

**REPORT ON EXAMINATION**  
**OF**  
**CAROLINA CASUALTY INSURANCE**  
**COMPANY**  
**JACKSONVILLE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2003**

**BY THE**  
**OFFICE OF INSURANCE REGULATION**

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Tallahassee, Florida  
December 21, 2004

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Kevin M. McCarty  
Commissioner  
Office of Insurance Regulation  
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Dear Madams and Sirs:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (FS), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination of December 31, 2003, of the financial condition and corporate affairs of:

**CAROLINA CASUALTY INSURANCE COMPANY  
4600 TOUCHTON ROAD EAST  
BUILDING 100, SUITE 400  
JACKSONVILLE, FLORIDA 32246**

Hereinafter referred to as the "Company". Such report of examination is herewith respectfully submitted.

## **SCOPE OF EXAMINATION**

This examination covered the period of January 1, 2001 through December 31, 2003. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2000. This examination commenced with planning at the Office, on August 2, 2004, to August 6, 2004. The fieldwork commenced on August 9, 2004, and was concluded as of December 21, 2004. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This financial examination was an association zone examination conducted in accordance with the Financial Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code (FAC), with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, and the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2003. Transactions subsequent to year-end 2003 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

Based on the review of the Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPAs, after verifying the statutory requirements for the following accounts:

Net Deferred Tax Assets  
Current Federal and Foreign Income Taxes

#### **Status of Adverse Findings from Prior Examination**

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2000, along with resulting action taken by the Company in connection therewith.

#### **Special Deposits**

The Company's Annual Statements for 1998, 1999 and 2000 failed to indicate the rates for bonds in Schedule E as required by the NAIC Annual Statement Instructions. **Resolution:** The 2003 annual statement contained the rates for bonds in the description of deposit in accordance with the NAIC Annual Statement Instructions.

## **Accounts and Records**

The Company's CPA's failed to indicate in the Accountant's Qualification Letter that they consent to the requirements and agree to make the workpapers available to the Office in accordance with Rule 4-137.002(12), FAC. **Resolution:** The Accountant's Qualification Letter for the year ended December 31, 2003, indicated that the CPA's will retain and make their workpapers available for review by the Office.

The accounts and records maintained by the Company's affiliates/underwriting managers, which included Monitor Surety Managers, Inc. (Monitor Surety), Monitor Liability Managers, Inc. (Monitor Liability) and Berkley Risk Service, Inc., did not clearly and accurately disclose the precise nature and details of the transactions for each underwriting manager in the holding company system. **Resolution:** The accounts and records of the underwriting managers were not maintained under the control of the Company; however, each affiliate was able to provide the examiners with details of the transactions.

## **Bonds**

The Company failed to non-admit \$101,829 in excess of the limitation required by Section 625.305(4d) (8), FS. **Resolution:** The Company reported an investment in one security rated 5 by the Securities Valuation Office of the NAIC. The total investment in this security did not exceed 1.5 percent of an insurer's admitted assets in accordance with Section 625.305(4d), FS.

## **Agents' Balances**

Dates other than the policy effective dates were used for aging. **Resolution:** Monitor Liability and Monitor Surety were converted from the invoice date to the policy effective date for aging purposes.

The Company used a 3-month period for determining non-admitted amounts rather than 90 days in accordance with Rule 4-138.024, FAC. **Resolution:** The Company, Monitor Liability and Monitor Surety used 90 days as the basis for determining non-admitted assets.

The Company was not non-admitting other installments and deferred billings associated with over 90 day receivables as required in Chapter 9 of the NAIC Accounting Practices and Procedures Manual. **Resolution:** Installment premiums over ninety days due, plus all future installments that have been recorded on that policy were non-admitted by the Company in accordance with SSAP 6, paragraph 9.

The Company was offsetting non-admitted premiums receivable with non-associated credit amounts. **Resolution:** The Company manually computed non-admitted receivables from agents and applied credit amounts to offset the receivables directly associated with the particular agent and/or insured.

### **EDP Equipment**

The Company failed to non-admit non-operating system software or to differentiate in accounting for its operating software from the non-operating software to comply with Section 625.012(11) , FS. **Resolution:** The examiners noted non-operating system software was not in the EDP Equipment account.



## HISTORY

### General

The Company was incorporated on April 18, 1951, as a stock property and casualty insurer under the laws of the State of Florida with the name of Insurance Company of America. By amendment to the Charter, the corporate name was changed on December 1, 1951 to Insurance Company of the South. In 1958, the Company became a member of Carolina Insurance Group after controlling interest of the outstanding stock was purchased by Carolina Casualty Insurance Company, a North Carolina corporation, which subsequently moved to Jacksonville, Florida. On January 30, 1985, the Company became a wholly owned subsidiary of W. R. Berkley Corporation. The Company commenced business on June 26, 1986 and began writing business in Florida in 1994.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2003:

Fire	Allied Lines
Inland Marine	Worker's Compensation
Other Liability	Commercial Automobile Liability
Commercial Auto Physical Damage	Fidelity
Surety	Glass
Burglary and Theft	Accident and Health

The Company has not written insurance coverage in the fidelity or accident and health lines of business during the period covered by this examination. Various states in which the Company writes surety and worker's compensation, require these lines to be maintained on the Company's certificate of authority. Therefore, the fidelity, accident and health lines have not been removed from the Company's certificate of authority as required by Section 624.430(1), FS.

The articles of incorporation and the bylaws were not amended during the period covered by this examination.

### **Capital Stock**

As of December 31, 2003, the Company's capitalization was as follows:

Number of authorized common capital shares	5,000,000
Number of authorized preferred capital shares	3,000,000
Number of common shares issued and outstanding	1,653,162
Number of preferred shares issued and outstanding	0
Total common capital stock	\$3,686,551
Par value per share	\$2.23

Control of the Company was maintained by its parent, W. R. Berkley Corporation (WRBC), a publicly held insurance holding company in Greenwich, Connecticut, who owned 100 percent of the stock issued by the Company. Further, Berkley Regional Insurance Company (10%) and Nautilus Insurance Company (5%), both subsidiaries of WRBC, also owned shares of the Company.

### **Profitability of Company**

With earned premiums of \$283,368,842 and \$211,625,014 for 2003 and 2002 respectively, the Company reported a net underwriting gain of \$24,755,640 and after tax income of \$27,924,834 in 2003. In 2002, the Company reported a net underwriting loss of (\$6,952,158) and after tax income of \$5,012,697. Gross premiums written increased 21.5% over the past year while losses incurred increased 12.8% and loss reserves increased 47.3%

### **Dividends to Stockholders**

No dividends were declared or paid to the stockholders during the period covered by this examination.

## Management

The annual shareholder's meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. Directors serving as of December 31, 2003, were:

### Directors

Name and Location	Principal Occupation
Eugene G. Ballard Greenwich, Connecticut	Sr. Vice President W. R. Berkley Corporation
William R. Berkley, Jr. Greenwich, Connecticut	Sr. Vice President W. R. Berkley Corporation
Armin W. Blumberg Jacksonville, Florida	President Carolina Casualty Insurance Company
Ira S. Lederman Greenwich, Connecticut	Sr. Vice President W. R. Berkley Corporation
Carroll D. Starmer Jacksonville, Florida	Vice President Carolina Casualty Insurance Company
Gary R. Wothe Jacksonville, Florida	Treasurer Carolina Casualty Insurance Company

The Board of Directors, in accordance with the Company's bylaws appointed the following senior officers:

### Senior Officers

Name	Title
Armin W. Blumberg	President
Gary R. Wothe	Treasurer & Vice President
Betty C. Sutherland	Secretary & Vice President
Donald J. Bromberek	Vice President
Robert F. Flannery	Vice President
James M. Macon	Vice President
William P. Sands	Vice President
Carroll D. Starmer	Vice President
Catherine P. Steckner	Vice President

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. Following are the principal internal board committees and their members as of December 31, 2003:

**Audit Committee**

Armin W. Blumberg<sup>1</sup>  
William R. Berkley, Jr.  
Gary R. Wothe

**Finance Committee**

Armin W. Blumberg<sup>1</sup>  
William R. Berkley, Jr.  
Gary R. Wothe

**Executive Committee**

Armin W. Blumberg<sup>1</sup>  
Gary R. Wothe  
Carroll D. Starmer  
Catherine P. Steckner

**Ethics Committee**

Armin W. Blumberg<sup>1</sup>  
Catherine P. Steckner  
Betty C. Sutherland

<sup>1</sup> Chairman

**Conflict of Interest Procedure**

The Company had adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, FS. No exceptions were noted during this examination period.

**Corporate Records**

The recorded minutes of the shareholder, Board of Directors, and Audit, Finance and Executive Committee meetings were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

## **Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales Through Reinsurance**

There were no acquisitions, mergers, disposals, dissolutions or purchase or sales through reinsurance during the period covered by this examination.

## **Surplus Debentures**

As of December 31, 2003, there were no outstanding surplus debentures of the Company.

## **AFFILIATED COMPANIES**

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on January 23, 2004, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

The following agreements were in effect between the Company and its affiliates:

### **Tax Allocation Agreement**

The Company, along with its parent and other affiliated companies, filed a consolidated federal income tax return. On December 31, 2003, the method of allocation between the Company and its parent was based on separate tax liability as if the Company had filed a separate tax return.

### **Program Administrator Agreement**

The Company entered into an agreement effective May 1, 1996, appointing Admiral Insurance Company as its administrator in California and Washington. This appointment granted the administrator authority to receive and accept proposals for Commercial General Liability and other related property coverage. The administrator was granted authority to solicit, accept and bind risks in accordance with underwriting rules prescribed by the Company.

The Company was also party to a second agreement with affiliate Berkley Risk Administrators Company LLC, (BRAC) formerly Berkley Risk Services, Inc. effective February 1, 1990, and appointed BRAC as the administrator. Duties of the administrator include, but are not limited to: solicit, accept and bind risk in accordance with underwriting rules prescribed by the Company, collect premiums, investigate, negotiate, or defend claims and losses on such policies.

### **Management Agreements**

The Company entered into several management agreements with various affiliates. The first agreement was effective May 15, 1995 between the Company and affiliates Monitor Surety Managers, Inc. and Monitor Liability Managers, Inc. (collectively, Monitor). The Company appointed Monitor to act as manager on its behalf with authority to act as underwriting manager with respect to the surety business in the name of the Company as issuing company. The authority granted to Monitor included, but was not limited to: acceptance and declination of risks, issuance, cancellation and amendment of surety bonds, collection of premiums and payment of losses and loss adjustment expenses.

The next agreement was effective January 1, 2003 with affiliate BRAC. BRAC was appointed manager and legal representative for the purpose of producing, underwriting and servicing

business on the Company's behalf. Duties included acceptance and declination of risks, issuance, cancellation and amendment of insurance policies, collection of premium, rejection, adjustment, compromise or payment of losses.

The last agreement entered into as of December 21, 2003, appointed Berkley Underwriting Partners LLC, to manage, coordinate and oversee all business activity related to the production of business underwritten by program administrators. The manager had authority to enter into underwriting management agreements, and adjust or settle claims arising out of or in connection with policies issued pursuant to any proper program administrator agreement entered into on the company's behalf. The manager would have the right to subcontract with program administrators and claims administrators. The agreement provided that the manager would begin accepting risk on January 1, 2004, with policy limits of less than \$1million per occurrence, \$2million in aggregate for any occurrence.

### **Management Services Agreement**

The Company maintained an agreement with its parent, WRBC as of January 30, 1985 appointing WRBC as a general consultant and advisor. WRBC agreed to furnish information, advise, provide analysis and recommendations with respect to legal, accounting, data processing, tax, financial, reinsurance, and actuarial matters. WRBC provided the Company the benefit of its experience, professional staff, and facilities for remuneration.

### **Standby Line of Credit Agreement**

The Company maintained an agreement with its parent, WRBC as of September 6, 2002, whereby WRBC agreed to make loans from time to time, in an amount not to exceed \$10 million and for a term not to exceed three months.

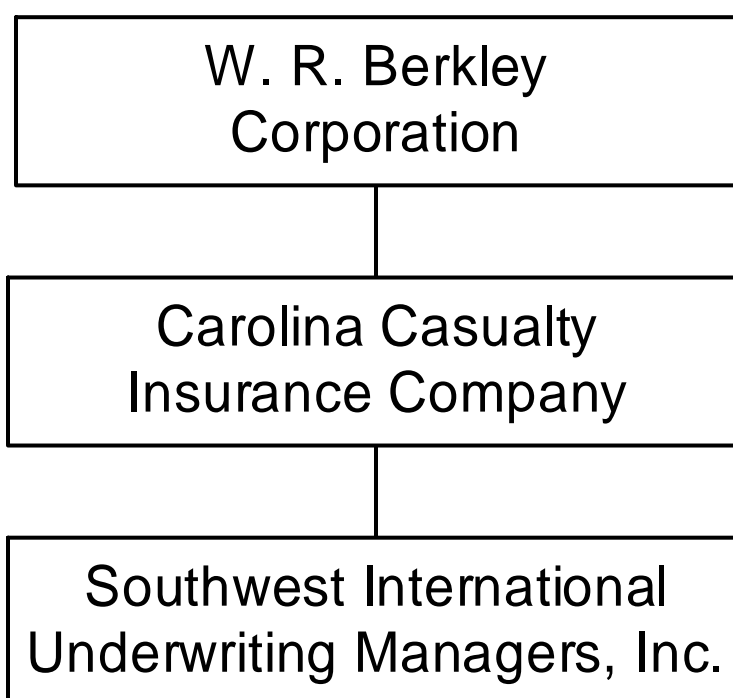
**Computer Service Agreement**

The Company entered into an agreement with affiliate Berkley Technology Services LLC, (BTS) on February 1, 2002 in which BTS would provide computer and data processing services, including programming, operations, network management and consulting services.



A simplified organizational chart as of December 31, 2003, reflecting the holding company system, is shown below. Schedule Y of the Company's 2003 annual statement provided a list of all related companies of the holding company group.

**CAROLINA CASUALTY INSURANCE COMPANY  
ORGANIZATIONAL CHART  
DECEMBER 31, 2003**



## FIDELITY BOND AND OTHER INSURANCE

As of year-end 2003, WRBC, including its subsidiaries, maintained fidelity bond coverage of \$15,000,000 with a deductible of \$250,000 for a single loss. This insurance adequately covered the suggested minimum amount of coverage for the Company, as recommended by the NAIC.

## PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company's employees participated in a profit sharing retirement plan sponsored by WRBC, the Company's ultimate parent. The plan provided for a minimum annual contribution of 5% of eligible compensation. Management was also eligible to participate in the parent's stock option plan. The Company did not offer a postretirement benefit plan.

## STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS, and with various state officials as required or permitted by law:

State	Description		Par Value	Market Value
FL	Miami Dade Cnty, 5.375%,	08/01/15	\$2,000,000	\$2,104,901
FL	USTNTS, 7.50%,	02/15/05	115,000	117,826
FL	USTNTS, 6.50%,	10/15/06	85,000	87,105
FL	USTNTS, 7.50%,	02/15/05	<u>1,205,000</u>	<u>1,228,065</u>
TOTAL FLORIDA DEPOSITS			\$3,405,000	\$3,537,897
AZ	USTNTS, 6.50%,	10/15/06	110,000	112,724
AR	USTNTS, 6.50%	10/15/06	250,000	259,545
CT	Houston Cnty, 6.875%,	04/01/07	200,000	200,000
DE	USTNTS, 6.50%,	10/15/06	100,000	99,724
GA	USTNTS, 6.50%,	10/15/06	115,000	117,848
LA	Denham Spgs, 7.20%,	08/01/10	80,000	80,000

MA	USTNTS,	6.75%,	05/15/05	550,000	555,206
NM	USTNTS,	6.50%,	10/15/06	200,000	199,447
NM	USTNTS,	7.50%,	02/15/05	130,000	132,488
NC	USTNTS,	7.50%,	02/15/05	300,000	307,372
NC	USTNTS,	7.50%,	02/15/05	200,000	203,828
NC	USTNTS,	7.50%,	02/15/05	445,000	453,518
OK	USTNTS,	7.50%,	02/15/05	300,000	305,742
OR	Denham Spgs,	7.20%,	08/01/10	145,000	145,000
OR	USTNTS,	6.50%,	10/15/06	140,000	139,613
RI	USTNTS,	6.50%	10/15/06	60,000	59,834
SC	USTNTS,	7.50%	02/15/05	150,000	153,686
SC	USTNTS,	7.50%	02/15/05	655,000	667,537
TN	USTNTS,	7.50%	02/15/05	100,000	103,376
VA	USTNTS,	7.50%	02/15/05	400,000	413,506
TOTAL OTHER DEPOSITS				<u>\$4,630,500</u>	<u>\$ 4,709,994</u>
Total Special Deposits				<u><u>\$8,035,500</u></u>	<u><u>\$8,247,891</u></u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operation**

The Company was authorized to transact insurance in all 50 states and the District of Columbia, in accordance with Section 624.401(2), FS.

### **Treatment of Policyholders**

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS.

## **REINSURANCE**

The reinsurance agreements reviewed did comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk and reporting and settlement information deadlines.

**Assumed**

The Company assumed insurance business on a 100% quota share basis from Consumers County Mutual Insurance Company, a Texas domiciled insurer. This business was administered by and marketed through Southwest International Underwriting Managers, Inc., a subsidiary of the Company.

**Ceded**

The Company ceded risk on an excess of loss and quota share basis to authorized and unauthorized, affiliated and non-affiliated reinsurers. The primary reinsurers were Converium Reinsurance North America (20%), an authorized unaffiliated reinsurer domiciled in CT; Nonprofits Insurance Company (16%), an authorized affiliated insurer domiciled in MN; HDI Reinsurance (Ireland) Ltd (15%), an unauthorized non-US reinsurer; St. Paul Fire and Marine Insurance Co. (12%), an authorized unaffiliated insurer domiciled in MN; and Continental Casualty Company (10%), an authorized unaffiliated reinsurer.

The Company entered into a commutation agreement with HDI Reinsurance (Ireland) Ltd, effective December 31, 2003. Upon the commutation, the reinsurer released funds held by the Company in an amount equal to the commuted loss, loss expense and unearned premium reserves of \$14,446,235. There was no gain or loss as a result of the commutation, however, the Company did recognize return premium of \$20,490,621 under the treaty's profit sharing provisions.

The reinsurance contracts were reviewed by the Company's internal actuary and were utilized in determining the ultimate loss opinion.

## **ACCOUNTS AND RECORDS**

An independent CPA audited the Company's statutory basis financial statements annually for the years 2001, 2002, and 2003, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, FAC.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office, with the exception of adjustments to line items as noted within this report.

The Company maintained its statutory home office in Jacksonville, Florida, where this examination was conducted.

The Company and non-affiliates had the following agreements:

### **Custodial Agreement**

The Company utilized the services of Morgan Stanley Prime Brokerage Services (Morgan Stanley) and JP Morgan Chase Bank. However, Morgan Stanley does not meet the definition of a custodian for insurance companies as defined in Rule 69O-143.041, FAC as being a national bank, state bank or trust company.

The custodial agreement with JP Morgan Chase Bank was dated January 1, 2004 because the original agreement was with Manufacturers Hanover. Manufacturers Hanover was sold several times over the years and was currently under the ownership of JP Morgan Chase. Therefore, a new agreement was provided that reflected the JP Morgan Chase name. The agreement indicated that either party may terminate the agreement upon 60 days written notice, in violation of Rule

69O-143.042(2)(o), FAC, which states the agreement be terminable by the insurance company on not more than 30 days' notice. Effective April 1, 2005, this agreement was amended to change the references to termination notice, from 60 days to 30 days.

The custodian agreement with Morgan Stanley was dated March 23, 2001. The agreement was subsequently authorized by resolution of the board of directors on November 7, 2001. The agreement did not contain the following six provisions specified in Rule 69O-143.042, FAC; however, the last four provisions were included in the prime broker margin agreement referenced in the custodian agreement.

- That a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, the custodian's records upon written instructions from an appropriate officer of the insurance company as required by Rule 69O-143.042 (2)(g), FAC.
- The custodian, upon written request from the Insurance Commissioner or from an appropriate officer of the insurance company, provide the appropriate affidavits, on Form DI4-341 (A), (B), or (C) or substantially similar forms with respect to custodied securities as required by Rule 69O-143.042 (2)(j), FAC.
- The custodian or its agents be required to send to the insurance company all reports which they receive from a clearing corporation or the Federal Reserve book-entry system on their respective systems of internal accounting control and reports prepared by outside auditors on the custodians or its agent's internal accounting control of custodied securities that the insurance company may reasonably request as required by Rule 69O-143.042 (2)(h), FAC.
- Indemnify the insurance company for any loss of custodied securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction pursuant to Rule 69O-143.042 (2)(k), FAC.

- In the event that there is a loss of custodied securities for which the custodian was obligated to indemnify the insurance company, the custodian shall promptly replace the securities or the value thereof and the value of any loss of rights or privileges resulting from said loss of securities in accordance with Rule 69O-143.042 (2)(l), FAC.
- Provide that the custodian will not be liable for any failure to take any action required to be taken under the agreement in the event and to the extent that the taking of such action is prevented or delayed by war, revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosion, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control in accordance with Rule 69O-143.042 (2)(m), FAC.

### **Investment Agreement**

The Company liquidated its investment in Milton Partners and entered into an investment management agreement with Milton Partners LP (Milton), a Delaware limited partnership dated January 1, 1997. Milton acts as the Company's investment manager for a specified portion of their investment portfolio. Services provided by Milton included providing investment research and advice, determining which securities should be purchased or sold, making purchases and sales of securities on behalf of the Company, and determining how voting and other rights with respect to securities of the Company should be exercised. The primary investment objective of Milton was merger arbitrage.

### **Independent Auditor Agreement**

The Company engaged KPMG LLP for the purpose of annually auditing and reporting on the statutory basis financial statements at year-end.

## **Risk-Based Capital**

The Company reported its risk-based capital at an adequate level.

## **INFORMATION TECHNOLOGY (IT) REQUIREMENTS**

The Company has undergone several changes in the IT Department during the past three years due to implementation of WRBC's goal to centralize all IT departments of its subsidiaries under the management and control of BTS. Because the centralization has not been concluded, the Office was unable to conduct a comprehensive examination of the Company's information systems requirements to determine if the Company was in compliance with IT standards.

However, under the current system, historical records cannot be modified, but can be changed by processing back off transactions and reprocessing of corrected records. Therefore, to ensure that no unauthorized changes are permitted, the Company should adhere to strict protocol and/or approval processes as well as document all changes or back off transactions that occur.

## **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2003, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."



**CAROLINA CASUALTY INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2003**

<b>Classification</b>	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Bonds	\$390,213,042	\$0	\$390,213,042
Stocks:			
Preferred	21,259,171	10,000,000	11,259,171
Common	38,098,531		38,098,531
Real estate	77,711		\$77,711
Cash & short term investments	43,422,552		43,422,552
Other invested assets	34,732		34,732
Receivable for securities	1,426,345		1,426,345
Aggregate write-in for invested assets	387,274	387,274	0
Investment income due & accrued	4,713,681		4,713,681
Premiums and considerations			
Uncollected premium	22,459,642		22,459,642
Deferred premiums	45,294,244		45,294,244
Reinsurance:			
Reinsurance recoverable	1,306,022		1,306,022
Other amounts receivable	710,847		710,847
Net deferred tax asset	14,453,256		14,453,256
EDP equipment	555,264		555,264
Receivable from PSA	309,655		309,655
Aggregate write-in for other than invested assets	695,415		695,415
Totals	\$585,417,384	\$10,387,274	\$575,030,110

**CAROLINA CASUALTY INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2003**

		Adjustments	Examination
Losses	\$185,134,719	16,000,000	\$201,134,719
Loss adjustment expenses	20,456,741		20,456,741
Commissions payable	1,969,987		1,969,987
Other expenses	998,449		998,449
Taxes, licenses and fees	2,943,986		2,943,986
Current federal and foreign income taxes	580,762		580,762
Unearned premium	149,226,248		149,226,248
Ceded reinsurance premiums payable	2,879,524		2,879,524
Funds held by Company under reinsurance treaties	1,169,127		1,169,127
Amounts withheld or retained by Company for account of others	14,571,542		14,571,542
Provision for reinsurance	38,836		38,836
Drafts outstanding	2,186,194		2,186,194
Payable to PSA	1,171,755		1,171,755
Payable for securities	1,876,634		1,876,634
Aggregate write-ins for liabilities	14,844,006		14,844,006
Total Liabilities	\$400,048,510	\$16,000,000	416,048,510
Common capital stock	3,686,551		3,686,551
Gross paid in and contributed surplus	117,089,964		117,089,964
Unassigned funds (surplus)	64,592,363	26,387,274	38,205,089
Surplus as regards policyholders	\$185,368,878	26,387,274	158,981,604
Total liabilities, capital and surplus	\$585,417,388	10,387,274	575,030,110

**CAROLINA CASUALTY INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2003**

**Underwriting Income**

Premiums earned	\$283,368,842
DEDUCTIONS:	
Losses incurred	153,186,268
Loss expenses incurred	22,771,998
Other underwriting expenses incurred	82,654,936
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$258,613,202</u>
Net underwriting gain or (loss)	\$24,755,640

**Investment Income**

Net investment income earned	\$12,950,242
Net realized capital gains or (losses)	5,098,432
Net investment gain or (loss)	<u>\$18,048,674</u>

**Other Income**

Net gain or (loss) from agents' or premium balances charged off	(\$23,816)
Finance and service charges not included in premiums	256,086
Aggregate write-ins for miscellaneous income	286,785
Total other income	<u>\$519,055</u>

Net income before dividends to policyholders and before federal & foreign income taxes	\$43,323,369
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$43,323,369
Federal & foreign income taxes	<u>15,398,535</u>

Net Income	\$27,924,834
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**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year	\$136,632,506
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**Gains and (Losses) in Surplus**

Net Income	\$27,924,834
Net unrealized capital gains or losses	1,996,768
Change in net unrealized foreign exchange capital gain	531,892
Change in net deferred income tax	3,666,416
Change in nonadmitted assets	(690,538)
Change in Provision for reinsurance	307,000
Surplus Adjustment: Paid In	15,000,000
Examination Adjustment	(26,387,274)
Change in surplus as regards policyholders for the year	<u>22,349,098</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$158,981,604</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Assets

#### Preferred Stocks \$11,259,171

The above amount is \$10 Million less than the \$21,259,171 reported by the Company. The Company owned 10 shares of preferred stock of Signet Star Holdings Inc., a direct subsidiary of WRBC, the parent, and reported a rate of \$1,000,000 per share. However, the NAIC last reviewed the security on December 4, 2003 and indicated that a current market price quotation was not obtainable or was not deemed reliable. Therefore the entire balance of \$10 Million shall be non-admitted.

#### Aggregate Write-in for Invested Assets \$-0-

The above amount is \$387,274 less than that reported by the Company. These assets were custodied with Morgan Stanley, who failed to provide an acceptable securities confirmation. Further, the Company erroneously included two put options for General Electric Co. as assets, when these securities were not included on the broker's statement.

### Liabilities

#### Losses and Loss Adjustment Expenses \$221,591,460

The Company's internal actuary, who was appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2003, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its contracts and agreements, and met the requirements of the insurance laws of the State of Florida.

The Office engaged Mercer Oliver Wyman Actuarial Consulting, Inc. to perform a reserve analysis to determine the adequacy of the Company's reserves. The results of this analysis determined that the Company's carried reserves of approximately \$206 Million were approximately \$16 Million less than the amount indicated in their projections.

**Taxes, Licenses and Fees**

\$2,943,986

The above amount is the same as that reported by the Company. However, the Company inadvertently reported guaranty fund assessments and accruals for payroll taxes on annual statement line L-5 entitled "Other Expenses" rather than including them on line L-6 "Taxes Licenses and Fees" as provided by the NAIC Annual Statement Instructions. No adjustment was made during this examination, as the amount was immaterial.

**CAROLINA CASUALTY INSURANCE COMPANY**  
**Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2003**

Surplus as Regards Policyholders  
per December 31, 2003, Annual Statement \$185,368,878

	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	INCREASE (DECREASE) <u>IN SURPLUS</u>
ASSETS:			
Preferred stocks	\$21,259,171	\$11,259,171	(\$10,000,000)
Aggregate write-in invested assets	\$387,274	-	(\$387,274)
LIABILITIES:			
Loss and LAE reserves	\$205,591,460	221,591,460	(\$16,000,000)
Net Change in Surplus:			(\$26,387,274)

Surplus as Regards Policyholders  
December 31, 2003, Per Examination \$158,981,604

## SUMMARY OF FINDINGS

### **Compliance with previous directives**

The Company has taken the necessary actions to comply with the comments made in the 2000 examination report issued by the Office.

### **Current examination comments and corrective action**

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2003.

### **Custodial Agreements**

A portion of the Company's securities were custodied with Morgan Stanley. Morgan Stanley did not meet the definition of a custodian for insurance companies as defined in Rule 69O-143.041, FAC. **The Office recommends the Company comply with Rule 69O-143.041, FAC and place its securities with a national bank, state bank or trust company. The Company is to provide documentation of compliance to the Office by December 31, 2005.**

The agreement with Morgan Stanley dated March 23, 2001 did not contain six of the required provisions specified in Rule 69O-143.042, FAC; however, four of the six provisions were included in a referenced prime broker margin agreement. **The Office recommends the Company amend the custodian agreement to include all six provisions.**

### **Preferred Stock**

The Company incorrectly reported the value of their investment in the preferred stock of an affiliate.

### **Subsequent event:**

The Company transferred the preferred stock to its parent by way of a dividend in 2004.

### **Aggregate Write-in for Invested Assets**

The Company erroneously included two put options for General Electric Co. as assets, when these securities were not included on the broker's statement. **The Office recommends that the Company report only assets owned at year-end on all future annual statements in accordance with the NAIC Annual Statement Instructions.**

### **Loss and Loss Adjustment Expenses**

The Company's carried reserves were deficient by approximately \$16 Million. **The Office recommends that the Company increase reserves in all future annual and quarterly statement filings by an additional amount to make them adequate in accordance with Section 625.101, FS.**

### **Taxes, Licenses and Fees**

The Company reported guaranty fund assessments and accruals for payroll taxes on annual statement line L-5 entitled "Other Expenses". **The Office recommends the Company prepare all future annual and quarterly statements in accordance with the NAIC Annual Statement Instructions.**



## CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Carolina Casualty Insurance Company** as of December 31, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$158,981,604, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Kethessa Carpenter, CPA, Financial Specialist; Kimberly A. Ferrell, FLMI, Financial Examiner/Analyst II; Richard A. Shaffer, FCLS, Financial Examiner/Analyst I; and Mercer Oliver Wyman Actuarial Consulting Inc., participated in the examination.

Respectfully submitted,

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Mary M. James, CFE, CPM  
Financial Examiner/Analyst Supervisor  
Florida Office of Insurance Regulation

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Kethessa Carpenter, CPA  
Financial Specialist  
Florida Office of Insurance Regulation