

REPORT ON EXAMINATION
OF
AMERICAN CAPITAL ASSURANCE
CORPORATION
ST. PETERSBURG, FLORIDA

AS OF
DECEMBER 31, 2009

BY THE
OFFICE OF INSURANCE REGULATION

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TALLAHASSEE, FLORIDA

February 4, 2011

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, Rule 69O-138.005, Florida Administrative Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2009, of the financial condition and corporate affairs of:

**AMERICAN CAPITAL ASSURANCE CORPORATION
805 EXECUTIVE CENTER DRIVE WEST, SUITE 300
ST. PETERSBURG, FLORIDA 33702**

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, 2009, through December 31, 2009. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2008. This examination commenced with planning at the Office on October 18, 2010, to October 22, 2010. The fieldwork commenced on November 1, 2010, and concluded as of February 4, 2011.

This financial examination was a statutory financial examination conducted in accordance with the Financial Condition 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, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating 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 and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

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

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

SUMMARY OF SIGNIFICANT FINDINGS

Current Exam Findings

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during this examination.

Dividends

The Company did not comply with Consent Order 89343-07, Article 13, which states that “During the first three years following the entry of this consent order, the Company shall pay only those dividends which have been approved in advance and in writing by the Office.” During the period under examination, the Company paid a \$6.5 million dividend to its parent that was not previously approved by the Office.

Prior Exam Findings

The following is a summary of significant adverse findings contained in the Office’s prior examination report as of December 31, 2008, along with resulting action taken by the Company in connection therewith.

Investments

The minutes of the Company's Board of Directors did not reflect approval of the investments for the year 2008 as required by Section 625.304, Florida Statutes.

Resolution: Beginning with the November 2010 Board Meeting, the investment committee began ratifying the investments as of part of its annual compliance review in order to satisfy the requirements of Section 625.304, Florida Statutes.

HISTORY

General

The Company was incorporated in Florida on June 1, 2006, and commenced business on June 30, 2006, as American Capital Assurance Corp.

The Company was party to Consent Order 86390-06-CO filed June 1, 2006, regarding application for the issuance of a Certificate of Authority. The Company was in compliance with the provisions of this consent order.

The Company was party to Consent Order 89343-07-CO filed February 28, 2007, regarding the proposed indirect acquisition of five percent or greater of the outstanding voting securities of the Company. The Office was notified of paid dividends; however, the Company failed to comply with the following provision of this consent order:

- The Company paid a dividend during the examination period in the amount of \$6.5 million without prior, advance approval in writing by the Office.

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2009:

Homeowners multi peril	Fire
Commercial multi peril	Allied Lines
Other liability	Inland Marine

The Articles of Incorporation and the Bylaws were not amended during the period covered by this examination.

Dividends to Stockholders

In accordance with Section 628.371, Florida Statutes, the Company declared and paid dividends to its stockholder in 2009 in the amount of \$6,500,000.

Capital Stock and Capital Contributions

As of December 31, 2009, the Company's capitalization was as follows:

Number of authorized common capital shares	1,000
Number of shares issued and outstanding	1,000
Total common capital stock	\$1,000
Par value per share	\$1.00

The Company was a wholly-owned subsidiary of Safe Harbour Holdings, LLC (Parent), a limited liability company formed in Delaware. The ultimate parents were Flexpoint Fund, LP (52%), New Capital Partners Private Equity, LP (8%), and ARX Holding Corp (40%).

The Parent contributed \$24,999,000 in cash to establish the Company. As of December 31, 2009, no additional funds had been contributed.

Surplus Debentures

On November 21, 2006, the Company issued a surplus note to the State Board of Administration of Florida in return for \$25 million. Interest on the unpaid principal balance was calculated at the rate

equivalent to the 10-year U.S. Treasury Bond rate as long as the Company maintains minimum premium writing guidelines. Any principal or interest payments were subject to approval by the Office. During the examination period, the Company paid \$1,615,118 in interest.

Subsequent Event: Per the agreement with The State Board of Administration of Florida, on January 4, 2010, the Company made its first principal payment in the amount of \$367,647 on its Surplus Note.

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

On January 23, 2008, the Company acquired 100% of the outstanding capital stock of ACA Home Insurance Company (ACA Home), formerly known as Home Pointe Insurance Company, a Florida domestic property and casualty insurer. During the current examination period, ACA Home remained a subsidiary of the Company and no acquisitions, mergers, disposals, dissolutions, purchases or sales through reinsurance took place.

CORPORATE RECORDS

The recorded minutes of the shareholder, Board of Directors (Board), and certain internal committees were reviewed for the period under examination. The recorded minutes of the Board did not adequately document its meetings and approval of Company transactions and events in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

Subsequent Event: Beginning with the November 2010 Board Meeting, the investment committee began ratifying the investments as of part of its annual compliance review in conformity with Section 625.304, Florida Statutes.

Conflict of Interest

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

MANAGEMENT AND CONTROL

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2009, were:

Directors

Name and Location	Principal Occupation
John Franklin Auer St. Petersburg, Florida	American Strategic Insurance Corp President, Director and CEO
Marc Fasteau New York, New York	Fulcrum Partners, LLC Managing Director
Gregory Scott Hendrick Hamilton, Bermuda	XL Re, Ltd Senior Vice President
Kevin Robert Milkey St. Petersburg, Florida	American Strategic Insurance Corp Executive Vice President
James Brawner Little, III Birmingham, Alabama	New Capital Partners, Inc. Managing Partner

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

Senior Officers

Name	Title
John Franklin Auer	President and Treasurer
Marc Fasteau	Secretary
Kevin Robert Milkey	Assistant Secretary
Bobby Chastain Dollar	Vice President

The Company's Board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following were the principal internal board committees and their members as of December 31, 2009:

Audit Committee

Marc Fasteau ¹
Gregory Scott Hendrick
James Brawner Little, III

Investment Committee

Marc Fasteau ¹
John Franklin Auer
James Brawner Little, III

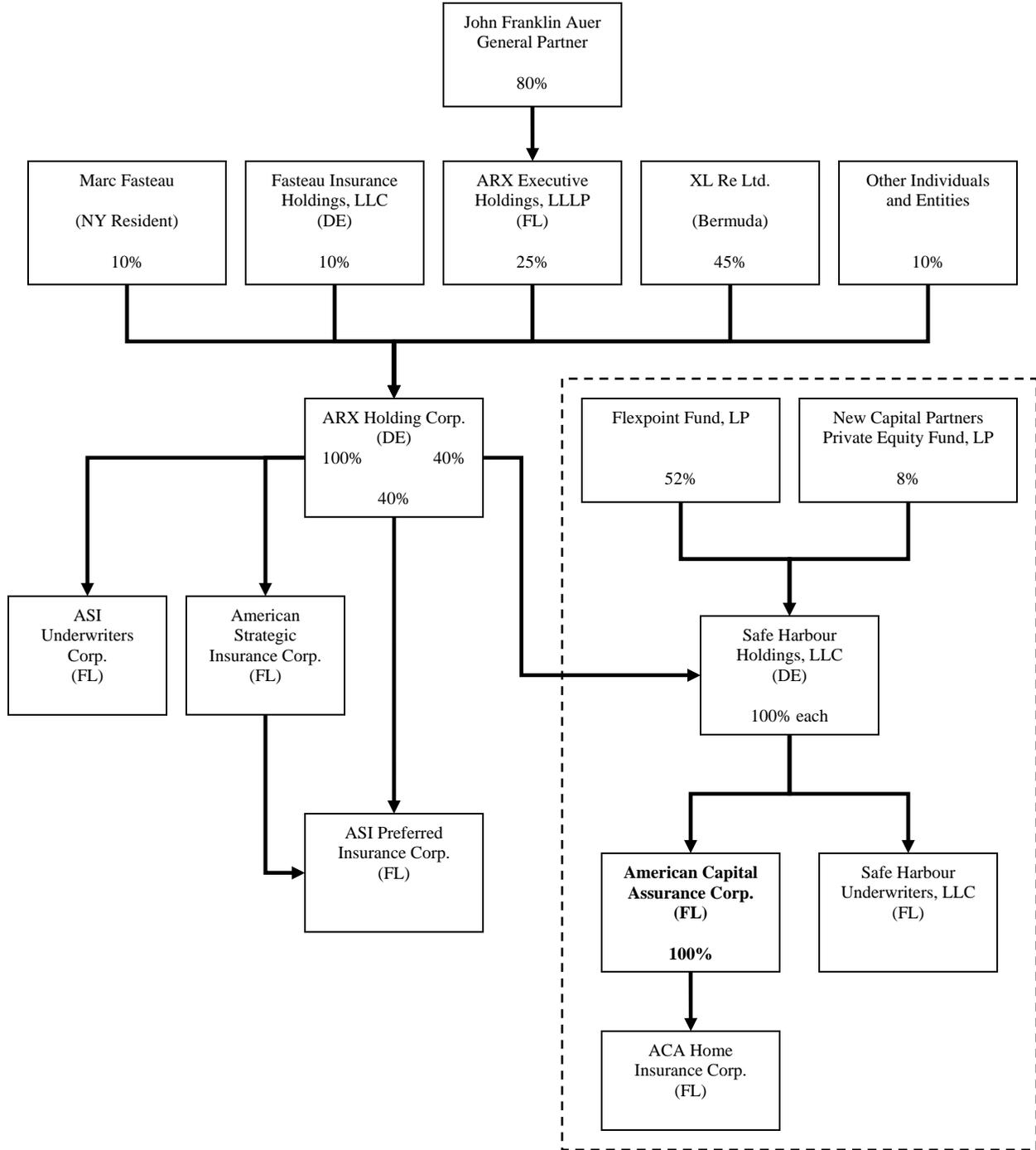
¹ Chairman

Affiliated Companies

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on March 1, 2010 as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A comprehensive organizational chart as of December 31, 2009, reflecting the holding company system, is shown below. Schedule Y of the Company's 2008 annual statement provided a list of all related companies of the holding company group.

**AMERICAN CAPITAL ASSURANCE CORPORATION
ORGANIZATIONAL CHART
DECEMBER 31, 2009**



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

Tax Allocation Agreement

The Company, along with its subsidiary, ACA Home, filed a consolidated federal income tax return. On December 31, 2009, the method of allocation for the liability of the federal income tax was in an amount not to exceed that which would have been due had the Company and its subsidiary filed a separate income tax return. Within ninety (90) days of the remittance by the Company of any income tax payment to the taxing authorities, all inter-company tax receivables/payables were settled.

Intercompany Settlement Agreement

The Company entered into an agreement with related parties through common ownership with ARX Holding Corp. and Safe Harbour Holding, LLC, effective March 21, 2008, whereby the Companies mutually acknowledge that in the ordinary course of business, it may become feasible for one company to pay expenses on behalf of another company. In such cases, the companies shall submit a monthly bill for any expenses incurred on behalf of another and shall remit payment in full no later than ninety (90) days after receipt.

Administration Agreement

The Company entered into an Administration Agreement with ARX Holding Corp (ARX) effective November 1, 2006, whereby ARX provided premium accounting and management functions to the Company. These functions included, but were not limited to, develop and file rates and forms, complete all necessary statutory accounting, create and make all required regulatory statistical reports; oversee the MGA; prepare monthly income statements and balance sheets; have all physician and electronic accounting files available for review; provide assistance to external

auditors and actuaries; and provide monthly management reports. The administration fee paid by the Company each month was equal to 2% of written premium on new and renewed business and was paid on a monthly basis within 20 days of the end of the month in order to reimburse ARX for the expenses of provided services. Fees incurred under this agreement during 2009 amounted to \$1,028,158.

Managing General Agent Agreement – Safe Harbour Underwriters, LLC

The Company entered into a Managing General Agency Agreement with its affiliate, Safe Harbour Underwriters, LLC (SHUL) on March 1, 2007 to solicit, underwrite and bind coverage for artisan contractors general liability products (RISC) and commercial package policies (CPP). The agreement was originally for a one-year term and automatically renews each successive year, unless otherwise terminated within the guidelines of the agreement. For underwriting and premium processing services, the Company pays 10% of written premium plus a \$25 policy fee. Claims administration services were included in the agreement. For claims processing, the Company paid a monthly commission based on 5% of non-catastrophe paid losses and 1% for catastrophe paid losses. Costs incurred under this agreement during 2009 amounted to \$5,140,788 for MGA commissions, \$83,709 in Loss commissions and \$41,525 in MGA fees.

Managing General Agent Agreement – ASI Underwriters Corp.

The Company entered into a Managing General Agreement with its affiliate, ASI Underwriters Corp. (ASIU) on June 1, 2006, to solicit, underwrite and bind coverage for policies, except RISC and CPP. The agreement was originally for a one-year term and automatically renews each successive year, unless otherwise terminated within the guidelines of the agreement. For underwriting and premium processing services, the Company pays 8% of written premium plus a \$25 policy fee. Claims administration services were included in the agreement. For claims

processing, the Company paid a monthly commission based on 5% of non-catastrophe paid losses and 1% for catastrophe paid losses. Since no policies were written in these lines, costs incurred under this agreement during 2009 were zero.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$1,500,000 with a deductible of \$50,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained Directors and Officers (D&O) liability, commercial package liability and property insurance coverage during the period of this examination.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

All employees of the Company were covered by a qualified, defined-contribution plan sponsored by the Company. The assets were commingled under one plan with its affiliates, Safe Harbour Underwriters LLC, American Strategic Insurance Corp., ASI Preferred Insurance Corp., ASI Underwriters Corp., ASI Lloyds and Sunshine Security Insurance Agency, Inc. Contributions of up to six percent of each employee's compensation were made each pay period. The Company's contribution for 2009 was \$21,372.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance only in the State of Florida.

Subsequent Event: In February 2010, the Company became licensed in the State of Louisiana.

Treatment of Policyholders

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

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) (i) 3a, Florida Statutes.

COMPANY GROWTH

Profitability of Company

The following table shows the profitability trend (in dollars) of the Company for the period of operations, as reported in the filed annual statements.

	2009	2008	2007	2006
Premiums Earned	34,498,450	43,011,010	20,758,172	133,718
Net Underwriting Gain/(Loss)	5,457,039	13,257,469	2,913,631	(1,180,391)
Net Income	5,929,374	9,609,510	2,013,383	(830,912)
Total Assets	105,361,163	103,337,454	82,457,830	55,092,679
Total Liabilities	43,880,641	40,528,487	29,690,389	5,647,226
Surplus As Regards Policyholders	61,480,523	62,808,972	52,767,440	49,445,453

LOSS EXPERIENCE

During the current examination period, the Company showed favorable development overall. This was a result of fewer claims being reported for prior accident years than management anticipated. The one and two-year net loss developments at the end of the current examination period were \$2.2 million and \$1.4 million, respectively.

REINSURANCE

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

Assumed

The Company assumed risk on a 100% quota share basis from ACA Home covering all policies issued subsequent to the purchase of the subsidiary.

Ceded

The Company ceded risk on an excess of loss basis to a variety of authorized and unauthorized affiliate and non-affiliate reinsurers. The Company's reinsurance program consists of multiple layers of excess catastrophe coverage, multi-line excess per risk coverage and excess catastrophe coverage (hurricane only – Florida Hurricane CAT Fund).

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

ACCOUNTS AND RECORDS

The Company maintained its principal operational offices in St. Petersburg, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statement 2009 in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

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.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with JP Morgan Worldwide Securities Services entered into on November 2, 2007. The Company was in compliance with Rule 69O-143.042, Florida Administrative Code, which stipulates the requirements of a custodial agreement.

Independent Auditor Agreement

The Company contracted with the external independent CPA firm of Gregory, Sharer & Stuart, PA to perform the annual audit of its financial statements as required by Rule 69O-137.002 (7) (c), Florida Administrative Code.

Information Technology Report

Steven R. Sigler, CFE, AES performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology Report provided to the Company.

STATUTORY DEPOSITS

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

STATE	Description	Par Value	Market Value
FL	Ohio Water Dev Auth, 5.25%, 06/01/23	\$ 300,000	\$ 343,620
	TOTAL FLORIDA DEPOSITS	<u>\$ 300,000</u>	<u>\$ 343,620</u>
LA	US Treasury Note, 2.65%, 06/30/14	150,000	151,091
	TOTAL OTHER DEPOSITS	<u>\$ 150,000</u>	<u>\$ 151,091</u>
	TOTAL SPECIAL DEPOSITS	<u>\$ 450,000</u>	<u>\$ 494,711</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2009, 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."

AMERICAN CAPITAL ASSURANCE CORPORATION
Assets

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Bonds	\$75,606,080		\$75,606,080
Stocks:			
Common	15,361,508		15,361,508
Cash:	7,960,482		7,960,482
Investment income due and accrued	607,138		607,138
Premiums and Considerations:			
Uncollected premium	1,763,609		1,763,609
Deferred premium	415,430		415,430
Current federal and foreign income tax recoverable and interest thereon	1,108,664		1,108,664
Net Deferred Tax Asset	2,086,351		2,086,351
Aggregate write-in for other than invested assets	451,901		451,901
Totals	\$105,361,163	\$0	\$105,361,163

AMERICAN CAPITAL ASSURANCE CORPORATION
Liabilities, Surplus and Other Funds

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Losses	\$9,519,953		\$9,519,953
Reinsurance payable	259,729		259,729
Loss adjustment expenses	1,526,573		1,526,573
Commissions payable	629,717		629,717
Other expenses	849,302		849,302
Taxes, licenses and fees	(13,438)		(13,438)
Borrowed money	498,972		498,972
Unearned premiums	16,865,976		16,865,976
Advance premiums	3,254,152		3,254,152
Ceded reinsurance premiums payable	10,234,626		10,234,626
Provision for reinsurance	215,000		215,000
Payable to parent, subsidiaries and affiliates	39,895		39,895
Aggregate write-ins for liabilities	284		284
Total Liabilities	\$43,880,741	\$0	\$43,880,741
Aggregate write-ins for special surplus funds	\$160,581		\$160,581
Common capital stock	1,000		1,000
Surplus Notes	25,000,000		25,000,000
Gross paid-in and contributed surplus	24,999,000		24,999,000
Unassigned funds (surplus)	11,319,942		11,319,942
Surplus as regards policyholders	\$61,480,523	\$0	\$61,480,523
Total liabilities, surplus and other funds	\$105,361,264	\$0	\$105,361,264

AMERICAN CAPITAL ASSURANCE CORPORATION
Statement of Income

DECEMBER 31, 2009

Underwriting Income

Premiums earned		\$34,498,450
	Deductions:	
Losses incurred		6,859,815
Loss expenses incurred		1,684,433
Other underwriting expenses incurred		20,497,162
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$29,041,410
Net underwriting gain or (loss)		\$5,457,040

Investment Income

Net investment income earned		\$1,036,851
Net realized capital gains or (losses)		418,970
Net investment gain or (loss)		\$1,455,821

Other Income

Finance and service charges not included in premiums		\$101,074
Aggregate write-ins for miscellaneous income		0
Total other income		\$101,074

Net income before dividends to policyholders and before federal & foreign income taxes		\$7,013,934
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$7,013,934
Federal & foreign income taxes		1,084,560
Net Income		\$5,929,374

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$62,808,970
Net Income		\$5,929,374
Net unrealized capital gains or losses		288,110
Change in net deferred income tax		(1,015,555)
Change in non-admitted assets		184,623
Change in provision for reinsurance		(215,000)
Change in excess statutory over statement reserves		0
Dividends to stockholders		(6,500,000)
Aggregate write-ins for gains and losses in surplus		0
Examination Adjustment		0
Change in surplus as regards policyholders for the year		(\$1,328,448)
Surplus as regards policyholders, December 31 current year		\$61,480,522

A comparative analysis of changes in surplus is shown below.

AMERICAN CAPITAL ASSURANCE CORPORATION
Comparative Analysis of Changes In Surplus

DECEMBER 31, 2009

The following is a reconciliation of Surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders
December 31, 2009, per Annual Statement \$61,480,523

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No Adjustments			\$0
LIABILITIES:			
No Adjustments			\$0
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2009, Per Examination			<u><u>\$61,480,523</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$11,046,526

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2009, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office engaged an independent actuarial firm, The Actuarial Advantage, Inc., to review the Loss and Loss Adjustment Expense Reserves carried in the Company's balance sheet as of December 31, 2009 and they were in concurrence with this opinion.

Capital and Surplus

The amount reported by the Company of \$61,480,523, exceeded the minimum of \$4,187,619 required by Section 624.408, Florida Statutes.

SUMMARY OF RECOMMENDATIONS

Dividends

We recommend that the Company comply with all articles of its consent orders in the future.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **American Capital Assurance Corporation** as of December 31, 2009, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$61,480,523, which exceeded the minimum of \$4,187,619 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Steven R. Sigler, CFE, AES, Examiner-In-Charge, Sheri Kenney, CFE, Participating Examiner, Brad Hazelwood, Participating Examiner, and Tracy Gates, CPA, CISA, IT Manager, of Highland Clark, LLC; Dennis Henry, FCAS, MAAA, consulting actuary of Actuarial Resources; and Maurice Fuller, Financial Examiner/Analyst II and Frank Jones, Reinsurance Financial Specialist, of the Office, participated in the examination.

Respectfully submitted,

Kethessa Carpenter, CPA
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation