assets nonadmitted	330	—	330	465	—	465	(135)
Net admitted deferred tax assets (liabilities)	$ 2,956	—	2,956	3,285	—	3,285	(329)
Net change in total DTAs nonadmitted	$ (135)	—	(135)	106	—	106	

Tax-planning strategies did not impact the total adjusted gross DTA or the net admitted adjusted DTA at December 31, 2013.

There are no temporary differences for which deferred tax liabilities are not recognized.

Deferred income tax assets and liabilities consist of the following major components:

	December 31 2013	December 31 2012
	(In thousands)	
Deferred tax assets:		
Loss reserves	$ 1,086	1,393
Unearned premium reserve	1,872	1,866
Receivables-nonadimitted	138	172
Other	247	342
Total deferred tax assets	3,343	3,773
Nonadmitted deferred tax assets	(330)	(465)
Admitted deferred tax assets	3,013	3,308
Deferred tax liabilities:		
Investments	4	1
Fixed assets	42	18
Other	11	4
Total deferred tax liabilities	57	23
Net deferred tax assets	$ 2,956	3,285

The change in deferred income taxes reported in surplus before consideration of nonadmitted assets is comprised of the following components:

	2013	2012	Change
		(In thousands)	
Total deferred tax assets	$ 3,343	3,773	(430)
Valuation allowance adjustment	—	—	—
Total adjusted deferred tax assets	3,343	3,773	(430)
Total gross deferred tax liabilities	57	23	34
Net adjusted deferred tax assets	$ 3,286	3,750	(464)
Tax effect of unrealized gains (losses)			10
Change in net deferred income tax			$ (454)

The amount of adjusted gross DTAs admitted under each component is as follows:

		2013		
		Total	Capital (In thousands)	Ordinary
Following the principles of SSAP 101 paragraphs 11.a. through 11.c.:				
Admitted under paragraph 11.a.	$	2,782	—	2,782
Admitted under paragraph 11.b.i.		174	—	174
Admitted under paragraph 11.b.ii.		—	—	—
Admitted under paragraph 11.c.		57	—	57
Admitted under admissibility test	$	3,013	—	3,013

		2012		
		Total	Capital (In thousands)	Ordinary
Following the principles of SSAP 101 paragraphs 11.a. through 11.c.:				
Admitted under paragraph 11.a.	$	3,023	—	3,023
Admitted under paragraph 11.b.i.		262	—	262
Admitted under paragraph 11.b.ii.		—	—	—
Admitted under paragraph 11.c.		23	—	23
Admitted under admissibility test	$	3,308	—	3,308

The Company's risk-based capital level used for purposes of paragraph 11.b. was 1355% as of December 31, 2013.

Current income taxes incurred consists of the following significant components:

		2013	2012
		(In thousands)	
Federal	$	3,915	2,239
Federal income tax on net realized capital gains (losses)		(28)	14
Federal income tax incurred	$	3,887	2,253

The Company's income tax incurred and change in deferred income tax differ from the amount obtained by applying the federal statutory rate of 35% to income before income taxes as follows:

		2013	2012
		(In thousands)	
Income before taxes, which includes net realized capital gains (losses)	$	13,906	16,362
Income tax expense (benefit) at 35% statutory rate		4,867	5,727
Increase (decrease) in tax resulting from:			
Nondeductible expenses		11	17
Tax-exempt income		(662)	(450)
Other		125	245
Total statutory income taxes	$	4,341	5,539
Current income taxes incurred	$	3,915	2,239
Change in deferred income tax (without tax on unrealized gains and losses)		454	3,286
Tax expense (benefit) on net realized capital gains (losses)		(28)	14
Total statutory income taxes	$	4,341	5,539

A reconciliation of federal income tax expense, computed by applying the statutory federal income tax rate of 35% in both 2013 and 2012 to income before federal income taxes, which includes net realized capital gains, to the income tax expense shown in the accompanying statutory financial statements is as follows:

		2013	2012
		(In thousands)	
Computed "expected" tax (benefit) expense	$	4,867	5,727
Tax-exempt interest		(662)	(450)
Discounting of liability for losses and loss adjustment expenses		(307)	(79)
Change in unearned premiums		5	(54)
Change in accrued compensation		—	(3,123)
Tax on net realized capital losses		(28)	14
Other		40	204
Federal income tax (benefit) expense	$	3,915	2,239

As of December 31, 2013, the Company had no operating loss carryforwards available to offset future net income subject to federal income tax.

Income taxes incurred in current and prior years that will be available for recoupment in the event of future net losses are $4.0 million for 2013 and $2.2 million for 2012.

(9) Employee Benefits

The Company, along with its affiliates and ultimate parent (RLI Corp.), has an Employee Stock Ownership Plan (ESOP), 401(k) Plan, and bonus and incentive plans covering executives, managers, and associates. At the board of directors' discretion, funding of these plans is primarily dependent upon reaching predetermined levels of operating return on equity, combined ratio and Market Value Potential (MVP). MVP is a compensation model that measures components of comprehensive earnings against a minimum required return on RLI Corp.'s capital. Bonuses are earned as RLI Corp. generates earnings in excess of this required return. While some management incentive plans may be affected somewhat by other performance factors, the larger influence of corporate performance ensures that the interests of executives, managers and associates correspond with those of shareholders.

The Company's 401(k) plan allows voluntary contributions by employees and permits ESOP diversification transfers for employees meeting certain age or service requirements. The Company provides a basic 401(k) contribution of 3% of eligible compensation. Participants are 100% vested in both voluntary and basic contributions. Additionally, an annual discretionary profit-sharing contribution may be made to the ESOP and 401(k), subject to the achievement of certain overall financial goals and board approval. Profit-sharing contributions vest after three years of plan service.

The Company's ESOP and 401(k) cover all employees meeting eligibility requirements. ESOP and 401(k) profit-sharing contributions are determined annually by the board of directors and are expensed in the year earned. ESOP and 401(k) profit-sharing contributions are determined annually by the board of directors and are expensed in the year earned. The total amount of expense for these plans for 2013 and 2012 was $12.4 million and $7.8 million, respectively. The Company receives an allocation for its share of the expense per the terms of the intercompany services agreement.

Annual bonuses are awarded to executives, managers, and associates through the Company's incentive plans, provided certain financial and operational goals are met. The total amount of expense for these incentive plans for 2013 and 2012 was $23.2 million and $16.7 million, respectively. The Company receives an allocation for its share of the plan expense per the terms of the intercompany services agreement.

(10) Commitments and Contingent Liabilities

The Company is party to numerous claims, losses and litigation matters that arise in the normal course of business. Many of such claims, losses or litigation matters involve claims under policies that the Company underwrites as an insurer. The Company believes that the resolution of these claims and losses will not have a material adverse effect on its financial condition, results of operations or cash flows. The Company is also involved in various other legal proceedings and litigation unrelated to its insurance business that arise in the ordinary course of business operations. The Company believes that any liabilities that may arise as a result of these legal matters will not have a material adverse effect on its financial condition or results of operations.

Other contingencies arise in the normal conduct of the Company's operations and are not expected to have a material impact on the Company's financial condition or results of operations. However, adverse outcomes are possible and could negatively impact the Company's financial condition and results of operations.

(11) Leases

The Company leases regional office facilities and computers under operating leases. These leases expire in various years through 2019. Minimum future rental payments under noncancelable leases are as follows (in thousands):

2014	$	807
2015		670
2016		617
2017		559
2018 and thereafter		598
Total minimum future rental payments	$	3,251

(12) Subsequent Events

The Company has evaluated subsequent events through May 2, 2014, the date the accompanying statutory financial statements were available to be issued. No significant subsequent events were identified.

CONTRACTORS BONDING AND INSURANCE COMPANY

Schedule of Supplemental Investment Risk Interrogatories

December 31, 2013

(In thousands)

1) Total admitted assets: $ 195,534

2) 10 largest exposures to a single issuer/borrower/investment:

Issuer		Amount	Percentage
Teva Pharm Fin IV BV	$	4,180	2.1%
Louisiana State		4,154	2.1
Washington State		4,021	2.1
Nevada State		3,780	1.9
New York State Thruway		3,308	1.7
Verizon Communications		3,112	1.6
Ocean County New Jersey		3,100	1.6
Intercontinental Exchange		2,998	1.5
Arizona Water Infrastructure		2,988	1.5
Met Life Global Funding		2,940	1.5

3) Total admitted assets held in bonds by NAIC rating:

Bonds		Amount	Percentage
NAIC-1	$	169,808	86.8%
NAIC-2		9,344	4.8
NAIC-3		—	—
NAIC-4		—	—
NAIC-5		—	—
NAIC-6		—	—

The Company holds no preferred stocks.

4) Assets held in foreign investments:

		Amount	Percentage
Total admitted assets held in foreign investments	$	9,679	5.0%
Foreign currency denominated investments		—	—
Insurance liabilities denominated in that same foreign currency		—	—

5) Aggregate foreign investment exposure categorized by NAIC sovereign rating:

		Amount	Percentage
Countries rated NAIC-1	$	9,679	5.0%
Countries rated NAIC-2		—	—
Countries rated NAIC-3 or below		—	—

6) Largest foreign investment exposures by country, categorized by NAIC sovereign rating:

		Amount	Percentage
Countries rated NAIC-1:			
Country 1: Israel	$	4,180	2.1%
Country 2: United Kingdom		2,075	1.1
Countries rated NAIC-2:			
Country 1:		—	—
Country 2:		—	—
Countries rated NAIC-3 or below:			
Country 1:		—	—
Country 2:		—	—

		Amount	Percentage
7) Aggregate unhedged foreign currency exposure:	$	—	—%

8) Aggregate unhedged foreign currency exposure categorized by the country's NAIC sovereign rating:

		Amount	Percentage
Countries rated NAIC-1	$	—	—%
Countries rated NAIC-2		—	—
Countries rated NAIC-3 or below		—	—

(Continued)

CONTRACTORS BONDING AND INSURANCE COMPANY

Schedule of Supplemental Investment Risk Interrogatories

December 31, 2013

(In thousands)

9) Largest unhedged foreign currency exposure by country, categorized by the country's NAIC sovereign rating:

	Amount	Percentage
Countries rated NAIC-1:		
Country 1:	$ —	—%
Country 2:	—	—
Countries rated NAIC-2:		
Country 1:	—	—
Country 2:	—	—
Countries rated NAIC-3 or below:		
Country 1:	—	—
Country 2:	—	—

10) Ten largest nonsovereign (i.e. nongovernmental) foreign issues:

Issuer	NAIC Rating	Amount	Percentage
Teva Pharm Fin IV BV	1	$ 4,180	2.1%
BG Energy Capital PLC	1	2,075	1.1
Schlumberger Investment	1	2,070	1.1
Rio Tinto Fin USA Ltd	1	1,354	0.7

11) Assets held in Canadian investments and unhedged Canadian currency exposure are less than 2.5% of the reporting entity's total admitted assets; therefore, detail not required.

12) There were no admitted assets held in investments with contractual sales restrictions exceeding 2.5% of the reporting entity's total admitted assets.

13) There were no assets held in equity interests exceeding 2.5% of the Company's total admitted assets.

14) There were no assets held in nonaffiliated, privately placed equities, exceeding 2.5% of the Company's total admitted assets.

15) There were no admitted assets held in general partnership interests that exceeded 2.5% of the Company's total admitted assets.

16) There were no mortgage loans reported on the Company's Annual Statement Schedule B; therefore, detail not required for interrogatories 16 and 17.

18) No real estate was reported in the Annual Statement Schedule A.

19) There were no admitted assets held in investments held in mezzanine real estate loans.

20) Total admitted assets subject to the following types of agreements:

	At year-end		At end of each quarter		
Agreement type	Amount	Percentage	1st Qtr	2nd Qtr	3rd Qtr
Securities lending	$ —	—%	$ —	—	—
Repurchase	—	—	—	—	—
Reverse repurchase	—	—	—	—	—
Dollar repurchase	—	—	—	—	—
Dollar reverse repurchase	—	—	—	—	—

21) The Company owns no warrants not attached to other financial instruments, options, caps, and floors.

22) The Company has no exposure to collars, swaps, or forwards.

23) The Company has no exposure for future contracts.

See accompanying independent auditors' report.

Schedule 2

CONTRACTORS BONDING AND INSURANCE COMPANY

Summary Investment Schedule

December 31, 2013

(In thousands)

Investment categories	Gross investment holdings		Admitted assets as reported in the annual statement	
Bonds:				
U.S. Treasury securities	$ 5,022	2.78%	$ 5,022	2.78%
U.S. government agency and corporate obligations:				
Issued by U.S. government agencies	—	—	—	—
Issued by U.S. government-sponsored agencies	—	—	—	—
Non-U.S. government	—	—	—	—
Foreign government:				
Securities issued by states, territories, and political subdivisions in the U.S.:				
State, territory, and possession and general obligations	22,378	12.38	22,378	12.38
Political subdivisions of states, territories, and possessions' political subdivisions' general obligations	36,196	20.03	36,196	20.03
Revenue and assessment obligations	40,476	22.40	40,476	22.40
Industrial development and similar obligations	—	—	—	—
Mortgage-backed securities:				
Pass-through securities:				
Guaranteed by GNMA	—	—	—	—
Issued by FNMA and FHLMC	—	—	—	—
All other	2,355	1.30	2,355	1.30
CMOs and REMICs:				
Issued by FNMA, FHLMC, GNMA, or VA	21,271	11.77	21,271	11.77
Issued by non-U.S. government issuers and collateralized by mortgage-backed securities issued or guaranteed by above agencies	—	—	—	—
All other	—	—	—	—
Other debt and other fixed income securities:				
Unaffiliated domestic securities	41,775	23.11	41,775	23.11
Unaffiliated foreign securities	9,679	5.36	9,679	5.36
Affiliated securities		—		—
Equity interests:				
Investments in mutual funds	—	—	—	—
Preferred stocks:				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Publicly traded equity securities:				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Tangible personal property under lease:				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Other equity securities:				
Affiliated	—	—	—	—
Unaffiliated	—	—	—	—
Mortgage loans:				
Construction and land development	—	—	—	—
Agricultural	—	—	—	—
Single-family residential properties	—	—	—	—
Multifamily residential properties	—	—	—	—
Commercial loans	—	—	—	—
Mezzanine real estate loans	—	—	—	—

(Continued)

Schedule 2

CONTRACTORS BONDING AND INSURANCE COMPANY

Summary Investment Schedule

December 31, 2013

(In thousands)

Investment categories	Gross investment holdings		Admitted assets as reported in the annual statement	
Real estate investments:				
Property occupied by the Company	$ —	—%	$ —	—%
Property held for production of income	—	—	—	—
Property held for sale	—	—	—	—
Policy loans	—	—	—	—
Receivable for securities	—	—	—	—
Cash and short-term investments	1,579	0.87	1,579	0.87
Write-in invested assets	—	—	—	—
Total invested assets	$ 180,731	100.00%	$ 180,731	100.00%

See accompanying independent auditors' report.

CONTRACTORS BONDING AND INSURANCE COMPANY

Supplemental Schedule of Reinsurance Interrogatories

Year ended December 31, 2013

7.1 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 [X]

7.2 If yes, indicate the number of reinsurance contracts containing such provisions.

7.3 If yes, does the amount of reinsurance credit taken reflect the reduction in quota share coverage caused by any applicable limiting provision(s)? Yes [ ] No [ ]

8.1 Has this reporting entity reinsured any risk with any other entity and agreed to release such entity from liability, in whole or in part, from any loss that may occur on this risk, or portion thereof, reinsured? Yes [ ] No [X]

8.2 If yes, give full information.

9.1 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 3% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 3% of prior year-end surplus as regards policyholders;

(ii) it accounted for that contract as reinsurance and not as a deposit; and

(iii) the contract(s) contain one or more of the following features or other features that would have similar results:

(a) A contract term longer than two years and the contract is noncancelable 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;

(d) An unconditional or unilateral right by either party to commute the reinsurance contract except for such provisions, which 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); or

(f) Payment schedule, accumulating retentions from multiple years, or any features inherently designed to delay timing of the reimbursement to the ceding entity. Yes [ ] No [X]

9.2 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), 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 fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or

(b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates Yes [ ] No [X]

CONTRACTORS BONDING AND INSURANCE COMPANY

Supplemental Schedule of Reinsurance Interrogatories

Year ended December 31, 2013

9.3 If yes to 9.1 or 9.2, please provide the following information in the Reinsurance Summary Supplemental Filing for general interrogatory 9:

(a) The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;

(b) A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and

(c) A brief discussion of management's principal objectives in entering into the reinsurance contract including the economic purpose to be achieved.

9.4 Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62, *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 financial statement, and either:

(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); or

(b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP? Yes [ ] No [X]

9.5 If yes to 9.4, explain in the Reinsurance Summary Supplemental Filing for general interrogatory 9 (Section D) why the contract(s) is treated differently for GAAP and SAP.

9.6 The reporting entity is exempt from the Reinsurance Attestation Supplement under one or more of the following criteria:

(a) The entity does not utilize reinsurance; or Yes [ ] No [X]

(b) The entity only engages in a 100% quota share contract with an affiliate or lead company has filed an attestation supplement; or Yes [ ] No [X]

(c) The entity has no external cessions and only participates in an intercompany pool and the affiliated lead company has filed an attestation supplement. Yes [ ] No [X]

See accompanying independent auditors' report.