

REPORT ON EXAMINATION
OF
ASSOCIATED INDUSTRIES INSURANCE
COMPANY, INC.
BOCA RATON, FLORIDA

AS OF
DECEMBER 31, 2011

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

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June 15, 2012

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 of December 31, 2011, of the financial condition and corporate affairs of:

**ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.
903 N.W. 65th STREET, SUITE 300
BOCA RATON, FLORIDA 33487-2864**

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, 2007, through December 31, 2011. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2006. This examination commenced with planning at the Office on March 19, 2012, to March 23, 2012. The fieldwork commenced on March 26, 2012, and concluded as of June 15, 2012.

This financial examination was a multi-state 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.

Premium Deficiency Reserve

Based on the analysis performed by the independent actuary, it was determined that a premium deficiency reserve was necessary as of December 31, 2011.

Prior Exam Findings

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2006, along with resulting action taken by the Company in connection therewith.

Reinsurance

There was no documentation indicating that two of the reinsurance intermediary brokers used by the Company were properly licensed either in Florida or in the United States. Therefore the Company is not in compliance with Section 626.7492 (6), Florida Statutes – Reinsurance intermediaries. **Resolution: The Company is no longer utilizing Arthur Gallagher Ltd or Swift Intermediaries to place its reinsurance program.**

Management and Control

The Company was not in compliance with Section 625.304, Florida Statutes, as there was no indication in the minutes of the board of directors that the board approved or ratified the presentation of the investment report and investment activity. **Resolution: The Company initiated procedures in 2007 to document the review and approval of the Company's investments in the Board minutes.**

HISTORY

General

The Company originated as Southeast Title and Insurance Company, Inc. (Southeast), which was incorporated on October 3, 1953, under the laws of the State of Florida and commenced writing business on May 13, 1954. On March 15, 1993, Associated Industries Insurance Services, Inc. (Parent) was incorporated for the purpose of providing insurance administration and management services for certain insurance companies and self-insurance funds. In January 1995, the Parent purchased Southeast, a stock insurance company licensed to write business in the State of Florida, and changed the Company's name to Associated Industries Insurance Company, Inc.

On June 10, 1996, Associated Industries of Florida Property & Casualty Trust (Associated Trust) received approval from the Office of Insurance Regulation to convert to an assessable mutual insurer, simultaneously converting to a non-assessable stock insurer. Also on this same day the Associated Industries Insurance Company, Inc acquired 100% of the stock of Associated Trust, the non-assessable stock insurer, merged into what is now known as Associated Industries Insurance Company, Inc. (Company), and assumed all of the liabilities and assets of the stock insurer.

Simultaneous with the conversion, the Company also executed a lost portfolio transfer (LPT) agreement with a reinsurer. Pursuant to the LPT agreement, the reinsurer assumed the Company's claims liabilities incurred prior to January 10, 1996.

Effective September 7, 2007 the Company and its parent, were acquired by AmTrust Financial Services, Inc. (AFSI).

During the fourth quarter of 2010, AmTrust Financial Services, Inc. assigned to the Company all of the rights, title, and interest in Boca NW65, LLC. Boca NW65, LLC is a limited liability company organized and existing under the laws of Delaware. Boca NW65, LLC owns a real estate investment that is being developed for occupancy and production of income by the Company.

The Company is licensed to write workers' compensation insurance in Florida, Alabama, Georgia, and Mississippi. The Company has submitted requests to surrender its licenses in Alabama, Georgia, and Mississippi. Upon surrender of each license, the Company will apply for Excess & Surplus Lines authorization.

During 2011, the Company applied in every state except Alabama, Florida, Georgia, and Mississippi for authorization to write business as a surplus lines insurer. As of December 31, 2011, the Company was eligible to write insurance in 44 states, with applications pending in Delaware, Massachusetts, and New York.

The Company focuses on writing workers' compensation insurance for small commercial businesses by working with a network of independent insurance agents to bind policies in businesses such as grocery stores, retail shops, restaurants, hotels, private schools, light

manufacturing, physicians and other professional offices. In addition to regular payment plans, the Company is also offering payment of insurance premiums through the payroll company an insured uses. Insurance premium is deducted by the payroll company each pay cycle and remitted to the Company directly.

Through the surplus lines insurance, the Company is expanding into the special middle market segments such as retail and wholesale operations, service operations and non-profit organizations. The Company partners with managing general agents and claims administrators to originate and manage this book of business.

The Articles of Incorporation and the Bylaws were amended during the period covered by this examination. The amendment changed the address of the Company's offices and was filed with the Office on October 5, 2011.

Dividends to Stockholders

In accordance with Section 628.371, Florida Statutes, the Company declared and paid dividends to its stockholder in 2011, 2010 and 2009 in the amounts of \$5,839,145, \$5,000,000 and \$4,506,752, respectively.

Capital Stock and Capital Contributions

As of December 31, 2011, the Company's capitalization was as follows:

Number of authorized common capital shares	25,000
Number of shares issued and outstanding	20,000
Total common capital stock	\$2,000,000
Par value per share	\$100.00

All outstanding shares of the Company were owned by AmTrust North American of Florida, Inc. a company incorporated in Florida, which is a wholly owned subsidiary of AmTrust Financial Services, Inc.

Surplus Debentures

The Company did not have any surplus debentures during the period of this examination.

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

During the fourth quarter of 2010, the Company was assigned and accepted all of the rights, title and interest in Boca NW65, LLC from AmTrust Financial Services, Inc. Boca NW65, LLC is a limited liability company organized and existing under the laws of Delaware.

CORPORATE RECORDS

The recorded minutes of the Shareholder(s), 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 and including the authorization of investments as required by 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 Section 628.231, Florida Statutes. Directors serving as of December 31, 2011, were:

Directors

Name and Location	Principal Occupation
Barry Dov Zyskind Rockaway Park, New York	President & CEO AmTrust Financial Services, Inc.
Harry Schlachter Brooklyn, New York	Senior Vice President of Finance & Treasurer AmTrust Financial Services, Inc.
Stephen Barry Ungar Great Neck, New York	General Counsel & Secretary AmTrust Financial Services, Inc.
Donald Thomas DeCarlo Southold, New York	Attorney
Jay Jerome Miller New York, New York	Attorney

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

Senior Officers

Name	Title
Elissa Marie Pacheco	President
Kerry James Heitz	Treasurer
Stephen Barry Ungar	Secretary

The Company's Board appointed several internal committees. Following were the principal internal board committees and their members as of December 31, 2011:

Executive Committee	Audit Committee	Compensation Committee
Barry Zyskind ¹	Abraham Gulkowitz ¹	Donald DeCarlo ¹
Michael Karfunkel	Donald DeCarlo	Michael Karfunkel
George Karfunkel	Jay Miller	Jay Miller

¹ Chairman

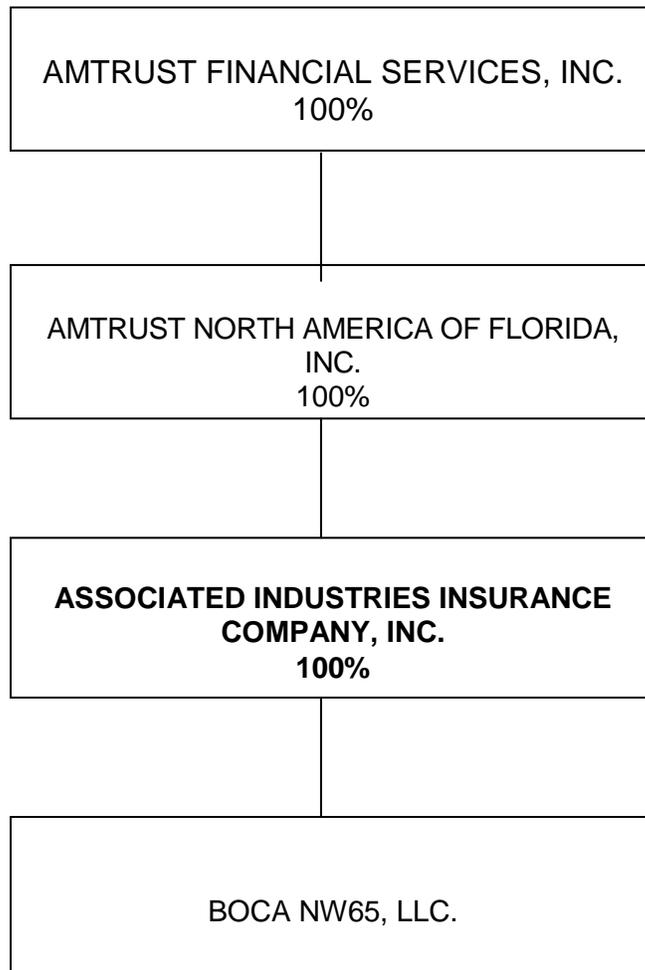
Affiliated Companies

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 February 23, 2012, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2011, reflecting the holding company system, is shown on the following page. Schedule Y of the Company's 2011 annual statement provided a list of all related companies of the holding company group.

**ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.
ORGANIZATIONAL CHART**

DECEMBER 31, 2011



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

Tax Allocation Agreement

The Company, along with its parent, AmTrust Financial Services, Inc., and affiliates, filed a consolidated federal income tax return. On December 31, 2011, the method of allocation between the Company and its parent was based upon separate return calculations with current credit for net losses. Intercompany tax balances are settled annually in the first quarter.

Premium Processing Agreement

The Company entered into an agreement with its parent, AmTrust North America of Florida, Inc. (ANAFI) and AmTrust North America, Inc. (ANA) whereby ANAFI subcontracts to ANA the collection and posting of workers' compensation premium.

Management Agreement

The Company had a management contract with ANAFI at December 31, 2011 whereby ANAFI provided comprehensive management and operational services to the Company. For the services, the Company agreed to pay ANAFI 15% of gross earned premium on a monthly basis. Fees incurred under this agreement during 2011 amounted to \$2,694,534.

Reinsurance Agreement

The Company entered into a quota share reinsurance agreement with Technology Insurance Company and AmTrust International Insurance Ltd. during 2007. Income incurred under this agreement during 2011 amounted to \$14,344,517. The reinsurance recoverable under the agreement was \$38,761,967.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$10,000,000 with a deductible of \$100,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained excess bond coverage with a limit of \$5,000,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

AmTrust Financial Services maintains a 401(k) defined contribution plan that covers substantially all employees and makes discretionary employer contributions on a variable matching basis. The Company has no legal obligation for benefits under these arrangements.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to write workers' compensation insurance in the states of Alabama, Florida, Georgia and Mississippi.

During 2011, the Company applied in every state except Alabama, Florida, Georgia and Mississippi for licenses as a surplus lines insurer. As of December 31, 2011, the Company was eligible to write insurance in 44 states with applications pending in Delaware, Massachusetts and New York.

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

The Company has increased its premium writings within the last year. During the 4th quarter of 2010, the Company acquired an affiliate - Boca NW65, LLC. Boca owns a real estate investment that is being developed for occupancy and production of income by the Company. During 2011, The Company applied in every state except FL, AL, GA, and MS to write surplus lines.

In the past year, the Company's net financial position has increased. The investment strategy of the Company emphasized liquidity and safety of principal while at the same time considering a realization of a reasonable rate of return.

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.

	2011	2010	2009	2008	2007
Premiums Earned	2,246,062	1,554,010	1,477,511	6,049,473	54,260,836
Net Underwriting Gain/(Loss)	9,630,157	7,105,094	14,529,324	12,590,742	(5,443,453)
Net Income	13,546,493	10,988,152	10,973,124	13,507,346	386,335
Total Assets	166,704,004	166,530,613	191,556,926	176,372,523	211,741,603
Total Liabilities	94,669,731	108,139,161	139,921,760	131,305,008	178,501,769
Surplus As Regards Policyholders	72,034,273	58,391,452	51,635,166	45,067,515	33,239,834

LOSS EXPERIENCE

The Company has experienced favorable development of unpaid loss and LAE estimates since the previous exam. Unearned premiums increased due to increased written premiums during the year. The adjusting and other expenses both decreased during the year.

The Company did not book a Premium Deficiency Reserve (PDR) as of year-end 2011. Statement of Statutory Accounting Principle (SSAP) #53 states that “when the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, and any future installments premiums on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency.” Based on an independent analysis performed in consideration of the above guidance, it was determined that a PDR was required as of year-end

2011. For examination purposes, it was recommended that PDR as of December 31, 2011 be adjusted from \$0 to the examination estimate of \$480,000. Due to the immateriality of the balance (did not meet 5% of surplus) an adjustment was not made to the financial statements. However, it is recommended that the Company evaluate the PDR requirement in conjunction with preparing future financial statements.

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 did not assume any reinsurance during the period of this examination.

Ceded

The Company entered into a Quota Share Agreement with Technology Insurance Company and AmTrust International Insurance Ltd. for policies with an effective date of September 1, 2007 and after. Under the terms of the agreement, the Company ceded 90% of subject premium to the two affiliated companies.

The Company was party to several quota share agreements with various reinsurers as of December 31, 2011, which applied to unearned premiums and premiums written during specified periods of time.

The AmTrust companies (Group) purchased excess reinsurance on a group basis to protect against large losses. The Company was covered under the Group's corporate reinsurance coverage for its workers' compensation line of business under excess of loss reinsurance agreements as of December 31, 2011.

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 Boca Raton, Florida.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2007, 2008, 2009, 2010 and 2011 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 and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with SunTrust Bank executed on September 24, 2001. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

Independent Auditor Agreement

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

INFORMATION TECHNOLOGY REPORT

Phillip McMurray, CISA, CISSP 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	USTNTS, 1.75%, 01/31/14	\$ 1,250,000	\$ 1,288,188
FL	USTNTS, 3.625%, 05/15/13	50,000	52,321
FL	USTNTS, 4.5%, 05/15/17	<u>1,250,000</u>	<u>1,482,525</u>
TOTAL FLORIDA DEPOSITS		\$ 2,550,000	\$ 2,823,034
GA	STFDS	\$ 102,547	\$ 102,547
GA	STFDS	<u>21</u>	<u>21</u>
TOTAL OTHER DEPOSITS		<u>\$ 102,568</u>	<u>\$ 102,588</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 2,652,568</u>	<u>\$ 2,925,622</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2011, 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."

ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.
Assets

DECEMBER 31, 2011

	Per Company	Examination Adjustments	Per Examination
Bonds	\$130,496,522		\$130,496,522
Cash and Short-Term Investments	4,342,581		4,342,581
Other investments	9,064,232		9,064,232
Investment income due and accrued	1,620,936		1,620,936
Agents' Balances:			
Uncollected premium	6,477,723		6,477,723
Deferred premium	6,764,521		6,764,521
Accrued retrospective premiums	389,103		389,103
Reinsurance recoverable	6,258,972		6,258,972
Net deferred tax asset	1,289,414		1,289,414
Totals	\$166,704,004	\$0	\$166,704,004

ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.
Liabilities, Surplus and Other Funds

DECEMBER 31, 2011

	Per Company	Examination Adjustments	Per Examination
Losses	\$62,993,254		\$62,993,254
Loss adjustment expenses	10,784,373		10,784,373
Commissions payable	2,074,515		2,074,515
Other expenses	734,945		734,945
Taxes, licenses and fees	348,078		348,078
Current federal and foreign income taxes	2,509,567		2,509,567
Unearned premium	2,097,406		2,097,406
Advance Premiums	158,092		158,092
Ceded reinsurance premiums payable	2,698,557		2,698,557
Funds held under reinsurance treaties	3,759,248		3,759,248
Provision for reinsurance	609,106		609,106
Payable to parent, subsidiaries and affiliates	5,856,319		5,856,319
Aggregate write-ins for liabilities	46,271		46,271
Total Liabilities	\$94,669,731	\$0	\$94,669,731
Common capital stock	\$2,000,000		\$2,000,000
Gross paid in and contributed surplus	7,769,666		7,769,666
Unassigned funds (surplus)	62,264,607		62,264,607
Surplus as regards policyholders	\$72,034,273	\$0	\$72,034,273
Total liabilities, surplus and other funds	\$166,704,004	\$0	\$166,704,004

ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.
Statement of Income

DECEMBER 31, 2011

Underwriting Income

Premiums earned		\$2,246,062
	Deductions:	
Losses incurred		(\$5,917,216)
Loss expenses incurred		(684,190)
Other underwriting expenses incurred		(782,689)
Total underwriting deductions		(\$7,384,095)
Net underwriting gain or (loss)		\$9,630,157

Investment Income

Net investment income earned		\$6,453,412
Net realized capital gains or (losses)		2,410,252
Net investment gain or (loss)		\$8,863,664

Other Income

Net gain or (loss) from agents' or premium balances charged off		(\$501)
Aggregate write-ins for miscellaneous income		38,428
Total other income		\$37,927

Net income before dividends to policyholders and before federal & foreign income taxes		\$18,531,748
Dividends to policyholders		431,905
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$18,099,843
Federal & foreign income taxes		4,553,350
Net Income		\$13,546,493

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$58,391,452
Net Income		\$13,546,493
Change in net unrealized capital losses		(27,783)
Change in net deferred income tax		(1,198,207)
Change in non admitted assets		637,914
Change in provision for reinsurance		(522,948)
Dividends to stockholders		(5,839,145)
Aggregate write-ins for gains and losses in surplus		7,046,497
Examination Adjustment		0
Change in surplus as regards policyholders for the year		\$13,642,821
Surplus as regards policyholders, December 31 current year		\$72,034,273

A comparative analysis of changes in surplus is shown below.

**ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.
Comparative Analysis of Changes in Surplus**

DECEMBER 31, 2011

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, 2011, per Annual Statement \$72,034,273

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS: No Adjustment			
LIABILITIES: No Adjustment			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2011, Per Examination			<u><u>\$72,034,273</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$73,777,627

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, 2011, 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 actuary, Brent Sallay, FCAS, MAAA and Randall Ross, ACAS, MAAA of Taylor Walker & Associates, reviewed the loss and loss adjustment expense work papers provided by the Company and was in concurrence with this opinion.

Capital and Surplus

The amount of Capital and surplus reported by the Company of \$72,034,273, exceeded the minimum of \$8,310,004 required by Section 624.408, Florida Statutes.

SUMMARY OF RECOMMENDATIONS

Premium Deficiency Reserve

We recommend that the Company correctly book a premium deficiency reserve.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Associated Industries Insurance Company, Inc.** as of December 31, 2011, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$72,034,273, which exceeded the minimum of \$8,310,004 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Rachelle Gowins, CFE, Examiner-In-Charge and Neal Rischall, CFE, CPA Participating Examiner, of Examination Resources, LLC. participated in the examination. Other participants in the examination included, Tracy Gates, CISA, CPA, Exam Manager, of Highland Clark, LLC, Brent Sallay, FCAS, MAAA and Randall Ross, ACAS MAAA, consulting actuaries of Taylor Walker & Associates and Vetrecia Smith, MBA, Financial Examiner of the Office.

Respectfully submitted,

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