

STATE OF WASHINGTON  
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION  
OF  
CONTRACTORS BONDING AND INSURANCE COMPANY  
SEATTLE, WASHINGTON

NAIC CODE 37206  
December 31, 2012

Order No. 14-87  
Contractors Bonding and Insurance Company  
Exhibit A

Participating States:  
Washington  
Illinois

**SALUTATION**

Seattle, Washington  
February 24, 2014

The Honorable Mike Kreidler, Commissioner  
Washington State Office of the Insurance Commissioner (OIC)  
Insurance Building-Capitol Campus  
302 Sid Snyder Avenue SW, Suite 200  
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

**Contractors Bonding and Insurance Company**

of

Seattle, Washington

hereinafter referred to as "CBIC," or the "Company" at the location of its administrative office, 9025 North Lindbergh Drive, Peoria, IL 61615. This report is respectfully submitted showing the financial condition and related corporate matters of CBIC as of December 31, 2012.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Contractors Bonding and Insurance Company of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2012.



Patrick H. McNaughton  
Chief Examiner

5-1-14

Date

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## **SCOPE OF THE EXAMINATION**

This examination covers the period January 1, 2008 through December 31, 2012 and comprises a risk focused review of the books and records of the Company. The examination followed statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination through the end of fieldwork on February 24, 2014.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following section of this report. In addition, the Company's Certified Public Accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was performed in compliance with the 2012 NAIC FCEH which requires the examiner to consider the Company's risk management process, corporate governance structure, and control environment. The examiners utilized the information obtained during the examination to assess the Company's overall potential risks both currently and on an on-going basis, to allow the examiners to focus on the Company's greatest areas of risk, and to provide assurance on the Company's financial statements as of the examination date.

This examination was classified as a coordinated lead state examination. Illinois was designated the lead state of the coordinated examination and examiners from the states of Washington and Illinois participated and assessed the financial condition and corporate affairs of the Company.

## **INSTRUCTIONS**

The examiners reviewed the Company's filed 2012 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as outlined in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review:

### **1. Schedule Y – Part 2**

The Company did not report certain transactions among CBIC affiliates as required by the NAIC Annual Statement Instructions. For example, the Company did not report related party transactions pertaining to the tax allocation agreement and an intercompany services agreement in Schedule Y – Part 2, Column 8 in the 2012 NAIC Annual Statement.

**The Company is instructed to comply with RCW 48.05.250 and WAC 284-07-050(2) by accurately completing Schedule Y – Part 2 as outlined in the NAIC Annual Statement Instructions.**

## COMMENTS AND RECOMMENDATIONS

None

## COMPANY PROFILE

### **Company History**

CBIC received its Certificate of Authority on October 9, 1979 to transact surety insurance business in the state of Washington. The Certificate of Authority was amended on July 15, 1980, authorizing the transaction of marine and transportation, vehicle, property and general casualty insurance. In 1994, CBIC began writing other commercial property and casualty (P&C) lines, and focused on certain niche markets such as contractors' general liability insurance.

On April 28, 2011, RLI Insurance Company (RLIC), an Illinois domiciled stock corporation, purchased all of the outstanding common capital stock of Data and Staff Service Co. (DSSC), CBIC's parent and sole shareholder, for approximately \$136 million.

### **Capitalization**

On April 25, 2011, CBIC common capital stock increased by \$500,000 when the Company issued 50,000 of common stock dividends to its parent, DSSC. The capital stock dividend did not change total capital and surplus.

As of December 31, 2012, CBIC had 1,000,000 shares authorized and 300,000 shares issued and outstanding of common stock, with a par value of \$10 per share. The Company met the minimum capital requirements of RCW 48.05.340 with \$101,431,933 of capital and surplus as of December 31, 2012.

### **Territory and Plan of Operations**

CBIC, a subsidiary of RLIC, is authorized to write multiple lines of insurance on an admitted basis in all fifty states and the District of Columbia. Over 75 percent of the Company's direct premium is written in the states of Washington (32 percent), Oregon (14.4 percent), Arizona (13.3 percent), California (9.5 percent) and Montana (6.3 percent). CBIC specializes in underwriting surety bonds, with an emphasis on license, miscellaneous, contract and court bonds, and related niche P&C insurance products. Approximately half of the business written by CBIC is P&C packages offered to small to medium-sized businesses such as artisan and general contractors. Other available coverages include surety bonds, general liability, property, inland marine, commercial automobile, commercial multiple peril, and umbrella insurance.

### Growth of Company

The following reflects the Company's growth as reported in its filed NAIC Annual Statements for the five year period under examination:

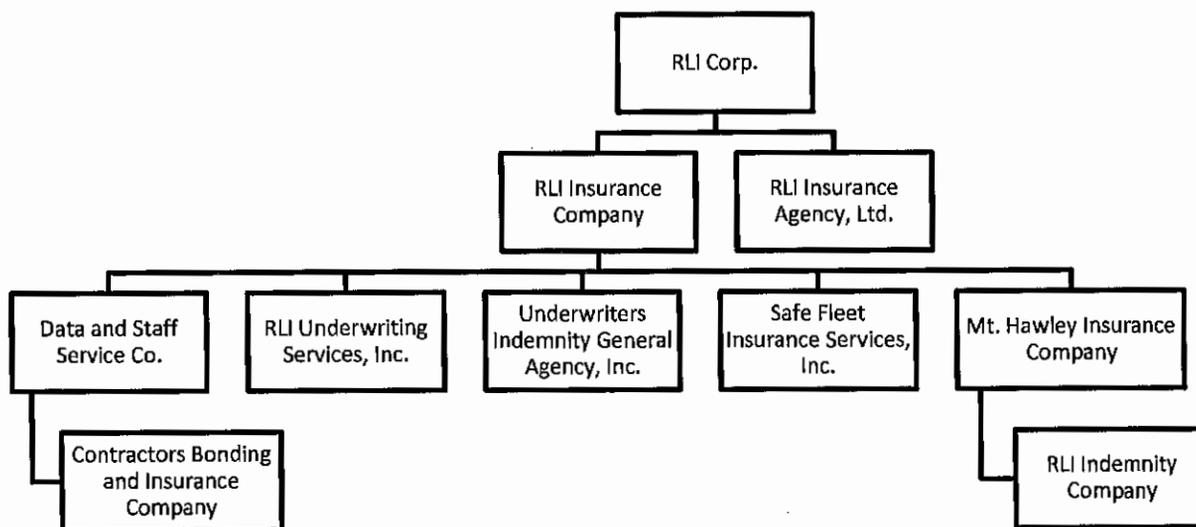
<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital &amp; Surplus</u>	
2012	\$190,716,426	\$89,284,493	\$101,431,933	
2011	198,690,044	108,326,434	90,363,610	
2010	215,373,202	103,450,520	111,922,682	
2009	217,922,038	109,760,866	108,161,172	
2008	213,947,889	115,839,257	98,108,632	

<u>Year</u>	<u>Premium Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2012	\$49,459,478	\$12,082,271	\$3,827,602	\$14,108,222
2011	45,855,402	(28,799,903)	7,012,879	(16,564,790)
2010	53,309,952	4,168,046	5,095,688	6,815,341
2009	61,984,253	9,484,883	6,728,630	11,987,296
2008	75,792,965	15,825,319	6,784,137	15,797,291

### Affiliated Companies

The following organization chart was taken from CBIC's 2012 NAIC Annual Statement:



RLI Corp., an Illinois stock corporation that is publically traded on the New York Stock Exchange, engages in P&C insurance business principally through CBIC and the following three insurance company subsidiaries:

**RLI Insurance Company**

RLIC writes multiple lines of P&C insurance in all fifty states, the District of Columbia, and Puerto Rico.

**Mt. Hawley Insurance Company**

Mt. Hawley Insurance Company (MHIC), an Illinois domiciled stock corporation wholly owned by RLIC, has authority to write surplus lines insurance in all fifty states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and Guam.

**RLI Indemnity Company**

RLI Indemnity Company (RLII), an Illinois domiciled stock corporation wholly owned by MHIC, has authority to write multiple lines of P&C insurance in forty-nine states and the District of Columbia.

**Intercompany Agreements**

The Company was a party to two intercompany agreements with RLIC and affiliates which were in compliance with SSAP No. 70. Both agreements in force as of December 31, 2012 are listed below:

**Intercompany Services Agreement (Amended and Restated) – 2012**

The Company entered into the Intercompany Services Agreement, dated July 18, 2012, with RLIC; RLI Corp.; MHIC; RLII; Safe Fleet Insurance Services, Inc.; Underwriters Indemnity General Agency, Inc.; RLI Underwriting Services, Inc.; and DSSC. Under the terms of the agreement, RLIC performs reinsurance placement, claim adjustment services, actuarial services, and underwriting services for the four RLI insurance companies. In addition, RLIC provides various services for all parties to this agreement including investment, finance, and accounting services; information technology services; data processing and system development; legal and regulatory compliance; payroll, employee benefits and human resources; cash management; and any other services.

The Agreement also provides that RLI Corp. performs investment services on behalf of the four RLI insurance companies.

**Tax Allocation Agreement Addendum Number Five**

Effective May 1, 2011, CBIC and DSSC were added as parties to the Tax Allocation Agreement dated January 1, 1993, as subsequently amended, with RLI Corp. and its affiliates. The agreement specifies the method by which the consolidated RLI Corp. tax liability is allocated to the RLI Corp. subsidiaries in accordance with the Internal Revenue Code. The agreement also stipulates that RLI Corp. will prepare the Company's tax return and calculate its tax liability.

## MANAGEMENT AND CONTROL

### **Board of Directors (BOD)**

Directors as of December 31, 2012:

Jonathan E. Michael	Chairman
Michael J. Stone	Vice Chairman
Thomas L. Brown	
Todd W. Bryant	
Donald J. Driscoll	
Jeffrey D. Fick	
Craig W. Kliethermes	

### **Officers**

Officers as of December 31, 2012:

Jonathan E. Michael	Chairman and Chief Executive Officer
Michael J. Stone	President and Chief Operating Officer
Thomas L. Brown	Vice President, Chief Financial Officer and Assistant Treasurer
Todd W. Bryant	Vice President, Controller
Seth A. Davis	Vice President, Internal Audit
Roy C. Die	Senior Vice President, Surety
Aaron P. Diefenthaler	Vice President, Chief Investment Officer
Donald J. Driscoll	Vice President, Claim
Jeffery D. Fick	Vice President, Human Resources
Daniel O. Kennedy	Vice President, General Counsel
Craig W. Kliethermes	Senior Vice President, Risk Services
Jennifer L. Klobnak	Vice President, Risk Services
Murali Natarajan	Vice President, Information Technology
Robert M. Ogle	Vice President, Treasurer
David C. Sandoz	Vice President, Miscellaneous Surety
Jean M. Stephenson	Assistant Vice President, Corporate Secretary

### **Conflict of Interest**

The Company requires its officers, directors, and key employees to complete a conflict of interest statement annually. All disclosures were reviewed and discussed by the BOD. No exceptions were noted in our review.

### **Fidelity Bond and Other Insurance**

The Company maintains a financial institution bond coverage that meets the amount suggested by NAIC guidelines. Also, the Company is the named insured on various insurance policies to cover risks in the normal course of business.

### **Officers', Employees', and Agents' Welfare and Pension Plans**

The Company does not have any direct employees, so CBIC does not have any direct obligations for retirement plans, deferred compensation, or post employment benefits.

## CORPORATE RECORDS

The Company's Articles of Incorporation, Bylaws, Certificates of Authority, and meeting minutes of the BOD and its committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present. Investment purchases, transfers, and disposals were ratified by the BOD and noted in the minutes.

## UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

<u>Year</u>	<u>Losses</u>	<u>Loss Adjustment Expenses</u>
2012	\$38,018,277	\$10,754,774
2011	41,521,895	12,627,884
2010	41,554,809	11,336,036
2009	43,515,390	11,329,265
2008	46,662,140	11,691,144

As shown above, the reserves carried by the Company for unpaid losses and loss adjustment expenses were \$38,018,277 and \$10,754,774, respectively, as of December 31, 2012.

The actuarial consulting firm contracted by the Illinois Department of Insurance, Merlinos & Associates, Inc., reviewed the unpaid loss and loss adjustment expense reserves for the four RLI insurance companies, which includes CBIC, and concluded that the reserves for the RLI insurance companies were within a range of reasonable estimates. Therefore, the Company's loss and loss adjustment expense reserves were accepted as reasonable and no adjustments were proposed to the amounts reported in the Company's 2012 NAIC Annual Statement.

## REINSURANCE

The Company is a party to excess of loss and quota share reinsurance agreements with various retention amounts and limits. CBIC and its affiliates are protected against catastrophic losses for up to \$250 million. CBIC assumes no premiums and losses.

Reinsurance agreements were reviewed and found to be in compliance with Washington State reinsurance statutes and the agreements transfer risk in accordance with SSAP No. 62R, paragraph 10. The reinsurers were properly classified in Schedule F of the 2012 NAIC Annual Statement. The Company has controls in place to monitor its reinsurance program including the financial condition of the reinsurers.

The Company's reinsurance arrangements are facilitated by reinsurance intermediaries-brokers Aon Benfield Inc., Willis Re Inc., and Guy Carpenter & Company, LLC. The Company's reinsurance intermediaries-brokers contracts were in compliance with provisions of Chapter 48.94 RCW, Reinsurance Intermediary Act.

### STATUTORY DEPOSITS

The Company maintained the following statutory deposits as of December 31, 2012:

<u>State</u>	<u>Type</u>	<u>Book Value</u>	<u>Fair Value</u>
Florida	Bond	\$301,148	\$301,313
Georgia	Bond	50,191	50,219
Massachusetts	Bond	602,297	602,625
New Mexico	Bond	386,474	386,684
North Carolina	Bond	351,340	351,531
Oregon	Bond	301,148	301,313
Virginia	Bond	235,899	236,028
Washington	Bond	2,790,641	2,792,163
<b>Total</b>		<b><u>\$5,019,138</u></b>	<b><u>\$5,021,876</u></b>

### ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Statutory Accounting Principles (SAP) basis and is audited annually by the certified public accounting firm of KPMG LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The Company's Information Technology (IT) environment was reviewed during the planning and testing phase of the examination, focusing on the following Control Objectives for Information and related Technology (COBIT) Framework domains:

- Plan and Organize
- Acquire and Implement
- Deliver and Support
- Monitor and Evaluate

The IT system and controls were evaluated to gain an understanding of the IT general control risks and assess the effectiveness of these controls to determine if appropriate mitigating and internal controls have been implemented. Appropriate mitigating and internal controls have been implemented to reduce residual risk to appropriate levels. The Company has an effective Business Continuity Plan and Disaster Recovery Plan, which have been tested on a regular basis and includes the availability of an alternate site.

### **SUBSEQUENT EVENTS**

Effective May 1, 2013, Paul A. Vendetti, Assistant Vice President, Risk Services, replaced Phillip S. Moore, Assistant Vice President, Risk Services, as the Appointed Actuary for the year ending December 31, 2013, and all subsequent years until his successor has been appointed and qualified.

Effective May 2, 2013, Craig W. Kliethermes was promoted to Executive Vice President, Operations.

On May 28, 2013, CBIC filed with the OIC its Amended and Restated Articles of Incorporation and its Amended and Restated By-Laws, both effective May 6, 2013. The filings replaced and superseded in their entirety all prior CBIC Articles of Incorporation and Bylaws.

On October 21, 2013, RLIC dissolved Underwriters Indemnity General Agency, Inc.

Two IT development projects are underway. A claim application initiative is migrating and consolidating all claims processing to a single platform, and a policy administration and rating system is being deployed for various insurance products. Both are targeted for completion by the end of 2014.

There were no additional material events impacting the Company between the examination date and the last day of our field work on February 24, 2014.

### **FINANCIAL STATEMENTS**

The following financial statements show the financial condition of Contractors Bonding and Insurance Company as of December 31, 2012:

Assets, Liabilities, Surplus and Other Funds  
Statement of Income and Capital and Surplus Account  
Five Year Reconciliation of Surplus

**Contractors Bonding and Insurance Company**  
**Assets, Liabilities, Surplus and Other Funds**  
**December 31, 2012**

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
<b>Assets</b>			
Bonds	\$154,602,923	\$0	\$154,602,923
Cash, cash equivalents, and short-term investments	18,210,570		18,210,570
Receivables for securities	400,000		400,000
<b>Subtotals, cash and invested assets</b>	<b><u>173,213,493</u></b>	<b><u>0</u></b>	<b><u>173,213,493</u></b>
Investment income due and accrued	1,495,054		1,495,054
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	2,180,377		2,180,377
Deferred premiums, agents' balances and installments booked but deferred and not yet due	6,460,017		6,460,017
Amounts recoverable from reinsurers	118,910		118,910
Net deferred tax asset	3,285,282		3,285,282
Electronic data processing equipment and software	26,777		26,777
Receivables from parent, subsidiaries and affiliates	2,974,956		2,974,956
Aggregate write-ins for other than invested assets	961,560		961,560
<b>Total Assets</b>	<b><u>\$190,716,426</u></b>	<b><u>\$0</u></b>	<b><u>\$190,716,426</u></b>
<b>Liabilities, Surplus and Other Funds</b>			
Losses	\$38,018,277	\$0	\$38,018,277
Loss adjustment expenses	10,754,774		10,754,774
Commissions payable, contingent commissions and other similar charges	281,078		281,078
Other expenses	42,980		42,980
Taxes, licenses and fees	7,867		7,867
Current federal and foreign income taxes	415,773		415,773
Unearned premiums	26,663,321		26,663,321
Advance premium	696,293		696,293
Ceded reinsurance premiums payable	1,757,336		1,757,336
Amounts withheld or retained by company for account of others	10,646,794		10,646,794
<b>Total Liabilities</b>	<b><u>89,284,493</u></b>	<b><u>0</u></b>	<b><u>89,284,493</u></b>
Common capital stock	3,000,000		3,000,000
Gross paid in and contributed surplus	2,510,250		2,510,250
Unassigned funds (surplus)	95,921,683		95,921,683
<b>Surplus as regards policyholders</b>	<b><u>101,431,933</u></b>	<b><u>0</u></b>	<b><u>101,431,933</u></b>
<b>Total Liabilities, Surplus and Other Funds</b>	<b><u>\$190,716,426</u></b>	<b><u>\$0</u></b>	<b><u>\$190,716,426</u></b>

**Contractors Bonding and Insurance Company**  
**Statement of Income and Capital and Surplus Account**  
**For the Year Ended December 31, 2012**

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
<b>Underwriting Income</b>			
Premiums earned	\$49,459,478	\$0	\$49,459,478
<b>Deductions</b>			
Losses incurred	5,221,782		5,221,782
Loss adjustment expenses incurred	3,447,548		3,447,548
Other underwriting expenses incurred	28,707,877		28,707,877
Total underwriting deductions	<u>37,377,207</u>	<u>0</u>	<u>37,377,207</u>
<b>Net underwriting gain (loss)</b>	<b><u>12,082,271</u></b>	<b><u>0</u></b>	<b><u>12,082,271</u></b>
<b>Investment Income</b>			
Net investment income earned	3,801,114		3,801,114
Net realized capital gains (losses)	26,488		26,488
<b>Net investment gain (loss)</b>	<b><u>3,827,602</u></b>	<b><u>0</u></b>	<b><u>3,827,602</u></b>
<b>Other Income</b>			
Net gain (loss) from agents' or premium balances charged off	(73,404)		(73,404)
Finance and service charges not included in premiums	495,063		495,063
Aggregate write-ins for miscellaneous income	16,183		16,183
<b>Total other income</b>	<b><u>437,842</u></b>	<b><u>0</u></b>	<b><u>437,842</u></b>
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	16,347,715		16,347,715
Federal and foreign income taxes incurred	2,239,493		2,239,493
<b>Net income</b>	<b><u>\$14,108,222</u></b>	<b><u>\$0</u></b>	<b><u>\$14,108,222</u></b>
<b>Capital and Surplus Account</b>			
<b>Surplus as regards policyholders, December 31 prior year</b>	<b><u>\$90,363,610</u></b>	<b><u>\$0</u></b>	<b><u>\$90,363,610</u></b>
Net income	14,108,222		14,108,222
Change in net deferred income tax	(3,285,799)		(3,285,799)
Change in nonadmitted assets	245,900		245,900
<b>Change in surplus as regards policyholders for the year</b>	<b><u>11,068,323</u></b>	<b><u>0</u></b>	<b><u>11,068,323</u></b>
<b>Surplus as regards policyholders, December 31 current year</b>	<b><u>\$101,431,933</u></b>	<b><u>\$0</u></b>	<b><u>\$101,431,933</u></b>

**Contractors Bonding and Insurance Company**  
**Five Year Reconciliation of Surplus**  
**For the Years Ended December 31,**

	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Capital and Surplus, December 31, prior year</b>	<b><u>\$90,363,610</u></b>	<b><u>\$111,922,682</u></b>	<b><u>\$108,161,171</u></b>	<b><u>\$98,108,632</u></b>	<b><u>\$87,418,255</u></b>
Net Income (loss)	14,108,222	(16,564,790)	6,815,341	11,987,296	15,797,291
Change in net unrealized capital gains (losses)		(676,579)	176,789	122,488	(658,570)
Changes in net deferred income tax	(3,285,799)	2,854,738	(557,550)	(645,197)	83,046
Change in nonadmitted assets	245,900	(572,025)	846,164	242,342	(1,931,390)
Change in provision for reinsurance		519,233	(519,233)		
Capital changes: Transferred from surplus		500,000			
Surplus adjustments: Transferred to capital		(500,000)			
Dividends to stockholders		(8,300,000)	(3,000,000)	(2,700,000)	(2,600,000)
Aggregate write-ins for gains and losses in surplus		1,180,351		1,045,610	
Change in surplus as regards policyholders for the year	<u>11,068,323</u>	<u>(21,559,072)</u>	<u>3,761,511</u>	<u>10,052,539</u>	<u>10,690,377</u>
<b>Capital and Surplus, December 31, current year</b>	<b><u>\$101,431,933</u></b>	<b><u>\$90,363,610</u></b>	<b><u>\$111,922,682</u></b>	<b><u>\$108,161,171</u></b>	<b><u>\$98,108,632</u></b>

**NOTES TO THE FINANCIAL STATEMENTS**

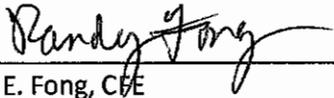
The Company has no special consents, permitted practices, or orders from the state of Washington.

### ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Contractors Bonding and Insurance Company and its affiliates during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Timothy F. Hays, CPA, JD, Investment Specialist; Tarik Subbagh, MSBA, CPA, CFE, Property and Casualty Field Supervising Examiner; Edsel R. Dino, AFE, Financial Examiner; and Zairina Othman, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, and examiners representing the Illinois Department of Insurance, participated in the examination and in the preparation of this report.

Respectfully submitted,



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Randy E. Fong, CFE  
Examiner-in-Charge  
State of Washington

