

Affirmative Insurance Company**Statement of Actuarial Opinion
Annual Statement For the Year Ended December 31, 2015**IDENTIFICATION

I, David M. Shepherd, am associated with the firm of Merlinos & Associates, Inc. I am a Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. I meet the basic education, experience, and continuing education requirements of the Specific Qualification Standard for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement, as set forth in the *Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States*, promulgated by the American Academy of Actuaries.

I was appointed by Ms. Anne Melissa Dowling, Acting Director of Insurance of the State of Illinois on December 1, 2015 to render this opinion for Affirmative Insurance Company ("The Company"). The Company was ordered into rehabilitation in Illinois on September 16, 2015. This is the first opinion I have provided for the Company. The Company relies on my reserve estimate as the basis for their carried reserve.

SCOPE

I have examined the reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 2015, and reviewed information provided to me through February 27, 2016.

The amounts in Exhibit A reflect the Loss Reserve Disclosure items (items 8 through 13) as listed in Exhibit B.

In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by Mr. Daniel Schlemmer, Chief Actuary and Dr. Penglin Huang, Reserving Actuary, both of whom are employees of Affirmative Insurance Company. I have evaluated the data for reasonability and consistency.

I also reviewed a reconciliation of the data to Schedule P Part 1 of the Company's current annual statement. This reconciliation was performed by the Company. I followed the reconciliation and tested the data through sampling. All data that I materially relied upon for my opinion reconciled to a material degree.

In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary.

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OPINION

In my opinion, the amounts carried in the Annual Statement for the sum of items 1 and 2 as well as the sum of items 3 and 4 in Exhibit A:

- A. Meet the requirements of the insurance laws of Illinois;
- B. Are computed in accordance with accepted loss reserving standards and principles; and,
- C. Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements.

And, the amounts carried in the Annual Statement for item 9 in Exhibit A:

- D. Make a reasonable provision for the probable loss in the unearned premiums reserve.

This Opinion should be considered a Determination of Reasonable Provision – the Company's carried reserves fall within my range of reasonable reserves based on my analysis.

Several segments of business are considered to be immaterial when compared to the total reserves of the Company. For these segments, we relied on estimates provided by Mr. Daniel Schlemmer, FCAS, MAAA, and Chief Actuary of Affirmative Insurance Holdings, Inc. The reserve estimates provided by Mr. Schlemmer represent less than 4% of the total net carried reserve.

RELEVANT COMMENTS

My analysis of the liabilities of the Company includes specific consideration of the following items:

- a) Risk of Material Adverse Deviation: I have analyzed the risk of adverse deviation using the materiality standard of \$1 as disclosed in Item 5 of Exhibit B. I have identified a major risk factor for the Company has being the general uncertainty associated with the run off of the Company's business, which would include uncertainty due to the effect of the rehabilitation status of the Company on the behavior of the claimants and Company personnel. I have also considered the relationship of the carried reserves to surplus, which was materially negative as of December 31, 2015. Since surplus is negative, it is my opinion that any amount of adverse development would be material. Based on this analysis, it is my opinion that there are significant risks and/or uncertainties to which the Company is exposed that could result in material adverse deviation.
- b) Other Disclosures in Exhibit B: I have analyzed the remaining Disclosure Items listed in Exhibit B for materiality.

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The Company does not discount its loss and loss and adjustment expense reserves.

The amounts shown in Exhibit A are net of anticipated salvage or subrogation.

In 2012, the Company acquired all the stock of its affiliate, Insurra Property and Casualty Insurance Company. With that merger, the Company took on some exposure, on a gross basis only, for asbestos and environmental from prior year reserves. As of 12/31/2015, the reinsurance on this contract has been commuted, leaving net reserve exposure for asbestos and environmental liability. The Company has recorded gross and net loss and loss adjustment expense reserves of \$1,083,361 for asbestos liability. Based on my review of the five-year history of calendar year payments as shown in the Notes to the Financial Statements, I do not find this risk to be material.

The Company does not write any policies which would result in the need for extended reporting reserves.

The Company does not participate in any pools.

The Company writes no policies or contracts related to single or fixed premium policies with coverage periods of thirteen months or greater which are non-cancelable and not subject to premium increase (excluding financial guaranty contracts, mortgage guaranty policies, and surety contracts).

In my opinion, these items, individually and collectively, do not have a material impact on the reserves shown in Exhibit A.

c) Reinsurance:

1. **Retroactive Reinsurance:** I have reviewed the Company's reinsurance program and had discussions with the Company in order to determine whether any of the reinsurance contracts into which the Company has entered is or should be considered "retroactive" per SSAP No. 62R. The Company does not maintain such agreements.
2. **Financial Reinsurance:** I have reviewed the Company's reinsurance program and had discussions with the Company in order to determine whether any of the reinsurance contracts into which the Company has entered is or should be considered "financial" reinsurance per SSAP No. 62R. The Company does not maintain such agreements.
3. **Reinsurance Collectability:** In order to determine whether there are any material issues regarding the collectability of outstanding reinsurance, I have solicited information from management regarding any known collectability problems, I have reviewed the A.M. Best ratings of the Reinsurers with which the Company maintains agreements, and I have examined Schedule F for the current year for indications of regulatory actions and reinsurance recoverable on paid losses over 90 days past due. All of the reinsurers are rated at least B++. There are overdue balances with one reinsurer, Swiss Re, as discussed below.

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The Company has represented to me that it knows of no uncollectible reinsurance cessions. The only dispute over reinsurance recoverables is an amount of approximately \$850,000 with Swiss Re, for which the Company has booked a charge of approximately \$170,000, for a net remaining exposure of \$680,000; it is my understanding that management expects to eventually recover the entire amount when the contract is commuted.

Reinsurance collectability does not appear to be a material issue. I have not anticipated any contingent liabilities that could arise if the reinsurers do not meet their obligations to the Company as reflected in the data and other information provided me.

- d) IRIS Ratios: I have calculated the NAIC IRIS Tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, and Estimated Current Reserve Deficiency to Surplus. Both the One-Year and Two-Year tests resulted in exceptional results.

The Company was put into receivership due in part to reserving issues prior to my involvement. I have not reviewed in detail the basis for prior period carried reserves. As such, I cannot provide comprehensive explanation of subsequent exceptional results in the IRIS tests.

- e) Methods and Assumptions: There has been a change in the Appointed Actuary since the prior 12/31/2014 opinion. However, there have not been significant changes in actuarial assumptions/methods utilized to analyze the reserves shown in Exhibit A.

- f) Other Disclosures:

Applicable Accounting Standard

The amounts in Exhibit A are established based on U.S. Statutory Accounting Principles.

Risk Margin

The amounts in Exhibit A do not include an explicit risk margin.

Unpaid Loss Adjustment Expenses

The amounts in Exhibit A for unpaid loss adjustment expense include all types of loss adjustment expenses defined by the applicable accounting standard discussed above.

The Company currently has an agreement with Affirmative Agencies, Inc. in which Affirmative Agencies, Inc. provides claims adjusting services for all of the Company's open and IBNR claims (excluding open PIP claims in Michigan). A pre-payment for these services has been made by the Company to Affirmative Agencies, Inc. In accordance with Statutory accounting practices, the Company has established the liability for unpaid loss adjustment expenses and included this balance in the loss adjustment expenses reserves included in Exhibit A.

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This Statement of Actuarial Opinion is intended to satisfy the requirements for such an opinion under the NAIC Annual Statement Instructions, and is intended for use by the Company, the Board of Directors of the Company, the Company's auditor, and the Company's regulators.

An actuarial report and underlying work papers supporting the findings expressed in this Statement of Actuarial Opinion will be provided to the Company to be retained for a period of seven years at its administrative offices and available for regulatory examination.



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March 4, 2016

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**Statement of Actuarial Opinion
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Supporting Exhibits**

Exhibit A: SCOPE

<u>Loss and Loss Adjustment Expense Reserves</u>	<u>Amount</u>
1. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Col 1, Line 1)	\$ 107,555,138
2. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Col 1, Line 3)	\$ 8,885,564
3. Reserve for Unpaid Losses – Direct and Assumed (Should equal Schedule P, Part 1, Summary, Totals from Columns 13 and 15 x 1000)	\$ 109,582,000
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Should equal Schedule P, Part 1, Summary, Totals from Columns 17, 19, and 21, Line 12 x 1000)	\$ 8,823,000
5. The Page 3 write-in item reserve, “Retroactive Reinsurance Reserve Assumed”	\$ 0
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$ 0
<u>Premium Reserve</u>	
7. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	\$ 0
8. Reserve for Net Unearned Premiums for Long Duration Contracts	\$ 0
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	\$487,159

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Exhibit B: Disclosures

	Column 1	Column 2 Shepherd	Column 3 David	Column 4 M.
1. Name of the Appointed Actuary				
2. The Appointed Actuary's Relationship to the Company. Enter E or C based upon the following: E if an Employee C if a Consultant			C	
3. The Appointed Actuary is a Qualified Actuary based upon what qualification? Enter F, A, M, or O based upon the following: F if a Fellow of the CAS (FCAS) A if an Associate of the CAS (ACAS) M if not a member of the CAS, but a Member of the AAA (MAAA) approved by the Casualty Practice Council, as documented with attached approval letter. O for Other			F	
4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following: R if Reasonable I if Inadequate or Deficient Provision E if Excessive or Redundant Provision Q if Qualified. Use Q when part of the OPINION is Qualified. N if No Opinion			R	
5. Materiality Standard expressed in US dollars (Used to Answer Question #6)	\$ 1			
6. Is there a Significant Risk of Material Adverse Deviation?		Yes [X]	No []	NA []
7. Statutory Surplus (Liabilities, Surplus and Other Funds Col 1, Line 37)	(\$30,369,425)			
8. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P (should equal Part 1 Summary, Col 23, Line 12 * 1000)	\$ 0			
9. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P				
9.1 Non-tabular Discount [Notes, Line 32B23, (Amounts 1, 2, 3 & 4)], Electronic Filing Cols 7, 8, 9, & 10,	\$ 0			
9.2 Tabular Discount [Notes, Line 32A23, (Amounts 1 & 2)], Electronic Filing Col 7 & 8.	\$ 0			
10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.	\$ 0			
11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.				
11.1 Asbestos, as disclosed in the Notes to Financial Statements (Notes, Line 33A03D, ending net asbestos reserves for current year) Electronic Filing Col 5	\$1,083,361			
11.2 Environmental, as disclosed in the Notes to Financial Statements (Notes, Line 33D03D, ending net environmental reserves for current year), Electronic Filing Col 5	\$ 0			
12. The total claims made extended loss and expense reserve (Schedule P Interrogatories).				
12.1 Amount reported as loss reserves	\$ 0			
12.2 Amount reported as unearned premium reserves	\$ 0			
13. Other items on which the Appointed Actuary is providing Relevant Comment (list separately)	\$ 0			