

REPORT ON EXAMINATION
OF
AMERICAN CAPITAL ASSURANCE
CORP.

ST. PETERSBURG, FLORIDA

AS OF
DECEMBER 31, 2013

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

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March 26, 2015

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 690-138.005, 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, 2013, of the financial condition and corporate affairs of:

**AMERICAN CAPITAL ASSURANCE CORP.
1 ASI WAY N
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, 2010 through December 31, 2013. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2009. This examination commenced with planning at the Office on November 9, 2014 to November 13, 2014. The fieldwork commenced on November 16, 2014, and concluded as of March 26, 2015.

This financial examination was a multi-state 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

There were no material findings or exceptions noted during the examination as of December 31, 2013.

Prior Exam Findings

Dividends

The Company did not comply with Consent Order 89343-07, Article 13, which stated 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.

Resolution: The Company has not paid any dividends since the prior examination and, therefore, has been in compliance with Consent Order 89343-07, Article 13.

SUBSEQUENT EVENTS

In early 2015, ARX Holding Corp., the Company’s parent, announced a sale of stock to Progressive Corporation for controlling interest of the Group. The effect of this transaction was reviewed as part of the prospective risks of this examination. No proposed changes in processes or controls resulted therefore, there was no effect on the examination approach.

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 party to Consent Order 126007-12-CO filed June 7, 2012, regarding the merger of ACAC Acquisition Inc. and the Company. The Company was in compliance with the provisions of these consent orders.

The Company was authorized to transact the following insurance coverage in Florida on December 13, 2011 and continued to be authorized as of December 31, 2013:

Allied Lines	Inland Marine
Fire	Homeowners Multi Peril
Other Liability	Commercial Multi Peril

The Articles of Incorporation and the Bylaws were amended during the examination period as a result of a merger of corporations. This merger and supporting documentation was approved by the office on July 25, 2012.

Dividends to Stockholders

The Company did not declare or pay any dividends during the period of this examination.

Capital Stock and Capital Contributions

As of December 31, 2013, the Company's capitalization was as follows:

Number of authorized common capital shares	5,000,000
Number of shares issued and outstanding	5,000,000
Total common capital stock	\$5,000,000
Par value per share	\$1.00

The Company was a wholly owned subsidiary of ARX Holding Corp. (Parent), a Delaware corporation. The ultimate parents were XL Re Ltd. (40%), ARX Executive Holdings, LLLP (22%), Fasteau Insurance Holdings, LLC (8%), Marc Fasteau (7%), Flexpoint Fund, LP (7%), PC Investment Company (5%), and other individuals and entities (each owning less than 4% and collectively owning less than 11%). The Company had a wholly owned subsidiary, ASI Home Insurance Corp., for the duration of the examination period. As of December 31, 2013, no additional funds had been contributed.

Surplus Notes

On November 21, 2006, the Company received funds from the State Board of Administration of Florida in the form of a surplus note in the amount of \$25 million. The note had a floating interest rate set quarterly based upon the ten year U.S. Treasury Bond rate. The term was twenty years; the first three years' payments were interest only followed by a seventeen year amortization period. As of December 31, 2013, all payments were made according to schedule with permission from the Office.

The terms of the note required the Company to maintain surplus in the amount of \$50 million and a 1.5:1 ratio of net written premium to surplus for the duration of the note. As of December 31, 2010, the Company met the surplus requirement but did not meet the 1.5:1 ratio of net written premium to surplus. As a result, the Company was charged additional interest of 450 basis points.

In June 2011, the Company filed an agreement with the State Board of Administration to accelerate the payment period of the note by five years thereby exempting the Company from the 1.5:1 ratio of net written premium to surplus.

As of December 31, 2013, the Company was in compliance with the terms of the agreement.

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

The Company had no acquisitions, mergers, disposals, dissolutions and purchase or sales through reinsurance during the period of this examination.

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 adequately documented its meetings and approval of Company transactions and events, in compliance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code, including the authorization of investments as required by Section 625.304, Florida Statutes.

Conflict of Interest

The Company adopted a policy statement requiring periodic 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 Section 628.231, Florida Statutes. Directors serving as of December 31, 2013, were:

Directors

Name and Location	Principal Occupation
Marc Fasteau Great Barrington, Massachusetts	Managing Director Fulcrum Partners, LLC
John Franklin Auer St. Petersburg, Florida	Director and Chief Executive Officer American Strategic Insurance Corp.
Kevin Robert Milkey St. Petersburg, Florida	Executive Vice President American Strategic Insurance Corp.
Gregory Scott Hendrick Wilton, Connecticut	Chief Executive of Insurance Operations XL Re Ltd
Charles Cooper Hamilton, Bermuda	President and Chief Underwriting Officer XL Re Ltd

In accordance with the Company's bylaws, the Board appointed the following senior officers:

Senior Officers

Name	Title
John Franklin Auer	President and Treasurer
Kevin Robert Milkey	Executive Vice President and Assistant Secretary
Bobby Chastain Dollar	Vice President
Marc Fasteau	Secretary
Angel Dawn Bostick	Vice President and General Counsel
Trevor Clark Hillier	Vice President
Tanya Judith Fjare	Vice President
Philip Loren Brubaker	Vice President
Jeffrey William Hannon	Vice President

The Company's Board of Directors appointed several internal committees. Following were the principal internal board committees and their members as of December 31, 2013:

Audit Committee

Marc Fasteau ¹
Gregory Scott Hendrick
Charles Cooper

Investment Committee

Mark Fasteau ¹
John Franklin Auer
Gregory Scott Hendrick

¹ Chairman

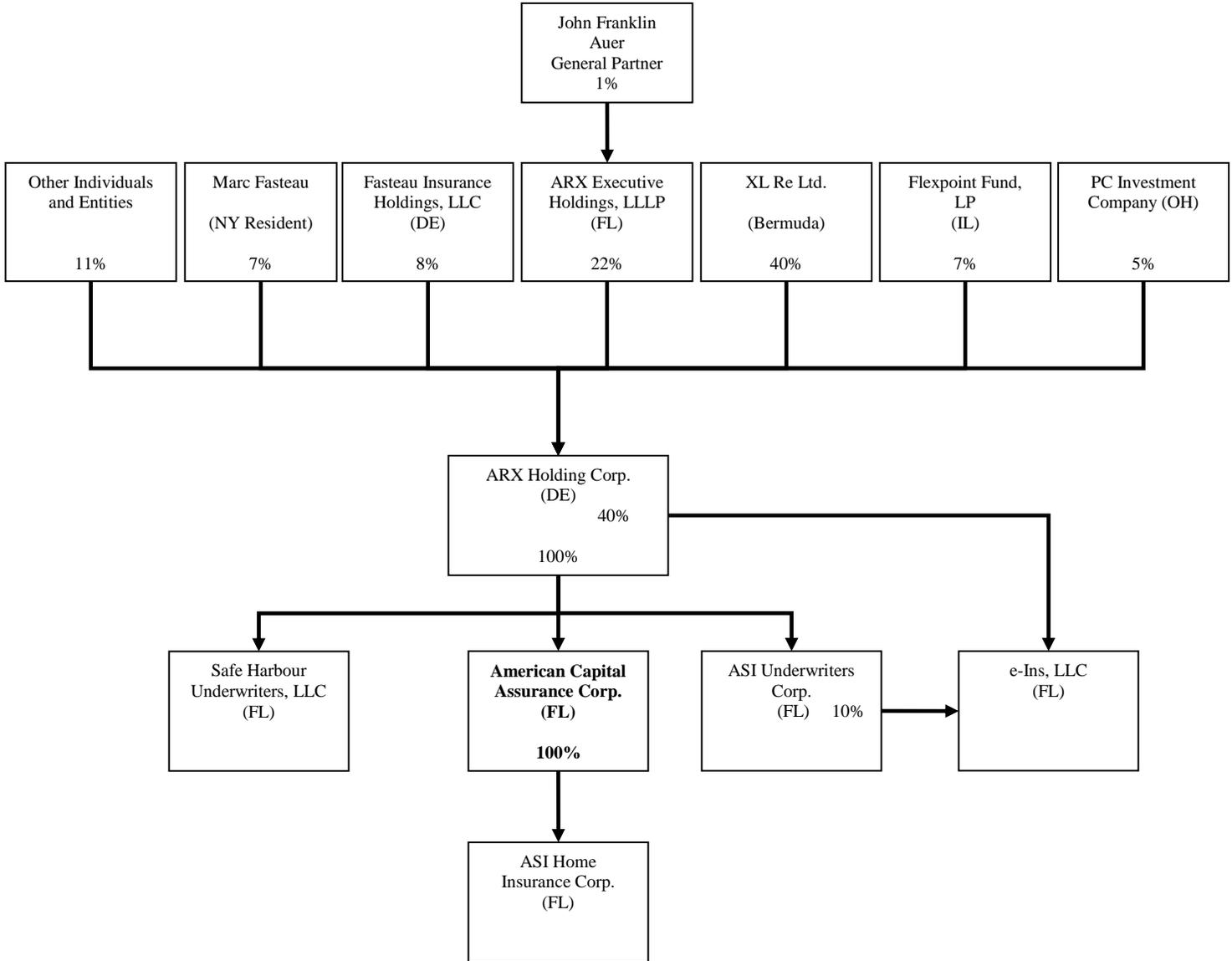
Affiliated Companies

The latest holding company registration statement was filed with the Office on April 15, 2014 as required by Section 628.801, Florida Statutes.

A simplified organizational chart as of December 31, 2013, reflecting the holding company system, is shown on the following page. Schedule Y of the Company's 2013 annual statement provided a list of all related companies of the holding company group.

**AMERICAN CAPITAL ASSURANCE CORP.
SIMPLIFIED ORGANIZATIONAL CHART**

DECEMBER 31, 2013



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

Tax Allocation Agreement

The Company, along with its affiliates, ARX Holding Corp., ASI Home Insurance Corp., American Strategic Insurance Corp., ASI Assurance Corp., ASI Preferred Insurance Corp., ASI Select Insurance Corp., ASI Lloyds, ASI Lloyds, Inc., ASI Underwriters Corp., ASI Underwriters of Texas, Inc., Sunshine Security Insurance Agency, Inc., Safe Harbour Underwriters, LLC and ASI Services, Inc., filed a consolidated federal income tax return. On December 31, 2013, 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 days of the remittance by the Company of any income tax payment to the taxing authorities, all intercompany tax balances were settled.

Intercompany Settlement Agreement

The Company entered into an agreement with related parties through common ownership with ARX Holding Corp., Safe Harbour Underwriters, LLC, ASI Home Insurance Corp., American Strategic Insurance Corp., ASI Assurance Corp., ASI Preferred Insurance Corp., ASI Select Insurance Corp., ASI Lloyds, ASI Lloyds, Inc., ASI Underwriters Corp., ASI Underwriters of Texas, Inc., Sunshine Security Insurance Agency, Inc., ASI Services, Inc., ASI RE, LLC, and e-Ins, LLC, 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 days after receipt.

Administration Agreement

The Company entered into an administration agreement with ARX Holding Corp. (ARX) effective November 1, 2006, whereby ARX provided to the Company accounting, statistical and compliance services. 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 twenty days of the end of the month in order to reimburse ARX for the expenses of provided services.

Managing General Agent Agreement

The Company entered into a managing general agency agreement with its affiliate, Safe Harbour Underwriters, LLC on March 1, 2007, to solicit, underwrite and bind coverage for artisan contractors, general liability products and commercial package policies. 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 per 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.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$3,000,000 with a deductible of \$100,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained Directors and Officers 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 Underwriters of Texas, Inc., and Sunshine Security Insurance Agency, Inc. Contributions of up to 6% of each employee's compensation were made each pay period. The Company's contributions for 2013 and 2012 were \$36,176 and \$21,942, respectively.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance in the following states:

Florida

Louisiana

South Carolina

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 examination, as reported in the filed annual statements.

	2010	2011	2012	2013
Premiums Earned	38,456,715	51,053,141	58,815,985	72,554,973
Net Underwriting Gain/(Loss)	5,550,705	(2,558,221)	8,282,233	18,481,838
Net Income/(Loss)	4,989,160	(2,319,320)	7,452,057	13,623,288
Total Assets	105,919,092	132,771,856	149,321,128	173,132,557
Total Liabilities	46,142,429	74,665,158	79,311,904	91,742,507
Surplus As Regards Policyholders	59,776,663	58,106,698	70,009,224	81,390,050

LOSS EXPERIENCE

During the current examination period, the Company showed favorable development overall. This was a result of decreases in the estimated costs of prior year losses and loss adjustment expenses. Current year losses and loss adjustment expenses reflected on the Statement of Income of \$13,855,704 were lower by \$3,398,757 due to favorable development of prior year estimates.

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 90% quota share basis from ASI Home Insurance covering all premiums and losses associated with the business produced through ASI Home Insurance Corp. The Company received a 24% ceding commission for these transactions. The Company also assumed risk on a 35% quota share basis from ASI Preferred Insurance Corp., all premiums and losses associated with the business produced through ASI Preferred Insurance Corp. The Company received a 27% ceding commission for these transactions.

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 through the Florida Hurricane Catastrophe 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. 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 executed on November 2, 2007. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

Independent Auditor Agreement

An independent CPA audited the Company's statutory basis financial statements annually for the years 2010, 2011, 2012 and 2013 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.

INFORMATION TECHNOLOGY REPORT

Phil Schmoyer, CFE, CISA, and Emily Cheng, CPA, CFE of Baker Tilly 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:

STATE	Description	Par Value	Market Value
FL	Cash Statutory Deposit	\$1,514,819	\$1,514,819
FL	Ohio Water Dev Auth, 5.25%, 06/01/23	<u>300,000</u>	<u>357,186</u>
TOTAL FLORIDA DEPOSITS		<u>\$1,814,819</u>	<u>\$1,872,005</u>
LA	US Treasury Note, 2.625%, 06/30/14	<u>150,000</u>	<u>151,893</u>
TOTAL OTHER DEPOSITS		<u>\$150,000</u>	<u>\$151,893</u>
TOTAL SPECIAL DEPOSITS		<u>\$1,964,819</u>	<u>\$2,023,898</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2013, 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 CORP.

Assets

DECEMBER 31, 2013

	Per Company	Examination Adjustments	Per Examination
Bonds	\$118,521,117		\$118,521,117
Stocks:			
Common	16,258,229		16,258,229
Cash and Short-Term Investments	22,815,988		22,815,988
Other investments	8,080,469		8,080,469
Investment income due and accrued	995,918		995,918
Premiums and Considerations			
Uncollected premiums and agents' balances in the course of collection	548,965		548,965
Deferred premiums, agent's balances and installments booked but deferred and not yet due	114,374		114,374
Reinsurance			
Amounts recoverable from reinsurers	71,441		71,441
Net deferred tax asset	4,603,916		4,603,916
Receivable from parents, subsidiaries and affiliates	732,405		732,405
Aggregate write-in for other than invested assets	389,735		389,735
Totals	<u>\$173,132,557</u>	<u>\$0</u>	<u>\$173,132,557</u>

AMERICAN CAPITAL ASSURANCE CORP.

Liabilities, Surplus and Other Funds

DECEMBER 31, 2013

	Per Company	Examination Adjustments	Per Examination
Losses	\$22,706,970		\$22,706,970
Reinsurance payable on paid losses and loss adjustment expenses	797,213		\$797,213
Loss adjustment expenses	3,284,288		3,284,288
Commissions payable, contingent commissions and other similar charges	1,090,126		1,090,126
Other expenses	1,276,531		1,276,531
Taxes, licenses and fees	2,009,651		2,009,651
Current federal and foreign income taxes	660,030		\$660,030
Unearned premium	42,290,394		42,290,394
Advance premium	2,472,163		2,472,163
Ceded reinsurance premiums payable	14,881,547		14,881,547
Payable for securities	263,118		263,118
Aggregate write-ins for liabilities	10,476		10,476
Total Liabilities	\$91,742,507		\$91,742,507
Common capital stock	\$5,000,000		\$5,000,000
Surplus notes	16,956,600		16,956,600
Gross paid in and contributed surplus	26,700,000		26,700,000
Unassigned funds (surplus)	32,733,450		32,733,450
Surplus as regards policyholders	\$81,390,050	\$0	\$81,390,050
Total liabilities, surplus and other funds	\$173,132,557	\$0	\$173,132,557

AMERICAN CAPITAL ASSURANCE CORP.

Statement of Income

DECEMBER 31, 2013

Underwriting Income

Premiums earned		\$72,554,973
	Deductions:	
Losses incurred		\$11,988,804
Loss expenses incurred		1,866,900
Other underwriting expenses incurred		40,217,431
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		<u>\$54,073,135</u>
Net underwriting gain or (loss)		\$18,481,838

Investment Income

Net investment income earned		\$2,235,876
Net realized capital gains or (losses)		47,046
Net investment gain or (loss)		<u>\$2,282,922</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off		\$31,176
Finance and service charges not included in premiums		33,889
Aggregate write-ins for miscellaneous income		0
Total other income		<u>\$65,065</u>

Net income before dividends to policyholders and before federal & foreign income taxes		\$20,829,825
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		<u>\$20,829,825</u>
Federal & foreign income taxes		7,206,537
Net Income		<u><u>\$13,623,288</u></u>

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$70,009,224
Net Income		\$13,623,288
Net unrealized capital gains or losses		(23,863)
Change in net deferred income tax		472,976
Change in non-admitted assets		43,360
Change in provision for reinsurance		0
Change in excess statutory over statement reserves		0
Surplus adjustments: Paid in		(2,734,935)
Aggregate write-ins for gains and losses in surplus		0
Examination Adjustment		0
Change in surplus as regards policyholders for the year		<u>\$11,380,826</u>
Surplus as regards policyholders, December 31 current year		<u>\$81,390,050</u>

A comparative analysis of changes in surplus is shown below.

AMERICAN CAPITAL ASSURANCE CORP.
Comparative Analysis of Changes in Surplus
DECEMBER 31, 2013

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

Surplus as Regards Policyholders
December 31, 2013, per Annual Statement \$81,390,050

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No Adjustment			
LIABILITIES:			
No Adjustment			
Other Expenses			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2013, Per Examination			<u><u>\$81,390,050</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses

\$25,991,258

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, 2013, 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 consulting actuaries Ronald T. Kuehn, FCAS, MAAA, CERA, CPCU, ARM, FCA, and Todd Dashoff, FCAS, MAAA, ARM of Huggins Actuarial Firm, reviewed the loss and loss adjustment expense work papers provided by the Company and they were in concurrence with this opinion.

Capital and Surplus

The amount of capital and surplus reported by the Company of \$81,471,171, exceeded the minimum of \$8,644,305 required by Section 624.408, Florida Statutes.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of American Capital Assurance Corp. as of December 31, 2013, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$81,391,050, which exceeded the minimum of \$8,644,305 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Phil Schmoyer, CFE, CISA, Examiner-In-Charge, and Jennifer Cox, Participating Examiner, of Baker Tilly participated in the examination. Additionally, Ronald Kuehn, FCAS, MAAA, CERA, CPCU, ARM, FCA, and Todd Dashoff, FCAS, MAAA, ARM, consulting actuaries of Huggins Actuarial Firm, Emily Cheng, CPA, CFE, IT Participating Examiner of Baker Tilly and Mikhael Goldgisser, Financial Examiner of the Office participated in the examination.

Respectfully submitted,

Robin Brown, CFE
Chief Examiner
Florida Office of Insurance Regulation