IFIC Surety GROUP

ALLEGHENY CASUALTY COMPANY
INTERNATIONAL FIDELITY INSURANCE COMPANY

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Management's Discussion and Analysis of Operations
INTERNATIONAL FIDELITY INSURANCE COMPANY
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International Fidelity Insurance Company
One Newark Center
Newark, NJ 07102

Management's Discussion and Analysis of Financial Condition and Results of Operations Annual Statement

For the year ending December 31, 2015

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NAIC Group Code: 4705
NAIC Company Code: 11592

OVERVIEW

International Fidelity Insurance Company (IFIC) is the largest US privately owned, independent insurance company, that specializes exclusively in surety. The Surety and Fidelity Association of America (SFAA) reports on United States surety writings rankings. For 2014, IFIC ranked number seventh by the SFAA. The Company operates through a network of 34 Regional Profit Centers located throughout the continental United States utilizing an independent agency system that specializes in surety. IFIC is rated A- ("Excellent") by A.M. Best.

The company is licensed in 50 states, Puerto Rico, Guam, US Virgin Islands and the District of Columbia. The company is treasury listed by the United States Treasury Department and is an authorized surety in all Federal Courts.

IFIC has five lines of business: Standard Contract, Commercial, Bail, Specialty Contract and Subdivision, accounting for 36.3%, 29.1%, 13.7%, 12.5% and 8.3%, respectively of the company's total direct and assumed premium for 2015.

IFIC has a wholly-owned subsidiary company, The Chestnut Group which has a wholly-owned subsidiary, Allegheny Casualty Company (ACC). ACC is also a New Jersey domiciled insurance company which writes essentially the same lines of surety as IFIC. In 2015, ACC was redomesticated from Pennsylvania to New Jersey. Bonds written in Specialty Contract line are issued in the name of ACC, while the risk is transferred to IFIC by way of an internal reinsurance agreement between IFIC and ACC. It maintains capital and surplus in excess of $22 million and is rated A- ("Excellent") by AM Best. ACC's "Management's Discussion and Analysis of Financial Condition and Results of Operations" provides a more detailed outline of this company.

HISTORY

IFIC was formed in 1904 with the first surety license issued by the State of New Jersey. The company was initially formed as a subsidiary of the Singer Sewing Company as its captive provider of fidelity coverage.

In 1964 IFIC was purchased by a group of investors led by agents specializing in surety bail bonds. Upon this sale, the company became a writer of surety bail bonds. Over the years, IFIC expanded into other types of non-bail, or in other words "civil," surety bonds.

Throughout the 1970's, 1980's and most of the 1990's the company was a contract specialty surety that operated primarily through one location writing both bail and civil surety. While the company's bail business had always been profitable, its civil surety business was not consistently profitable. Therefore, in the late 1990's the company changed the type of civil surety business it wrote from specialty contract to standard contract. This change also included its business being marketed, underwritten and processed through a branch network of regional profit centers. Since then, the company has expanded its civil surety business from one line of business to the five lines of business it has today (mention in the overview section of this report.) In 2009, IFIC acquired ACC. This enabled IFIC to expand its bail franchise with its existing and current bail MGA, AIA., It also enabled the company to have different rates and brand to differentiate its standard contract line from its specialty contract line.

STRATEGY

The company's strategy is to make corporate governance and ERM part of the fabric of its management while remain steadfast to its underwriting standards. This challenging strategy will enable the company to obtain meaningful profitable growth in its market share when the market cycle turns from "soft" to "hard." In the meantime, the company will focus on building further a corporate culture of sound governance and ERM as well as working to keep overhead in step with a strategy that does not promote revenue growth.

There are two dynamics that drive the company's current strategy: current surety market conditions and the company's malfeasance discovered in 2014 resulting in NJDOBI directing the company to refile its 2013 statement. Currently, the surety market is "soft". This is due to increasing capacity due to an increased number of companies entering the marketplace, as well as, a number of existing writers attempting to materially increase their market share.

FINANCIAL CONDITION

Assets
Cash and invested assets increased by $5,187,796 to $187,518,015 in 2015 and comprise 92.3% and 86.8% of total admitted assets in 2015 and 2014, respectfully. This increase is due to the current year's positive cash flow results from insurance operations. The company's bond portfolio also increased by 30% and the cash and short term assets have decreased by the same percentage, as the company's investment manager Prime Advisors, Inc., continues to invest in a safe portfolio.

Total admitted assets decreased by $7,046,793 to $203,095,056 in 2015. The decrease in total admitted assets is primarily due to the following:

1) A decrease in the Company's admitted Uncollected Premiums of $7.4 million. In 2014, IFIC requested a permitted practice from the NJDOBI to admit its agents balance over 90 days. In 2015, the company's management decided not to request this permitted practice, as a result the admitted assets includes a onetime hit of $4.6 million from the discontinuation of this permitted practice. This combined with an overall reduction is balances due to the Company in the amount of $2.8 million have resulted in the decrease.

2) A decrease in the Amounts Recoverable from Reinsurers of $4.4 million; this decrease is a result of the timing when paid losses are due from reinsurers. There have been no changes in the company's ceding program.

Liabilities
In 2015, total liabilities decreased by 5.6% to $119,218,031 from $126,234,737 in 2014. This is primarily due to a decrease of $2.1 million in losses and loss adjustment expenses reserves, a decrease in collateral held of $1.9 million and a decrease in unearned premiums of $1.2 million.

Surplus
The Company's Policyholders' Surplus decreased only $30,087 to $83,877,025 from $83,907,112 for the prior year. Despite the policyholders surplus being virtually flat for the year the company reported a $4.5 million increase in non-admitted assets primarily due to the one time hit from the discontinuation of the NJDOBI permitted practice to allow agents balance over 90 days as an admitted asset. Offsetting this decrease was the 2015 net income in the amount of $1.3 million, an increase in net deferred income tax of $1.7 million and the issuance of Treasury stock in the amount of $1.8 million.

The Company's ratio of net written premium to surplus is at a conservative level. For 2015 and 2014 it was 120.8% and 128.2% respectively.

For the year ended December 31, 2015, IFIC had Total Adjusted Capital of $83,877,024 and an Authorized Control Level RBC of $17,715,462. Adjusted Capital represents approximately 473.5% of the Authorized Control Level RBC. For the year ended December 31, 2014, the Company had Adjusted Capital of $83,907,112 and an Authorized Control Level RBC of $18,570,101 and Adjusted Capital represented 451.8% of the Authorized Control Level RBC.

RESULTS OF OPERATIONS

The Company's net Income after tax is $1.3 million in 2015 and $3.6 million in 2014. The major components of the 2015 net income are as follows:

Premiums
In 2015, the Company reported a decrease in direct written premium of $9.7M from $124.1M in 2014 to $114.4M in 2015 and a decrease of $6.4M in direct earned premium from $122.9M in 2014 to $116.5M in 2015. Net earned premiums decreased by $4.1M from $107.0M in 2014 to $102.6M in 2015. These decreases are due to soft market conditions.

Incurred Losses and LAE
In 2015, the loss and loss expense ratio was 19.3% compared to 21.4% for the prior year. This is due to the company increased emphasis on writing good business. The net pure loss ratios, which excludes loss adjustment expenses, for the past five years are as follows:

Year	Net Pure Loss Ratio
2015	11.8%
2014	14.2%
2013	11.6%
2012	13.9%
2011	21.3%

The Company maintains a level of Incurred but Not Reported Reserves ("IBNR") at more than 5% of in-force premiums. These reserves are adjusted each year based on an actuarial analysis of the historical loss data and ultimate net loss projections. In 2015, the Company's net loss and loss expense incurred included a decrease in IBNR reserves of approximately $556,000, consistent with the decrease in in-force premiums.

The liabilities for unpaid losses and loss expenses are determined using case basis evaluations, and represent estimates to the ultimate net cost of all unpaid losses and loss expenses for each year. Collateral, Contract Balances and Salvage Accruals are used to reduce the liability for unpaid losses. A conservative method is used to calculate anticipated Collateral, Contract Balances and Salvage Accruals, producing redundancies in later years. These estimates are continually reviewed as historical experience develops. The liabilities are adjusted based on management's best estimate of the ultimate net loss, with such adjustments being charged to current year operations.

For 2015, Schedule P-Part 2 Summary displayed a redundancy of $7,898,000 and $6,442,000 for the One Year and Two Year Developments, respectively. As of December 31, 2014, the One-Year Development of Schedule P exhibited a redundancy of 4,073,000 and the two-year development a redundancy of $6,820,000, please see attached schedule of historical loss development.

Investment Income

The company's investment policy is very conservative. During 2015, much of the portfolio was invested in liquid assets, yielding very little income. As the year progressed, Prime Advisors, the company's investment manager, continued to invest the excess cash held by the company in longer duration securities and a small portion in equity securities. As a result the portfolio reported an increase in its yield as the year went on, but not back the yields produced in prior years. The Company's net investment income decreased by $70,000, when compared to previous year.

In 2016, the Company working with its investment advisor, a leading US insurance portfolio manager, is expected to increase its yield through investments in longer duration securities and a small portion in equity securities.

In 2015, the Company recognized net capital losses of $78,000 versus capital gains of $3.9 million in 2014, (The prior year gains were realized as the portfolio was liquidated during the transition to a more secure portfolio.) The 2015, net loss includes a one-time write down of $474,000 due to the downgrade of a security that IFIC holds as a special deposit with the Commonwealth of Puerto Rico.

Other Income/Loss

In 2015, the company continues to analyze its agent's balances over 90 days and decided to expense $616,743 for doubtful accounts.

CASH FLOW and LIQUIDITY

During 2015, a large portion of the cash and short term securities were invested in high grade bonds and therefore the net Cash Flow decreased by $19.1 million from the prior year.

The fixed income portfolio (including short-term securities) is comprised primarily of securities with maturities of five years or less, as shown below:

	Adjusted Carrying Value	
	2015	**2014**
One year or less	$32,435,656	$23,423,601
One year through five years	65,096,712	52,564,567
Five years through ten years	15,354,680	7,736,800
Ten years through twenty years	1,146,390	812,030
Twenty years or greater	99,213	175,940
TOTAL Fixed Income Portfolio	**$114,132,651**	**$84,712,938**

Management believes that future cash needs can be met from general operating cash flow and improved investment income derived from new investment management and more diversification in 2016. The company has no material commitments or plans for future capital expenditures.

CONCLUSION

The years 2014 and 2015 were transition years for the Company as the investment portfolio was redeployed into a more stable and secure structure to ensure the Company maintains its surplus and liquidity, and is able to meet the demands of its policyholders. IFIC continues to write good solid business with excellent core underwriting results and will continue to operate in the same manner during 2016. This will ensure continued financial stability for the Company.