ASSOCIATION EXAMINATION
on
ALFA SPECIALTY INSURANCE CORPORATION
Glen Allen, Virginia
as of
December 31, 2011

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

JACQUELINE K. CUNNINGHAM
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

COMMONWEALTH OF VIRGINIA

P.O. BOX 1157
RICHMOND, VIRGINIA 23218
TELEPHONE: (804) 371-9741
TDD/VOICE: (804) 371-9206
http://www.scc.virginia.gov/division/boi

I, Jacqueline K. Cunningham, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Alfa Specialty Insurance Corporation as of December 31, 2011, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed to the original the seal of the Bureau at the City of Richmond, Virginia this 26th day of April, 2013

Jacqueline K. Cunningham
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
January 11, 2013

Honorable Jacqueline K. Cunningham
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Madam:

Pursuant to your instructions and by authority of § 38.2 - 1317 of the Code of Virginia, a financial condition examination of the records and affairs of the

ALFA SPECIALTY INSURANCE CORPORATION

Glen Allen, Virginia

hereinafter referred to as the Corporation, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Corporation is a stock property and casualty insurer and was last examined by representatives of the Alabama Department of Insurance as of December 31, 2006. The current examination, which was called and conducted under the auspices of the NAIC, was made by Examiners from the Bureau in coordination with Examiners from the State of Alabama. This examination covers the period from January 1, 2007 through December 31, 2011.

HISTORY

The Corporation was incorporated August 11, 1999, as a wholly-owned subsidiary of Alfa Mutual Insurance Company (AMI). The initial marketing plan for the Corporation was the writing of non-standard automobile insurance in Alabama, Georgia and Mississippi.

The Corporation's Articles of Incorporation (Articles) authorized 10,000,000 shares of common stock at a par value of $0.05 per share and 1,000,000 shares of preferred stock at a part value of $0.10 per share. No preferred stock had been issued as of the date of this examination. The Corporation's initial capitalization derived from the issue of 10,000,000 shares of its common stock to AMI for a price of $15,000,000, which provided $500,000 of paid up capital and $14,500,000 of paid in surplus.

On July 21, 2001, the Corporation's Articles were amended to change the par value of its common stock from $0.05 to $0.10 per share. Subsequent to this action, $500,000 was transferred from paid in surplus to capital.

The Corporation is affiliated with seven other property and casualty insurers in a reinsurance pooling agreement. The affiliates in the pooling agreement are AMI, Alfa Mutual Fire Insurance Company (AMF), Alfa Mutual General Insurance Company (AMG), Alfa Insurance Corporation (AIC), Alfa General Insurance Company (AGI), Alfa Vision Insurance Corporation (AVI) and Alfa Alliance Insurance Corporation (AAI). The terms of the agreement provide that all direct, assumed reinsurance and ceded reinsurance business of the affiliates will be ceded to AMI. The pooled business would then retro ceded according to percentages provided in the pooling agreement. In 1989, an intercompany reinsurance pooling committee, representing the boards of directors of the reinsurance pool participants, was established to review and approve any changes to the pooling agreement. The Corporation became a participant in the reinsurance pooling agreement in 2001.

In October 2010, the Corporation redomesticated from the State of Alabama to the Commonwealth of Virginia. In conjunction with the redomestication, the Board of Directors approved an increase in the par value of the Corporation's shares of common stock from $0.20 to $0.30 per share. The par value was changed in order to comply with the minimum capital requirements of the Commonwealth of Virginia. The increase was effective October 1, 2010.

The Corporation paid no dividends for the period under examination.

MANAGEMENT AND CONTROL

Management is vested in a board of directors consisting of between one and twenty members. A majority of the board members shall constitute a quorum for the transaction of business.

The bylaws provide that the board shall elect a president, an executive vice president, a secretary, a treasurer and a general manager. In addition, the board may appoint such other officers as may be deemed necessary. The president is the chief executive officer of the Corporation and has general charge and supervision of the business and affairs of the Corporation.

At December 31, 2011, the directors and officers of the Corporation were as follows:

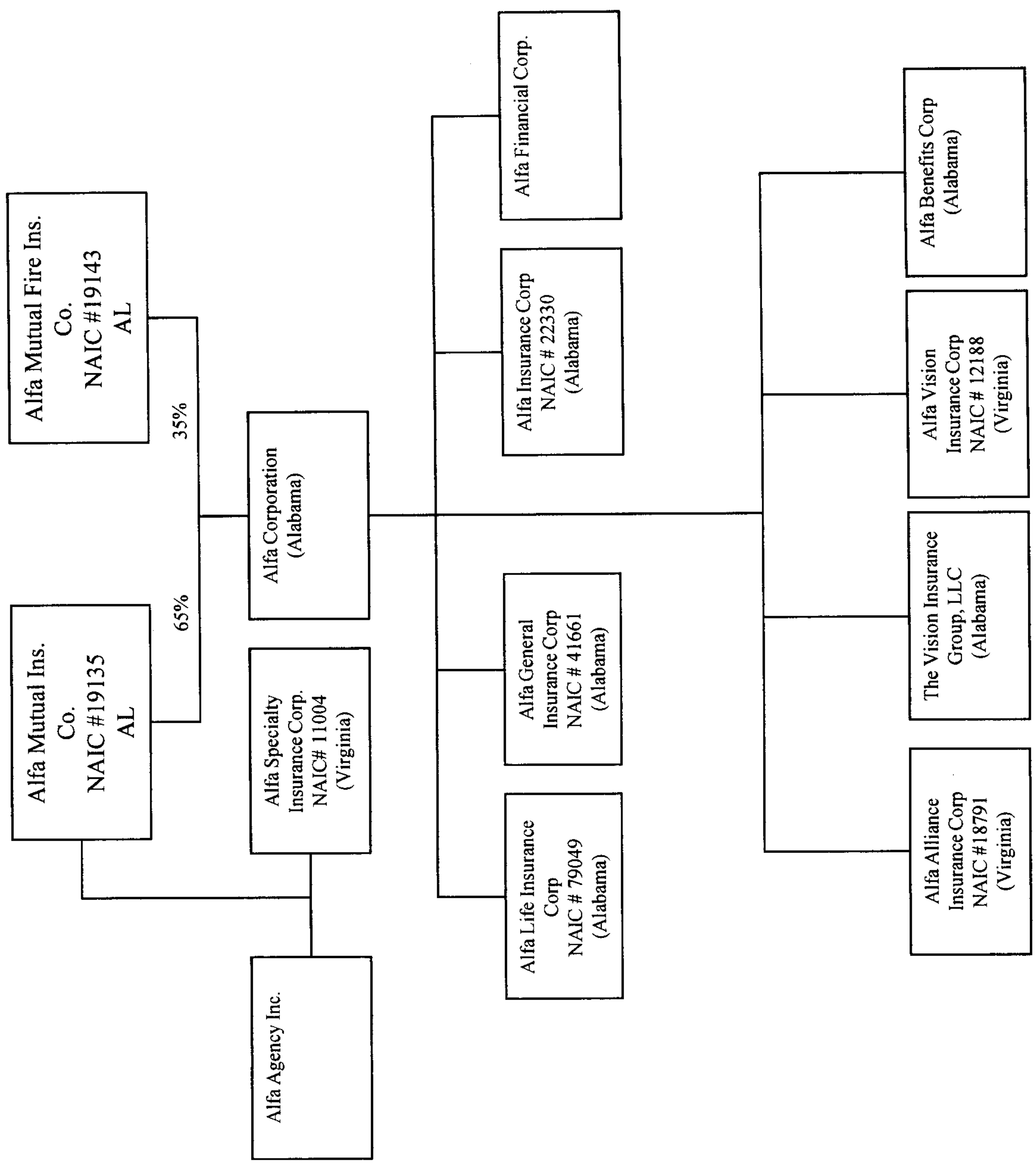
Directors	**Principal Business Affiliation**
Jerry A. Newby	Chairman of the Board, President and Chief Executive Officer Alfa Mutual Insurance Company Montgomery, Alabama
C. Lee Ellis, III	Executive Vice President – Operations and Treasurer Alfa Mutual Insurance Company Montgomery, Alabama
Stephen G. Rutledge	Executive Vice President – Business Operations Alfa Mutual Insurance Company Montgomery, Alabama
Herman A. Scott	Senior Vice President, General Counsel and Secretary Alfa Mutual Insurance Company Montgomery, Alabama

Officers	**Title**
Jerry A. Newby	Chairman of the Board and Chief Executive Officer
John C. Pace	President
C. Lee Ellis, III*	Treasurer and Executive Vice President, Operations
Herman A. Scott	Secretary

Officers (continued)

Stephen G. Rutledge	Executive Vice President, Business Development
Wyman W. Cabaniss	Senior Vice President, P&C Underwriting
Ralph C. Forsythe	Senior Vice President, Chief Financial Officer
John D. Hemmings, Jr.	Senior Vice President, Investments
Jerry W. Johnson	Senior Vice President, Claims
John T. Jung	Senior Vice President, Chief Information Officer
Alfred E. Schellhorn	Senior Vice President, Corporate Development
Donald E. Manis	Vice President, Property & Casualty Actuary
Joel F. Witt	Vice President, Actuarial

The Corporation is part of the Alfa Insurance Group. The following chart illustrates this insurance holding company system at December 31, 2011:


Alfa Mutual Fire Ins. Co. NAIC #19143 AL
Alfa Mutual Ins. Co. NAIC #19135 AL
35%
65%
Alfa Corporation (Alabama)
Alfa Specialty Insurance Corp. NAIC# 11004 (Virginia)
Alfa Agency Inc.
Alfa Financial Corp.
Alfa Insurance Corp NAIC # 22330 (Alabama)
Alfa General Insurance Corp NAIC # 41661 (Alabama)
Alfa Life Insurance Corp NAIC # 79049 (Alabama)
Alfa Benefits Corp (Alabama)
Alfa Vision Insurance Corp NAIC # 12188 (Virginia)
The Vision Insurance Group, LLC (Alabama)
Alfa Alliance Insurance Corp NAIC #18791 (Virginia)

RELATED PARTY TRANSACTIONS

Management, Service Contracts, Cost Sharing Agreements

Pursuant to a Management and Operating Agreement between AMI and the Corporation, AMF, AMG, AAI and Alfa Corporation (AC) and their subsidiaries, AMI provides management and operational services to the participating companies. The participating companies reimburse AMI for their services.

Tax Allocation Agreement

The Corporation is a participant in a tax sharing agreement between AC and its subsidiaries. The method of allocation is subject to a written agreement. The tax liability of the group shall be allocated to the members of the group based on the percentage of the tax for each member if determined on a separate return compared to the total amount of taxes for all members of the group. This percentage method allocates tax liability based upon the absorption of tax attributes, without taking into account the ability of any member to subsequently absorb its own tax attributes.

Loan Agreement

On September 30, 2010, the Corporation entered into a loan agreement with their affiliate, Alfa Financial Corporation (AFC), a wholly owned subsidiary of AC. According to the agreement, the Corporation agrees to lend to AFC up to the maximum principal sum stipulated by the agreement. The maximum principal amount is subject to change based on limitations set forth by Virginia law. Interest shall accrue at a variable annual rate equal to AC's primary bank credit facility rate. AFC will pay interest on the last day of each month and on the maturity date, September 30, 2015. As of December 31, 2011, there was no outstanding balance on this note.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2011, the Corporation had fidelity coverage of $3,000,000 in force, subject to a single loss deductible of $75,000. The Corporation also had the following coverages in place at December 31, 2011: insurance company errors and omissions and directors and officers liability and company indemnification.

TERRITORY AND PLAN OF OPERATION

At December 31, 2011, the Corporation was licensed to transact the business of insurance in the following jurisdictions:

Alabama	Kentucky	Tennessee
Arkansas	Mississippi	Texas
Georgia	Missouri	Virginia
Indiana	Ohio	

The Corporation, however, writes the majority of its business in Virginia (43%) and Alabama (18%). In Virginia, the Corporation was authorized to write the following lines of business as of December 31, 2011:

Auto Liability
Auto Physical Damage
Commercial Multi-Peril

Business is produced by independent agents in all states except Alabama, Georgia and Mississippi. Business is produced by employee agents in Alabama and independent exclusives in Georgia and Mississippi. Control over underwriting and settlement of claims is maintained at the Corporation's home office for the core states of Alabama, Georgia and Mississippi. The Corporation issues non-assessable policies only. In other states, control over underwriting and settlement of claims is handled out of Alfa's Brentwood, Tennessee office. All policies are issued annually. Insureds may elect to pay on an installment basis.

GROWTH OF THE CORPORATION

The following statistics, obtained from Annual Statements filed with the Bureau and from examination reports, indicate the growth of the Corporation for the ten-year period ending December 31, 2011:

Year	Admitted Assets	Liabilities	Aggregate Write ins For Special Surplus Funds	Common Capital Stock	Gross Paid In and Contributed Surplus	Unassigned Funds
2002	$19,539,775	$5,608,605		$1,000,000	$14,000,000	($1,068,830)
2003	19,823,904	6,220,726		1,000,000	14,000,000	(1,396,822)
2004	18,943,900	8,639,495	67,096	1,000,000	14,000,000	(4,762,691)
2005	25,307,931	9,400,236		1,000,000	24,000,000	(9,092,305)
2006	28,425,060	10,490,803		1,000,000	24,000,000	(7,065,743)
2007	28,905,804	9,669,019		1,000,000	24,000,000	(5,763,215)
2008	33,777,293	15,532,889		2,000,000	23,000,000	(6,755,596)
2009	36,839,113	19,521,622		2,000,000	23,000,000	(7,682,509)
2010	38,741,544	20,749,224		3,000,000	22,000,000	(7,007,680)
2011	37,487,005	21,702,814	676,438	3,000,000	22,000,000	(9,892,247)

Year	Premiums Earned	Losses and Loss Adjustment Expenses Incurred	Other Underwriting Expenses	Net Underwriting Gains or (Loss)
2002	$6,272,157	$5,334,101	$1,704,081	($766,025)
2003	6,637,623	6,331,403	1,885,443	(1,579,223)
2004	7,153,992	9,126,873	1,836,034	(3,808,915)
2005	7,985,530	11,121,515	2,368,807	(5,504,792)
2006	9,292,997	5,739,903	2,691,282	861,812
2007	9,660,651	5,878,330	2,668,588	1,113,733
2008	18,296,113	13,641,060	5,933,957	(1,278,904)
2009	19,556,079	16,061,549	5,854,959	(2,360,429)
2010	20,701,515	15,679,024	6,223,397	(1,200,906)
2011	20,674,954	18,864,085	6,138,089	(4,327,220)

REINSURANCE

Reinsurance Assumed and Ceded

At December 31, 2011, the Company assumed and ceded reinsurance via the intercompany pooling agreement.

Intercompany Pooling Agreement

The amended and restated intercompany pooling agreement, effective January 1, 2009, was between Alfa Mutual Insurance Company (AMI) and the following entities (hereinafter referred to as the Participating Companies):

- Alfa Mutual Fire Insurance Company (AMF)
- Alfa Mutual General Insurance Company (AMG)
- Alfa Insurance Corporation (AIC)
- Alfa General Insurance Corporation (AGI)
- Alfa Specialty Insurance Corporation (ASI)
- Alfa Vision Insurance Corporation (AVI)
- Alfa Alliance Insurance Corporation (AAI)

On January 1 (current year), all Participating Companies ceded 100% of its books of business (the premiums) and net liabilities to AMI. In turn, AMI:

- Ceded and each Participating Company accepted its proportionate share of unearned premiums on AMI's book of business in-force as of the close of business.
- Ceded and each Participating Company accepted its proportionate share of the net liability on all insurance written by AMI, including the net liability of business assumed.
- Paid each Participating Company its proportionate share of the combined net unearned premium reserves less commissions at a rate equal to its pooled underwriting expense ratio for the most recently filed financial statements.
- Paid each Participating Company its respective participation of all premiums written after first deducting premiums for all working cover reinsurance ceded to reinsurers.

The following pooling percentages were in effect at December 31, 2011:

	Pool 4	Pool 5	Pool 6	Pool 7
Name of Insurer	Loss Dates 1/1/01 - 2/13/04	Loss Dates 1/1/05 - 12/31/06	Loss Dates 1/1/07 - 12/31/07	Loss Dates 1/1/08 - current
AMI (Lead Company)	18%	18%	18%	52%
AMF	13%	13%	13%	30%
AMG	3%	3%	3%	4%
AIC	32.5%	30%	29%	3%
AGI	32.5%	30%	29%	4%
ASI	1%	1%	1%	2%
AVI	0%	5%	5%	4%
AAI	0%	0%	2%	1%

The Participating Companies agreed that all net premiums, losses and expenses on all insurance written by AMI and assumed under this agreement would be prorated between the Participating Companies based on each participant's proportionate share specified in the agreement. Each Participating Company would retain and be liable for outstanding net losses (including IBNR liability), for outstanding net expenses, and salvage and subrogation related to losses incurred.

Each of the Participating Companies provides AMI with a monthly accounting report within thirty days after the close of each month. Likewise, AMI provides each Participating Company with a monthly accounting report as well. The agreement was continuous and could only be terminated in writing by mutual agreement of all parties.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2007 through December 31, 2011. Assets were verified and liabilities were established at December 31, 2011.

This examination was conducted in accordance with the NAIC *Financial Condition Examiners Handbook* (Handbook). The Handbook requires that the Bureau plan and perform the examination to evaluate the Company's financial condition and identify prospective risks of the Company, assess corporate governance, identify and assess inherent risks within the Company and evaluate system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles, and annual statement instructions when applicable to domestic state regulations.

The Examination was conducted by the State of Alabama Department of Insurance on the Association Zone Plan with Alabama acting as the lead state. The examination of the Company was conducted concurrently with the examination of the following insurers:

Insurer	**Domiciliary Sate**
Alfa Mutual Insurance Company	Alabama
Alfa Mutual Fire Insurance Company	Alabama
Alfa Mutual General Insurance Company	Alabama
Alfa Insurance Corporation	Alabama
Alfa General Insurance Corporation	Alabama
Alfa Life Insurance Corporation	Alabama
Alfa Alliance Insurance Corporation	Virginia
Alfa Vision Insurance Corporation	Virginia

The services of Merlinos & Associates, Inc. were employed to provide an actuarial report as to the reasonableness of the Company's loss and loss adjustment expense reserves as of December 31, 2011.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2011, a statement of income for the period ending December 31, 2011, a reconciliation of surplus for the period under review and a statement of cash flow for the period ending December 31, 2011. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$16,628,659		$16,628,659
Common stocks	2,802,126		2,802,126
Cash and short-term investments	8,300,123		8,300,123
Investment income due and accrued	152,689		152,689
Uncollected premiums and agents' balances in course of collection	1,318,754	4,098	1,314,656
Deferred premiums, agents' balances and installments booked but deferred and not yet due	3,135,785	260	3,135,525
Amounts recoverable from reinsurers	3,198,330		3,198,330
Current federal income tax recoverable and interest thereon	115,064		115,064
Net deferred tax asset	1,926,830	274,442	1,652,388
Electronic data processing equipment	45,578	45,578	
Receivables from parent, subsidiaries, and affiliates	186,955		186,955
Health care and other amounts receivable	2,179	1,689	490
Aggregate write-ins for other than invested assets	8,571	8,571	
Totals	$37,821,643	$334,638	$37,487,005

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		$5,974,116
Reinsurance payable on paid losses and loss adjustment expenses		$1,574,074
Loss adjustment expenses		988,130
Commissions payable, contingent commissions and other similar charges		1,594,480
Other expenses		123,449
Taxes, licenses and fees		420,212
Unearned premiums		7,717,809
Advance premium		410,834
Ceded reinsurance premiums payable		772,436
Funds held by company under reinsurance treaties		1,374
Amounts withheld or retained by company for account of others		196,284
Remittances and items not allocated		117,677
Drafts outstanding		443,355
Payable to parent, subsidiaries, and affiliates		1,368,584
Total liabilities		$21,702,814
Aggregate write-ins for special surplus funds	$676,438	
Common capital stock	3,000,000	
Gross paid in and contributed surplus	22,000,000	
Unassigned funds (surplus)	(9,892,247)	
Surplus as regards policyholders		15,784,191
Totals		$37,487,005

UNDERWRITING AND INVESTMENT EXHIBIT
STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	$20,674,954
Deductions:	
Losses incurred	$17,822,968
Loss adjustment expenses incurred	1,041,117
Other underwriting expenses incurred	6,145,705
Aggregate write-ins for underwriting deductions	(7,616)
Total underwriting deductions	$25,002,174
Net underwriting gain	($4,327,220)

INVESTMENT INCOME

Net investment income earned	$721,644
Net realized capital gains	29,663
Net investment gain	$751,307

OTHER INCOME

Net loss from agents' or premium balances charged off	($78,857)
Finance and service charges not included in premiums	474,827
Aggregate write-ins for miscellaneous income	(93,890)
Total other income	$302,080
Net income before federal income taxes	($3,273,833)
Federal income taxes incurred	(17,591)
Net income	($3,256,242)

RECONCILIATION OF CAPITAL AND SURPLUS FOR PERIOD UNDER REVIEW

	2007	2008	2009	2010	2011
Surplus as regards policyholders, December 31, previous year	$17,934,257	$19,236,784	$18,244,404	$17,317,491	$17,992,319
Common stocks					
Net income	$1,007,098	($1,473,500)	($889,174)	$449,615	($3,256,242)
Change in net unrealized capital gains or (losses)			3,608	8,789	38,584
Change in net deferred income tax	35,137	647,823	(225,742)	(186,799)	1,145,400
Change in nonadmitted assets	144,380	(166,703)	184,395	403,223	(135,870)
Cumulative effect of changes in accounting principles	115,912				
Paid in capital		1,000,000		1,000,000	
Paid in surplus		(1,000,000)		(1,000,000)	
Change in surplus as regards policyholders for the year	$1,302,527	($992,380)	($926,913)	$674,828	($2,208,128)
Surplus as regards policyholders, December 31, current year	$19,236,784	$18,244,404	$17,317,491	$17,992,319	$15,784,191

CASH FLOW

Cash From Operations

Premiums collected net of reinsurance	$20,300,863
Net investment income	743,188
Miscellaneous income	387,571
Total	$21,431,622
Benefit and loss related payments	$17,560,844
Commissions, expenses paid and aggregate write-ins for deductions	6,958,548
Federal income taxes paid	50,100
Total	$24,569,492
Net cash from operations	($3,137,870)

Cash From Investments

Proceeds from investments sold, matured or repaid:	
Bonds	$6,717,748
Stocks	208,955
Other invested assets	1,000,000
Miscellaneous Proceeds	3,349
Total investment proceeds	$7,930,052
Cost of investments acquired (long-term only):	
Bonds	$8,792,777
Stocks	2,782,951
Total investments acquired	$11,575,728
Net cash from investments	($3,645,676)

Cash From Financing and Miscellaneous Sources

Cash provided (applied):	
Other cash provided (applied)	($75,712)
Net change from financing and miscellaneous sources	($75,712)
Net change in cash and short-term investments	($6,859,258)

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Cash and short-term investments:	
Beginning of year	$15,159,381
End of year	8,300,123
Net change in cash and short-term investments	($6,859,258)

SUBSEQUENT EVENTS

A review of events subsequent to the examination date, December 31, 2011 was performed. The following changes in AMI's corporate officers were noted:

- Jerry Allen Newby, President and Chief Executive Officer, announced his retirement, effective December 4, 2012. His replacement, James Louis Parnell of Chilton County, Alabama was elected at the Company's December 4, 2012 Board Meeting.

- Clyde Lee Ellis, Executive Vice President of Operations retired on February 1, 2012. Ralph Clayton Forsythe was elected as a director to fill the director position. Stephen Goddard Rutledge was elected as the Treasurer and appointed as Executive Vice President and Chief Operating Officer of the Corporation.

- Wyman Worley Cabaniss, Senior Vice President, Underwriting retired on June 30, 2012. Alfred Edwin Schellhorn, was promoted to Senior Vice President, Underwriting and Development Officer.

- John Jung, Chief Information Officer, announced his retirement at the July 19, 2012 Executive Committee meeting, to be effective October 31, 2012. Mr. Jung extended his retirement date to March 31, 2013 so he could assist in training of his replacement, who has yet to be hired.

- Ralph Clayton Forsythe, Chief Financial Officer, retired as of December 31, 2012.

CONCLUSION

The courteous cooperation extended by the Corporation's officers and employees during the course of the examination is gratefully acknowledged.

In addition to the undersigned, Jennifer K. Crawley, CFE, and Mario A. Cuellar, CFE, of the Bureau participated in the work of the examination.

Respectfully submitted,

T. Bradford Earley, Jr., CFE, CPCU, AIAF
Insurance Principal Financial Analyst
Commonwealth of Virginia
Representing the Southeastern Zone, NAIC

ALFA
INSURANCE ®

2108 EAST SOUTH BOULEVARD ■ POST OFFICE BOX 11000
MONTGOMERY, ALABAMA 36191-0001
334/288-3900

STATE BUREAU
13 APR

April 2, 2013

David H. Smith, CFE, CPA, CPCU
Chief Examiner
Commonwealth of Virginia
Bureau of Insurance
P.O. Box 1157
Richmond, Virginia 23218

Re: Alfa Specialty Insurance Corporation
Examination Report as of December 31, 2011

Dear Mr. Smith:

As requested, this will acknowledge receipt of the Examination Report for the above-referenced company.

If you have any questions, please let me know.

Sincerely,

H. Al Scott

H. Al Scott
Senior Vice President and General Counsel