



**DEPARTMENT OF INSURANCE, FINANCIAL
INSTITUTIONS AND PROFESSIONAL REGISTRATION**

P.O. Box 690, Jefferson City, Mo. 65102-0690

ORDER

After full consideration and review of the report of the financial examination of Cornerstone National Insurance Company for the period ended December 31, 2016, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers, I, Chlora Lindley-Myers, Director, Missouri Department of Insurance, Financial Institutions and Professional Registration pursuant to section 374.205.3(3)(a), RSMo, adopt such examination report. After my consideration and review of such report, workpapers, and written submissions or rebuttals, I hereby incorporate by reference and deem the following parts of such report to be my findings and conclusions to accompany this order pursuant to section 374.205.3(4), RSMo: summary of significant findings, subsequent events, company history, corporate records, management and control, territory and plan of operation, reinsurance, accounts and records, financial statements, comments on financial statement items, analysis of changes to surplus, and general comments and/or recommendations.

Based on such findings and conclusions, I hereby ORDER that the report of the financial examination of Cornerstone National Insurance Company as of December 31, 2016 be and is hereby ADOPTED as filed and for Cornerstone National Insurance Company to take the following action or actions, which I consider necessary to cure any violation of law, regulation or prior order of the Director revealed by such report: (1) implement and verify compliance with each item mentioned in the Comments on the Financial Statement Items and/or General Comments and/or Recommendations section of such report; and (2) account for its financial condition and affairs in a manner consistent with the Director's findings and conclusions.

So ordered, signed and official seal affixed this 9th day of November, 2017.



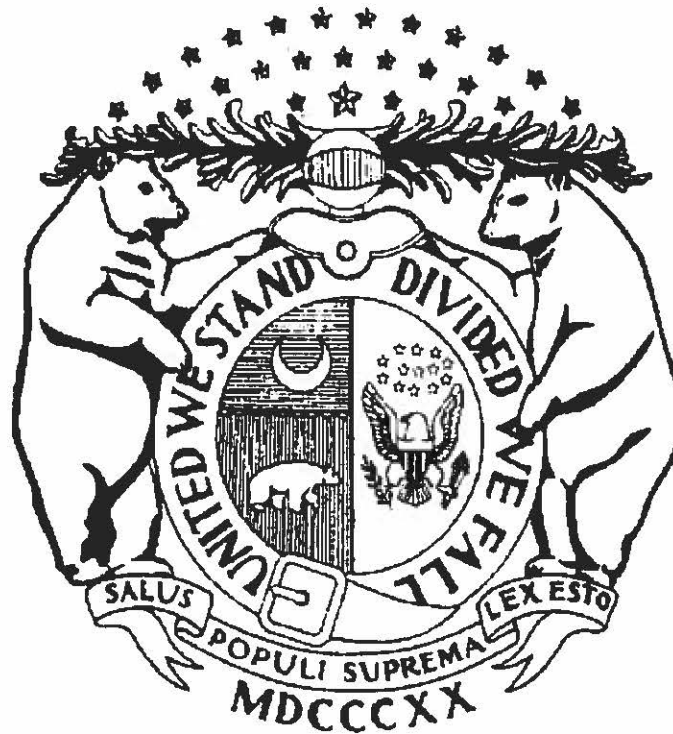
Chlora Lindley-Myers

Chlora Lindley-Myers, Director
Department of Insurance, Financial Institutions
and Professional Registration

**REPORT OF THE
FINANCIAL EXAMINATION OF
CORNERSTONE NATIONAL
INSURANCE COMPANY**

**AS OF
DECEMBER 31, 2016**

FILED
NOV 20 2017
DIRECTOR OF INSURANCE,
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION



**STATE OF MISSOURI
DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS
AND PROFESSIONAL REGISTRATION
JEFFERSON CITY, MISSOURI**

TABLE OF CONTENTS

SCOPE OF EXAMINATION	1
PERIOD COVERED	1
PROCEDURES.....	1
SUMMARY OF SIGNIFICANT FINDINGS	2
SUBSEQUENT EVENTS	3
COMPANY HISTORY	3
GENERAL	3
DIVIDENDS AND CAPITAL CONTRIBUTIONS	3
MERGERS AND ACQUISITIONS	3
CORPORATE RECORDS	3
MANAGEMENT AND CONTROL	4
CORPORATE GOVERNANCE	4
COMMITTEES	4
OFFICERS	5
HOLDING COMPANY, SUBSIDIARIES AND AFFILIATES	5
ORGANIZATIONAL CHART	6
INTERCOMPANY AGREEMENTS.....	6
INTERCOMPANY PAYMENTS	8
TERRITORY AND PLAN OF OPERATION	8
REINSURANCE	9
GENERAL	9
ASSUMED.....	9
CEDED.....	9

ACCOUNTS AND RECORDS	10
GENERAL	10
INDEPENDENT ACCOUNTANTS.....	10
ACTUARIAL OPINION	10
CONSULTING ACTUARY	10
INFORMATION SYSTEMS	11
FINANCIAL STATEMENTS.....	11
ASSETS.....	12
LIABILITIES, SURPLUS AND OTHER FUNDS.....	13
STATEMENT OF INCOME.....	14
RECONCILIATION OF SURPLUS	14
COMMENTS ON FINANCIAL STATEMENT ITEMS	15
ANALYSIS OF CHANGES TO SURPLUS	16
GENERAL COMMENTS AND/OR RECOMMENDATIONS.....	16
ACKNOWLEDGMENT.....	17
VERIFICATION.....	17
SUPERVISION	18

Columbia, Missouri
September 25, 2017

Honorable Chlora Lindley-Myers, Director
Missouri Department of Insurance, Financial Institutions
and Professional Registration
301 West High Street, Room 530
Jefferson City, Missouri 65101

Director Lindley-Myers:

In accordance with your financial examination warrant, a full scope financial examination has been made of the records, affairs and financial condition of

Cornerstone National Insurance Company

hereinafter referred to as such, "CNIC", or as the "Company". Its administrative office is located at 3100 Falling Leaf Court, Suite 200, Columbia, Missouri, 65201, telephone number (573) 817-2481. This examination began on March 6, 2017, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

We have performed a multi-state examination of CNIC. The last examination was completed as of December 31, 2013. This examination covers the period of January 1, 2014, through December 31, 2016. This examination also included the material transactions or events occurring subsequent to December 31, 2016.

Procedures

This examination was conducted using guidelines set forth in the Financial Condition Examiners Handbook (Handbook) of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the Department of Insurance, Financial Institutions and Professional Registration ("Department" or "DIFP") or statutes of the state of Missouri prevailed. The Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

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

This examination report includes significant findings of fact and general information about the Company and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

SUMMARY OF SIGNIFICANT FINDINGS

CNIC's capital and surplus has deteriorated significantly during 2016 and the first six months of 2017. A 33% decrease in capital and surplus has occurred over this 18 month period. There is a significant risk that the Company's RBC ratio will fall below 300% and the combined ratio will be above 120% by year-end 2017. These conditions would trigger a Company Action Level Event, pursuant to Section 375.1255.2 RSMo (Company Action Level Event).

The Company reported an asset for net deferred tax assets (DTAs) of \$542,756 at December 31, 2016. This asset represented 5.3% of capital and surplus, as of December 31, 2016, and 6.3% of capital and surplus, as of June 30, 2017. The Company experienced \$4.7 million of taxable net losses during the period 2014 to 2016. The net losses represent significant negative evidence that a valuation allowance is necessary. Therefore the DTA was non-admitted in the financial statements of this report of financial examination.

Several deficient or missing internal controls were noted in the examination, which resulted in errors in general ledger balances and Annual Statement reporting, an increased risk of fraud for cash disbursements, a lack of documented due diligence for new states and new agents, and inadequate case reserves for individual claims.

SUBSEQUENT EVENTS

The Company's capital and surplus decreased from \$10,250,886, as of December 31, 2016, to \$8,264,919, as of June 30, 2017, which is a decrease of \$1.9 million or 19%. The large decrease for the first six months of 2017 is in addition to a \$2.1 million decrease in capital and surplus during 2016. Underwriting losses are responsible for the majority of the drop in capital and surplus. Poor experience in new states entered in 2016, especially South Carolina, have contributed to the underwriting losses.

The Company's RBC ratio decreased from 304% at year-end 2016 to an estimated 245% at June 30, 2017. As a result, the Company has a significant risk of a Company Action Level event at December 31, 2017, pursuant to Section 375.1255.2 RSMo, which occurs when the RBC level is below 300% and the combined ratio exceeds 120%. This statute has various reporting requirements to explain the contributing factors causing the low RBC ratio and the development of an action plan to address to the financial difficulties.

COMPANY HISTORY

General

The Company was incorporated on March 6, 1997 and commenced business on March 19, 1997. The Company operates as a stock property and casualty insurer under the insurance laws of Chapter 379 RSMo (Insurance Other Than Life).

Dividends and Capital Contributions

CNIC did not pay any dividends or receive any capital contributions during the examination period.

Mergers and Acquisitions

There were no mergers or acquisitions involving the Company or the holding company system of the parent, Cornerstone Management Partners, Inc. (CMP), during the examination period.

CORPORATE RECORDS

The Company's Articles of Incorporation and Bylaws were reviewed. There were no amendments to the Articles of Incorporation during the examination period. The Bylaws were amended in November 2016 to allow for the Treasurer position to be elected only as needed. Prior to the amendment, a Treasurer was an officer that was required to be elected on an annual basis.

The minutes of the CNIC and CMP Board of Directors’ meetings and the CNIC shareholder annual consent in lieu of meeting were reviewed for proper approval of corporate transactions. In general, the minutes and consents appear to properly reflect and approve the Company’s major transactions and events for the period under examination.

MANAGEMENT AND CONTROL

Corporate Governance

The management of the Company is vested in a Board of Directors, which is appointed by the sole shareholder. The Company’s Bylaws specify that the Board of Directors shall consist of thirteen (13) members. The following directors were appointed and serving, as of December 31, 2016:

<u>Name</u>	<u>Address</u>	<u>Principal Occupation and Business Affiliation</u>
D. Scott Forrest	Columbia, MO	Vice President and General Counsel, CMP
James C. French	Columbia, MO	Owner, Centennial General Agency
James E. Godfrey, Jr.	St. Louis, MO	Attorney, Evans & Dixon, LLC
Brian G. Harrison	Columbia, MO	Owner, Harrison Agency, Inc.
R. Alan Hedrick	Dexter, MO	Owner, Country Wide Insurance Agency
Lewis E. Melahn	Mexico, MO	Attorney, Private Practice
Stephen M. Palmer	St. Louis, MO	Physician, Private Practice
David N. Ridgely	Shelbina, MO	President, Loyalty Lane, Inc.
Robert A. Rowles	Tipton, MO	President, Insurance Associates America, Inc.
Roger D. Walker	Columbia, MO	Senior VP and Chief Operating Officer, CMP
William J. Wheeler	Brentwood, TN	President and Chief Executive Officer, CMP

Committees

The Articles of Incorporation and Bylaws do not require any committees, but the Bylaws do allow for the creation of committees, if authorized by a resolution of the Board of Directors. The Company did not have any appointed committees, as of December 31, 2016. However, the parent company, CMP, had committees established throughout the exam period that regularly address and take actions on the business affairs of CNIC. The CMP committees appointed and serving, were as follows: Audit Committee, Executive Compensation Committee, Governance Committee, Marketing and Agency Relations Committee, and Technology Committee.

Officers

The officers elected by the Board of Directors and serving as of December 31, 2016, were as follows:

<u>Officer</u>	<u>Position</u>
William J. Wheeler	President and Chief Executive Officer
Roger D. Walker	Senior Vice President, Chief Operating Officer, Secretary
D. Scott Forrest	Vice President of Claims and Compliance, General Counsel, Assistant Secretary

Holding Company, Subsidiaries and Affiliates

The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by CNIC for each year of the examination period.

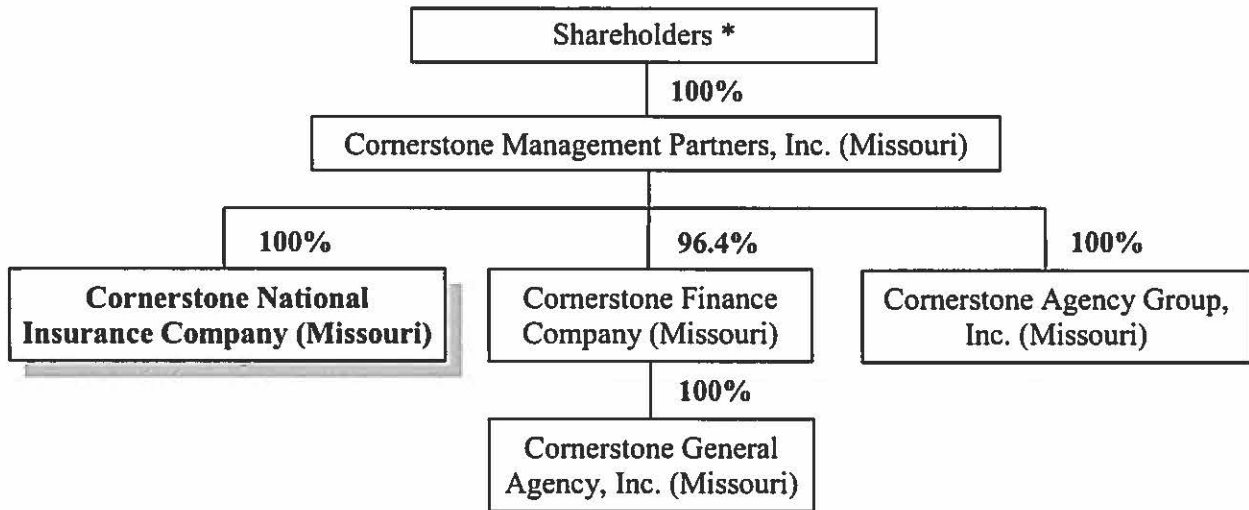
The Company is directly owned 100% by Cornerstone Management Partners, Inc., a holding company. CMP is a privately held stock company with approximately 350 common and preferred shareholders. The largest shareholder of CMP is James French, a director. Mr. French owned 13% of the outstanding common stock of CMP, as of December 31, 2016. Collectively, officers and directors of CNIC own 30% of CMP common stock. The 30 largest stockholders of CMP own 62% of CMP common stock.

CMP has other subsidiaries, which have business operations in or related to the insurance industry. CMP and its subsidiaries are collectively referred to as the Cornerstone Group. CNIC is the only entity with significant operations in the Cornerstone Group. A description of the business operations of CMP and its subsidiaries are as follows:

- Cornerstone Management Partners, Inc. – Holding company with a primary purpose to manage and support the business operations of CNIC. Employees of CMP perform the day-to-day operational functions of CNIC and its other subsidiaries.
- Cornerstone Finance Company – A commercial lender that issues loans to businesses for the purpose of financing insurance premiums on commercial policies.
- Cornerstone General Agency, Inc. (CGA) – An agency that is responsible for managing the network of independent agents that produce business for CNIC.
- Cornerstone Agency Group, Inc. – A holding company with no operations.

Organizational Chart

Below is the organizational chart of the Company and its affiliates in the CMP holding company system, as of December 31, 2016.



* James French is the ultimate controlling entity and largest shareholder with 13% ownership; no other shareholder owns 10% or more of CMP common stock.

Intercompany Agreements

The Company’s active agreements with related parties that were in effect, as of December 31, 2016, are outlined below.

1. **Type:** Tax Allocation Agreement
Affiliates: Cornerstone Management Partners, Inc. and Cornerstone Finance Company
Effective: October 4, 2006
Terms: All of the parties to the Agreement will annually file a consolidated federal income tax return commencing with the 2000 tax year. Each entity’s share of the consolidated tax liability or refund shall be calculated as the amount that would have been incurred if each entity would have filed a tax return on a stand-alone basis. The settlements of tax payments due to CMP are to be paid within 30 days of the date that each filing is due to the Internal Revenue Service (IRS). Any tax refunds receivable from CMP are due within 30 days of CMP’s receipt of the funds from the IRS.

2. Type: Cost Allocation Agreement

Affiliate: Cornerstone Management Partners

Effective: March 1, 2009

Terms: CMP will provide various management and administrative services for CNIC, which include claims processing, underwriting, policyholder services, marketing, accounting, tax reporting, premium rating, legal, human resources, investments, billing and collection, financial reporting, regulatory compliance, strategic planning, data processing, computer support, and office space. CMP will allocate the direct costs for salary and benefits of its employees that provide services to CNIC, based upon a mutually agreed upon methodology. Various other general and administrative expenses incurred by CMP to provide services to CNIC will be allocated with the same percentage used for the allocation of salary and benefits. CNIC will reimburse CMP for the depreciation of its computer hardware and software costs used to provide data processing services. CMP will invoice CNIC on a monthly basis for all direct and allocated costs under the agreement.

3. Type: General Agency Agreement

Affiliate: Cornerstone General Agency, Inc.

Effective: May 1, 2010; amended effective June 1, 2012

Terms: CGA will serve as the general agent to supervise and conduct the writing of CNIC's private passenger automobile business. CGA shall have the authority to appoint local agents and solicit applications for insurance in the states of Missouri, Arkansas, Oklahoma, Kansas and Texas. CGA must follow the underwriting guidelines of CNIC. CGA does not have the responsibility to collect premiums and will not process claims. CNIC will pay CGA a monthly fee equal to CGA's direct costs of providing services under the agreement.

A separate Assignment and Assumption Agreement was executed simultaneous with the General Agency Agreement to transfer the rights and obligations under CNIC's existing agent contracts to CGA, effective May 1, 2010.

4. Type: Service Agreement

Affiliate: Cornerstone General Agency, Inc.

Effective: September 1, 2016

Terms: CGA sells a roadside assistance product to CNIC policyholders, which is a non-insurance product serviced by an unaffiliated third-party. CNIC provides processing, billing, collection and accounting services for the membership fees due to CGA. CGA pays CNIC a monthly sliding scale fee based upon the volume of roadside assistance fees. The fees due CNIC begin at 20% when monthly roadside assistance membership fees are \$50,000 or less and decrease

gradually to 12.5% when monthly roadside assistance membership fees are \$100,000 or more.

Intercompany Payments

The following table summarizes the payments made during the examination period, between CNIC and its affiliates, pursuant to intercompany agreements and other transactions.

<u>Affiliate</u>	<u>Agreement / Transaction</u>	<u>Net Paid / (Received)</u>		
		<u>2014</u>	<u>2015</u>	<u>2016</u>
CMP	Cost Allocation	\$4,628,544	\$4,847,534	\$4,515,171
CMP	Tax Allocation	(a)	(a)	(a)
CGA	General Agency	4,507,177	3,585,367	4,009,796
CGA	Service	0	0	10,373
TOTAL		<u>\$9,135,721</u>	<u>\$8,432,901</u>	<u>\$8,535,340</u>

(a) No cash settlements with CMP occurred during the examination period. However, CNIC incurred the following tax benefits (due to taxable losses), pursuant to the Tax Allocation Agreement: 2014 - \$529,322, 2015 - \$402,078, 2016 - \$676,337.

TERRITORY AND PLAN OF OPERATION

Cornerstone National Insurance Company is licensed as a property and casualty insurer by the Missouri DIFP under Chapter 379 RSMo (Insurance Other than Life). The Company is licensed in 21 states, but only wrote business in nine states during 2016. The states with the largest written premiums were as follows:

<u>State</u>	<u>2016 Direct Written Premiums</u>	<u>% of Total</u>
Missouri	\$ 7,897,142	26.4%
Arkansas	7,243,899	24.2%
Oklahoma	6,180,932	20.6%
South Carolina	4,443,120	14.8%
All Other	<u>4,183,335</u>	<u>14.0%</u>
Total	<u>\$29,948,428</u>	<u>100.0%</u>

The Company’s two main lines of business are Private Passenger Auto Liability and Auto Physical Damage, which accounted for 61% and 39% of net written premiums in 2016, respectively. The Company also writes minor amounts of Allied Lines business for the National Flood Insurance Program that is 100% ceded.

The Company insures standard and non-standard auto risks, targeting individuals that rent homes or apartments in mostly rural areas. Only low limit policies are issued with maximum bodily injury coverage of \$50,000 per person and \$100,000 per occurrence. During the examination

period, the Company diversified its geographical risk from its traditional Midwestern states of Arkansas, Missouri, and Oklahoma. The Company's expansion into new states began in 2015 and includes South Carolina, Alabama, Tennessee, Illinois and Indiana. Direct written premium in these new five states totaled \$0.5 million in 2015, but increased to \$7.3 million in 2016.

An agency force of over 800 independent agents is utilized to produce business. The production of business is highly diversified among the agencies. No agent accounted for more than 2% of direct written premiums in 2016.

REINSURANCE

General

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	<u>Assumed</u>		
	<u>2014</u>	<u>2015</u>	<u>2016</u>
Direct Business	\$ 36,681,508	\$ 27,634,195	\$ 29,948,428
Reinsurance Assumed	0	0	0
Reinsurance Ceded:			
Affiliates	0	0	0
Non-affiliates	(3,457,177)	(1,464,513)	(1,227,473)
Net Premiums Written	<u>\$ 33,224,331</u>	<u>\$ 26,169,682</u>	<u>\$ 28,720,955</u>

CNIC did not assume any premiums during the exam period and there are no plans to assume business in the future.

Ceded

The Company has a two-layer casualty excess of loss agreement, effective from April 1, 2015 to December 31, 2016, that cedes 100% of liability losses in excess of a \$500,000 retention, subject to a maximum loss of \$5,000,000 per occurrence. A new casualty excess of loss agreement, effective from January 1, 2017 to December 31, 2017, has mostly the same coverage and retentions as the 2015-16 agreement. One minor change in the 2017 agreement was to decrease the cession to 90% for the layer applicable to losses between \$1,500,000 and \$5,000,000.

Property business is reinsured on a catastrophe basis only, due to the low insured values of personal autos. The Company has a two-layer property catastrophe excess of loss agreement, effective from April 1, 2015 to December 31, 2016, that cedes 100% of property losses in excess

of a \$250,000 retention, subject to a maximum loss of \$4,000,000 per occurrence. A new property catastrophe excess of loss agreement, effective from January 1, 2017 to December 31, 2017, has the same coverage and retentions as the 2015-16 agreement.

CNIC implemented a quota share agreement in 2017 to improve the net written premium to surplus ratio. The quota share agreement is in effect from January 1, 2017 to December 31, 2017 and cedes 25% of all property and liability risks for automobile policies in effect, renewed or written, on or after January 1, 2017.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

ACCOUNTS AND RECORDS

General

A number of weaknesses in internal controls were discovered during in the examination, which were communicated to management in a separate letter. Individually these issues may not have a material impact on the Company's financial condition; however, these issues have the potential to materially affect future financial stability. Deficient or missing internal controls were identified for the following areas: due diligence prior to entering new states, documentation of the vetting process for new agents, initiation and approval of checks and ACH transfers, bank reconciliations, Annual Statement reporting, formula reserves for new claims, and the adequacy and updating of case reserves.

Independent Accountants

The certified public accounting firm, Williams Keepers, LLC (WK), in Columbia, Missouri, performed statutory audits of the Company for all years in the examination period. WK's 2016 audit workpapers were reviewed and used in the course of the examination as deemed appropriate.

Actuarial Opinion

The Company's actuarial opinion regarding loss reserves, loss adjustment expenses (LAE) reserves, and other actuarial items was issued by Mark A. Doepke, FCAS, MAAA, for all years in the examination period. Mr. Doepke is employed by Actuarial Resources, Inc. in Minneapolis, Minnesota.

Consulting Actuary

Pursuant to a contract with the Missouri DIFP, Kristine M. Fitzgerald, ACAS, MAAA of Actuarial and Technical Solutions, Inc., reviewed the underlying actuarial assumptions and methodologies used by CNIC to determine the adequacy of loss reserves and LAE reserves. Ms.

Fitzgerald determined that the Company made a reasonable provision for the loss and LAE reserves that were reported in the statutory financial statements, as of December 31, 2016.

Information Systems

In conjunction with this examination, Andy Balas, CFE, AES, CPA, Information Systems Financial Examiner with the Department, conducted a review of the Company's information systems.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by Cornerstone National Insurance Company with the DIFP and present the financial condition of the Company for the period ending December 31, 2016. The accompanying "Comments on Financial Statement Items" section reflects any examination adjustments to the amounts reported in the 2016 Annual Statement and should be considered an integral part of the financial statements.

There may have been additional differences found in the course of this examination, which are not shown in the "Comments on Financial Statement Items" section. These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

ASSETS
as of December 31, 2016

	Assets	Non-Admitted Assets	Net Admitted Assets
Bonds	\$ 24,396,038	\$ 0	\$ 24,396,038
Common Stocks	815,092	0	815,092
Cash and Short-Term Investments	(174,909)	0	(174,909)
Investment Income Due and Accrued	267,416	0	267,416
Uncollected Premiums and Agents' Balances	5,266,544	17,932	5,248,612
Amounts Recoverable from Reinsurers	371,111	0	371,111
Other Reinsurance Amounts Receivable	218,106	0	218,106
Federal Income Tax Recoverable	3,938,050	3,938,050	0
Net Deferred Tax Asset (Note 1)	542,756	0	542,756
EDP Equipment and Software	387,762	387,762	0
Receivable from Parent, Sub., Affiliates	20,463	0	20,463
Aggregate Write-In Assets	124,917	0	124,917
TOTAL ASSETS	\$ 36,173,346	\$ 4,343,744	\$ 31,829,602

LIABILITIES, SURPLUS AND OTHER FUNDS
as of December 31, 2016

Losses	\$ 9,403,808
Loss Adjustment Expenses	2,891,760
Commissions Payable	0
Other Expenses	319,853
Taxes, Licenses and Fees	183,256
Unearned Premium	8,116,432
Advance Premium	186,059
Ceded Reinsurance Premiums Payable	165,391
Funds Held Under Reinsurance Treaties	0
Payable to Parent, Subsidiaries and Affiliates	312,157
TOTAL LIABILITIES	\$ 21,578,716
Common Capital Stock	2,350,000
Surplus Notes	5,672,638
Gross Paid-In and Contributed Surplus	12,624,342
Unassigned Funds (Surplus)	(10,396,094)
Capital and Surplus	<u>\$ 10,250,886</u>
TOTAL LIABILITIES AND SURPLUS	<u>\$ 31,829,602</u>

STATEMENT OF INCOME
For the Year Ended December 31, 2016

Premium Earned	\$27,247,083
DEDUCTIONS:	
Losses Incurred	18,783,631
Loss Adjustment Expenses Incurred	3,167,115
Other Underwriting Expenses Incurred	11,049,398
Total Underwriting Deductions	<u>\$33,000,144</u>
Net Underwriting Loss	(\$5,753,061)
Net Investment Income Earned	1,020,052
Net Realized Capital Losses	22,265
Net Investment Gain	<u>\$1,042,317</u>
Other Income	2,508,230
Dividends to Policyholders	0
Federal Income Taxes Incurred	(676,337)
Net Income	<u>(\$1,526,177)</u>

RECONCILIATION OF SURPLUS
Changes from December 31, 2013 to December 31, 2016

	2014	2015	2016
Capital and Surplus, End of Prior Year	\$ 10,739,069	\$ 11,541,180	\$ 12,307,586
Net Income (Loss)	248,564	1,028,563	(1,526,177)
Change in Net Unrealized Gains (Losses)	(31,840)	(83,007)	101,158
Change in Net Deferred Income Tax	69,742	(473,579)	(124,118)
Change in Non-Admitted Assets	515,644	294,428	(507,564)
Change in Surplus Notes	167,956	227,495	248,813
Dividends to Stockholders			0
Agg. Write-Ins for Gains (Losses) in Surplus	(167,955)	(227,495)	(248,813)
Change in Capital and Surplus for the Year	<u>802,111</u>	<u>766,405</u>	<u>(2,056,701)</u>
Capital and Surplus, End of Current Year	<u>\$11,541,180</u>	<u>\$12,307,586</u>	<u>\$10,250,886</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS**Note 1 – Net Deferred Tax Asset****\$0**

Statement of Statutory Accounting Principle (SSAP) No. 101, Income Taxes, provides guidance for deferred tax assets (DTAs). Paragraph 7.e. of SSAP No. 101 states that a statutory valuation allowance adjustment shall be made to reduce gross DTAs that are more than likely not to be realized. SSAP No. 101 further states that the statutory valuation allowance is to be determined in accordance with paragraphs 20-25 of Statement of Financial Accounting Standard (FAS) No. 109.

Paragraph 23 of FAS 109 states – “Forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years.” CNIC had taxable losses of at least \$1 million each year and cumulative taxable losses of \$4.7 million for the three year period from 2014 to 2016. This factor supports a conclusion that a valuation allowance is needed.

A DTA is realized when it is used as a loss carryforward to reduce taxes in a future year with positive taxable income. The Company did not realize any DTAs in the 2014 to 2016 exam period, due to the taxable losses that occurred. It appears more than likely that CNIC will not be able to realize the year-end 2016 balance for DTAs, based upon the losses that have occurred in the three year review period. Further, the Company reported a taxable loss of approximately \$1.5 million in the first half of 2017. This is another indication DTAs will not be realized in the near future. An examination change was made to non-admit the \$542,756 balance of DTAs that were reported in the 2016 Annual Statement.

ANALYSIS OF CHANGES TO SURPLUS

Reported Surplus at December 31, 2016			\$10,250,886
	<u>Increase</u>	<u>Decrease</u>	
Net Deferred Tax Assets	0	\$542,756	
Net Increase (Decrease)			<u>(542,756)</u>
Adjusted Surplus at December 31, 2016			\$9,708,130

GENERAL COMMENTS AND/OR RECOMMENDATIONS

Capital and Surplus (page 2)

The Company should be prepared to develop an RBC Action Plan if a Company Action Level Event occurs, pursuant to Section 375.1255.2 RSMo. An RBC Action Plan would be required if the RBC ratio is below 300% and the combined ratio is 120% or greater. The Company should consider all options to raise capital and change strategy to improve underwriting results. This could include opportunities for a merger, acquisition, or stock offerings that may provide capital from new or additional ownership.

Internal Controls (page 10)

Management should review the internal control issues that were determined in the examination and implement corrective actions to mitigate the financial reporting and operational risks that were identified.

Net Deferred Tax Assets (page 15)

In accordance with valuation allowance requirement of SSAP No. 101, the Company should non-admit 100% of its recorded DTAs until such time that positive taxable income is achieved for a three year cumulative period.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Cornerstone National Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Scott Reeves, CPA, CFE, Joshua Nash, CPA, Jeff Blume, CFE, Andy Balas, CFE, AES, examiners for the Missouri DIFP, participated in this examination. Kristine Fitzgerald, ACAS, MAAA, of Actuarial & Technical Solutions, Inc., also participated as a consulting actuary.

VERIFICATION

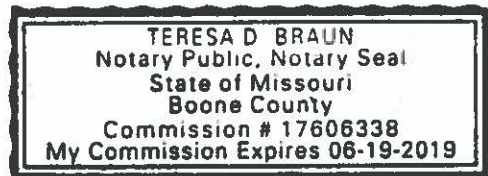
State of Missouri)
)
County of)

I, Tim L. Tunks, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Cornerstone National Insurance Company its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Tim Tunks
Tim L. Tunks, CPA, CFE
Examiner-In-Charge
Missouri DIFP

Sworn to and subscribed before me this 25th day of Sept, 2017.

My commission expires: 6-19-19 Teresa D. Braun
Notary Public

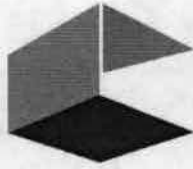


SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.



Michael Shadowens, CFE
Audit Manager
Missouri DIFP



CORNERSTONE
NATIONAL INSURANCE COMPANY
Our Foundation is You

October 30, 2017

Ms. Leslie Nehring, Chief Financial Examiner
Missouri Department of Insurance
301 West High Street, Room 530
P.O. Box 690
Jefferson City, MO 65102-0690

Dear Ms. Nehring:

Enclosed is the formal response for the Examination Report of Cornerstone National Insurance Company for the period ending December 31, 2016. Specifically, each of the general comments and/or recommendations are reiterated and addressed with the Company's response and/or actions taken. Please include our response in the report as a public document.

GENERAL COMMENTS AND/OR RECOMMENDATIONS

Capital and Surplus (page 2)

The Company should be prepared to develop an RBC Action Plan if a Company Action Level Event occurs, pursuant to Section 375.1255.2 RSMo. An RBC Action Plan would be required if the RBC ratio is below 300% and the combined ratio is 120% or greater. The Company should consider all options to raise capital and change strategy to improve underwriting results. This could include opportunities for a merger, acquisition, or stock offerings that may provide capital from new or additional ownership.

Company Response:

The Company is currently pursuing various options and strategies to further improve underwriting and operating results, as well as opportunities for a merger or acquisition to provide additional capital. The Company has already taken significant actions to tighten underwriting standards and increase pricing in areas previously experiencing subpar results. These actions appear to now be improving underwriting results. The Company will be prepared to provide an RBC Action Plan, if necessitated and requested to do so by the Missouri Department of Insurance.

Internal Controls (page 10)

Management should review the internal control issues that were determined in the examination and implement corrective actions to mitigate the financial reporting and operational risks that were identified.

Company Response:

Management has reviewed the internal control issues that were reported by the examination. These issues were primarily the result of staffing changes. The Company has taken corrective actions to mitigate the financial reporting and operational risks that the examination report identified. Such actions included: clarification of assigned duties, an additional review level of staff & financial statements, segregation of functions, and ensuring reconciliations are done timely. Additionally, claim procedures have been revised, software has been fixed and agency reviews have been bolstered.

Net Deferred Tax Assets (page 15)

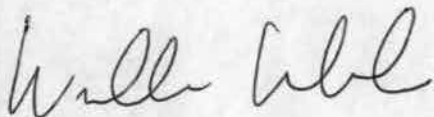
In accordance with valuation allowance requirement of SSAP No. 101, the Company should non-admit 100% of its recorded DTAs until such time that positive taxable income is achieved for a three-year cumulative period.

Company Response:

The Company has non-admitted 100% of its recorded Deferred Tax Asset, which will be shown in its September 30, 2017 Quarterly Financial Statement, December 31, 2017 Annual Statement, and after to be compliant with SSAP No. 101.

Please advise if you need further information or commentary regarding the above responses. We are always available to discuss such matters and our operations with Department personnel.

Sincerely,



William Wheeler, President & Chief Executive Officer
Cornerstone National Insurance Company