

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

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

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

## TABLE OF CONTENTS

LETTER OF TRANSMITTAL .....	-
SCOPE OF EXAMINATION .....	1
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION .....	2
HISTORY .....	6
General .....	6
Capital Stock .....	7
Profitability of Company .....	7
Dividends to Stockholders .....	8
Management .....	8
Conflict of Interest Procedure .....	9
Information Technology Evaluation .....	10
Corporate Records .....	10
Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales Through Reinsurance .....	11
Surplus Debentures .....	11
AFFILIATED COMPANIES .....	11
Tax Allocation Agreement .....	11
Administrative Services Management Agreement .....	12
Royalty Agreement .....	12
Maintenance and Management Agreement .....	12
ORGANIZATIONAL CHART .....	13
FIDELITY BOND AND OTHER INSURANCE .....	14
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS .....	14
STATUTORY DEPOSITS .....	14
INSURANCE PRODUCTS AND RELATED PRACTICES .....	15
Territory and Plan of Operation .....	15
Treatment of Policyholders .....	15

REINSURANCE .....	15
Assumed .....	15
Ceded .....	15
 ACCOUNTS AND RECORDS .....	18
Custodial Agreement .....	18
Investment Management Agreement .....	19
Risk-Based Capital .....	19
 FINANCIAL STATEMENTS PER EXAMINATION .....	19
Assets .....	20
Liabilities, Surplus and Other Funds .....	21
Statement of Income .....	22
 COMMENTS ON FINANCIAL STATEMENTS .....	23
Liabilities .....	23
 COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS .....	24
 SUMMARY OF FINDINGS .....	25
 SUBSEQUENT EVENTS .....	26
 CONCLUSION .....	28

Tallahassee, Florida

October 27, 2004

Kevin M. McCarty  
Commissioner  
Office of Insurance Regulation  
State of Florida  
Tallahassee, Florida 32399-0329

Honorable John Oxendine  
Secretary, Southeastern Zone  
NAIC Commissioner  
Georgia Department of Insurance  
2 Martin Luther King, Jr. Drive  
Floyd Memorial Bldg., 704 West Tower  
Atlanta, Georgia 30334

Dear 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 Company (NAIC), we have conducted an examination as of December 31, 2003, of the financial condition and corporate affairs of:

**ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.**  
**901 N. W. 51st STREET**  
**BOCA RATON, FLORIDA 33431**

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, 2000 through December 31, 2003. The Florida Office of Insurance Regulation (Office) last examined the Company as of December 31, 1999. This examination commenced with planning at the Office on July 1, 2004. The fieldwork commenced on July 5, 2004 and was concluded as of October 27, 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 a statutory financial 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, 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.

Reliance was placed on the work papers prepared by Johnson & Lambert CPA. The work papers used concerned legal requests from attorneys for contingent liability confirmations.

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 was 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.

### **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, 1999, along with resulting action taken by the Company in connection therewith.

#### **General and Management**

The Company was not in compliance with its bylaws regarding annual meetings, election of directors and the appointment of officers and establishing an audit committee. The Company did not amend its bylaws as authorized in the July 14, 1999 board resolution. The Company did not file articles of amendment and restated articles of incorporation as authorized in the July 14, 1999 board resolution.

**Resolution: The Company amended its articles of incorporation during 2001. The Company is in compliance with its by-laws regarding annual meetings, establishing an audit committee, election of directors and appointment of officers.**

#### **Audit Committee**

The Company did not maintain an audit committee as required by Section 624.424 (8), FS.

**Resolution: The Company established an audit committee as required by Section 624.424 (8), FS.**

#### **Conflicts of Interest**

The Company's directors and officers had not completed conflict of interest statements for 1999.

**Resolution: All officers and directors listed on the Jurat page of the Annual Statement had signed the conflict of interest statements for 2003.**

#### **Corporate Records**

There was no documentation in the minutes reviewed that the Company's directors reviewed the previous examination report.

**Resolution: The report was reviewed by the Board of Directors in June of 2001.**

#### **Maintenance and Management Agreement**

The Company did not amend this agreement to reflect the changes of its name and address that occurred subsequent to the agreement's effective date of January 1, 1993.

**Resolution: The Company amended the agreement to reflect the changes in its name and address.**

#### **Commercial Lease Agreement**

The draft of a commercial lease with an affiliated company, Associated Industries of Florida Service Corporation (AIFSC), reflected the Company's former name.

**Resolution: The Company properly executed the commercial lease agreement.**

#### **Organizational Chart**

The Company did not include all affiliated companies on Schedule Y of the 1999 annual statement.

**Resolution: The Company included all affiliated companies on Schedule Y on subsequent quarterly and annual statement filings.**

#### **Accounts and Records**

The Company's warranty deeds for real estate, tax assessments, and lease agreements reflected the Company's former name and address for the year ending 1999.

**Resolution: The Company updated warranty deeds, tax assessments, and lease agreements to reflect its current name.**

The Company did not have a claims recovery system in place at year-end 1999 that handled the various types of recoverable including deductibles. The effect on loss reserves was discussed



with the Office actuary and it was determined that the amounts were not material as of December 31, 1999.

**Resolution:** Company management stated that enhancements regarding claims recoveries to its system were included in its long-range technology plans. Additionally, they stated that the long-range technology plan is continually monitored and updated, with priorities assigned to the enhancements as requested.

The Company did not establish accruals due in 1999 for all contingent commissions and for other expenses due but not invoiced.

**Resolution:** The Company established proper expense accruals for annual and quarterly statement filings subsequent to the exam date of December 31, 1999.

The Company reported the state income tax accrual as federal income taxes due and accrued rather than as taxes, licenses and fees.

**Resolution:** The Company subsequently correctly and accurately reported the state income tax accrual as taxes, licenses and fees.

### **Custodial Agreements**

The Company's custodial agreement with SunTrust Bank did not contain all of the required clauses as stated in Rule 690-143.042, FAC.

**Resolution: The Company amended its custodial agreement with SunTrust Bank to meet the requirements of Rule 690-143.042, FAC.**

### **Standard Building Lease**

The Company did not amend the lease agreement to reflect a change in the tenant's name.

**Resolution: The Company amended its lease agreement to correctly state the name of its tenant.**

## **HISTORY**

### **General**

The Company, formerly called Associated Industries of Florida Property and Casualty Trust, was incorporated October 3, 1953, under the laws of the State of Florida. The Company, a non-assessable stock insurer, was authorized to write workers' compensation insurance in the states of Florida, Georgia, Mississippi and Alabama. The Company was a member of a holding company system and was a wholly owned subsidiary of Associated Industries Insurance Services, Inc. (AIIS) which was licensed as the managing general agent. Until 1999, 100% of AIIS was held and voted in a trust. Under a consent order approved on June 30, 1999, AIIS entered into an arrangement with Overseas Partners Re Ltd. (OPRe), an offshore reinsurer, in which OPRé acquired 22% of the stock of AIIS.

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

## **Capital Stock**

As of December 31, 2003, 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

The Company was 100 percent owned by AIIS, who in turn, was owned by Associated Industries of Florida Holding Trust (AIFHT), OPRé and members of the Company's Board of Directors and Management.

## **Profitability of Company**

As of December 31, 2003, the Company reported an underwriting loss and net loss of \$13,889,827 and \$9,691,002, respectively.

The Company's surplus for 2000, 2001, 2002, and 2003 was \$28,912,667, \$33,948,976, \$36,113,457, and \$23,504,379 respectively.

With the decrease in surplus, the Company was not in compliance with both statutory writing ratios and risk-based capital ratios as of December 31, 2003. The computed writing ratios for Gross and Net Written Premiums exceeded those allowed by Florida Statute. The ratios were 11.13 for gross written premium, and 4.64 for net written premium. Florida Statute allows a ratio of, 10 to 1 and 4 to 1 maximum, respectively. The Company is not in compliance with Section 624.4095, FS.

The Company significantly restructured its operations in 2004, by reducing its anticipated direct premium volume from a level of over \$200 million in 2003 to a projected amount of

approximately \$110 million in 2004. The Company anticipated that this reduction in writings would allow the Company to be in compliance with its statutory writing ratios for calendar year 2004. Pursuant to the annual statement for calendar year 2004, the Company was in compliance with the statutory writing ratios for calendar year 2004.

### **Dividends to Stockholders**

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

### **Management**

The annual shareholder 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**

<b>Name and Location</b>	<b>Principal Occupation</b>
Robert William West Tallahassee, Florida	Chairman, AIIS & the Company Bob West & Associates
Tine Wayne Davis Jacksonville, Florida	Vice Chairman - Operations, AIIS & the Company, Winn-Dixie Stores, Inc.
Guy Maxwell Spearman, III Cocoa, Florida	Vice Chairman - Finance, AIIS & the Company, Spearman Management, Inc.
Jon Lester Shebel Boca Raton, Florida	President & Chief Executive Officer of Associated Industries of Florida, Inc., AIFSC, AIIS, & the Company
Frank Thomas White Boca Raton, Florida	Executive Vice President & Chief Actuary, the Company
Michael Zagorac, Jr. Belleair, Florida	Senior Management Director—Public Affairs, Hill & Knowlton, Inc.

In accordance with the Company's bylaws, the board of directors appointed the following senior officers:

#### **Senior Officers**

<b>Name</b>	<b>Title</b>
Jon Lester Shebel	President & Secretary
Daniel Joseph McGarvey	Treasurer

The Company's board of directors did not appoint internal committees in accordance with Section 607.0825, FS. However, it had established an audit committee in accordance with Section 624.424(8), FS. The following are members of the audit committee as of December 31, 2003:

#### **Audit Committee**

Guy Spearman, Chairman  
T. Wayne Davis, Director  
Frank White, Director (until July 2004)  
Michael Zagorac, Director

**Subsequent Event:** In July 2004, the Company established an Executive Committee and a Compensation Committee. The board of directors elected directors to serve on these two committees as well as the Audit Committee.

#### **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.

## **Information Technology (IT) Evaluation**

The IT part of the financial examination was performed by Computer Aid, Inc. Comments from their evaluation are outlined below.

- To complete the disaster recovery plan for restoring computer systems and services, the Company should move backup tapes off-site.
- No internal audit function exists within the Company and no external independent IT audits have been conducted.
- The IT Department should review the job descriptions that have not been updated for several years.
- Provisions of the System Development Life Cycle (SDLC) not currently in place should be implemented. The initial focus should be on documentation standards and maintenance processes.
- A project team should be initiated to identify minimum documentation standards and review current documentation.
- Establish a budget to continue with previous security planning which included the installation of a network Intrusion Detection and Prevention System. Initial installation was postponed for budgetary reasons.
- The Company should consider using automated tools for managing and monitoring the network.

## **Corporate Records**

The recorded minutes of the shareholder, board of directors, and committee meetings were reviewed for the period under examination. The recorded minutes of the board of directors 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, and purchase or sales through reinsurance.

## **Surplus Debentures**

The Company had no surplus debentures at December 31, 2003.

## **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 August 3, 2003, as required by Section 628.801, FS, and Rule 690-143.046, FAC.

On December 31, 2003, the following agreements were in effect between the Company and its affiliates:

## **Tax Allocation Agreement**

The Company, along with its parent, filed a consolidated federal income tax return. As of December 31, 2003, the method of allocation between the Company and its parent was based upon a separate return calculation. An inter-company tax balance was established and was to be settled upon completion of the final consolidated federal income tax return.

**Administrative Services Management Agreement**

On January 1, 1998 the Company entered into an administrative services management agreement with its parent, AIIS. AIIS provided managerial and support services including underwriting, claims processing, premium collection, claims settlement, accounting, record keeping, investment management and maintenance of the computer system and other hardware. The agreement provided for the Company to pay 15% of the gross earned premium to AIIS on a monthly basis. Also, under this agreement, AIIS assumed the Company's liability relating to unallocated loss adjustment expenses. The Company compensated AIIS by paying 1½% of the Company's gross earned premium revenues on a monthly basis.

**Royalty Agreement**

On January 1, 1997, the Company entered into a royalty agreement with Associated Industries of Florida, Inc. (AIF) for the use of its name and logo. Royalties were calculated based on 1% of gross written premiums.

**Maintenance and Management Agreement**

On January 1, 1993, the Company entered into a maintenance and management agreement with AIFSC for maintenance and janitorial services, and also building management services for the building owned in Tallahassee, Florida.

**Commercial Lease Agreement**

On March 1, 1995, the Company entered into a commercial lease agreement with its affiliate, AIFSC, and leased a portion of its investment in real estate. The Company received rental income based on the terms of the lease.

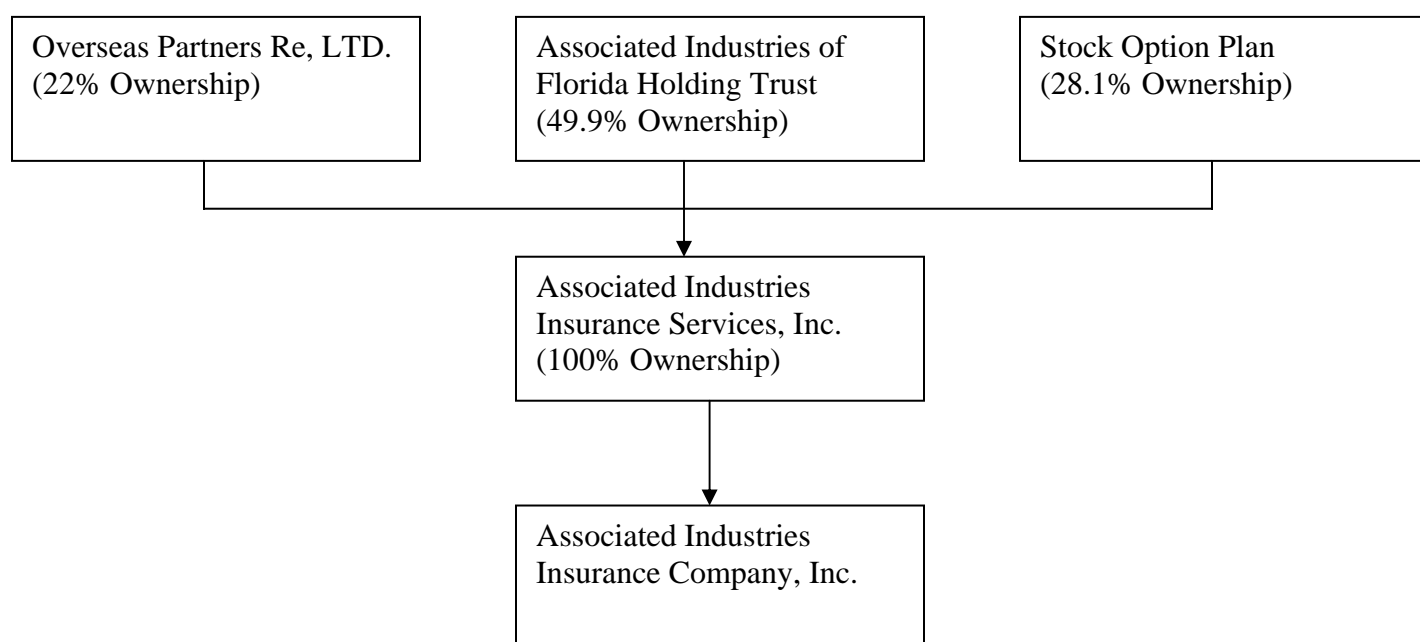


A simplified organizational chart as of December 31, 2003, reflecting the holding company system is shown below. Schedule Y of the Company's 2003, annual statement provided a list of all related companies of the holding company group.

**ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.**

**ORGANIZATIONAL CHART**

**DECEMBER 31, 2003**



## FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$2,000,000 with a deductible of \$25,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC. The Company maintained other insurance coverage usual to the operation of an insurer.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no employees.

## 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	USTN, 6.50%, 10/15/06	\$ 750,000	\$ 767,110
FL	USTN, 6.250%, 2/15/07	50,000	55,735
FL	USTN, 7.250%, 5/15/04	750,000	835,313
FL	USTN, 5.875% 11/15/05	<u>500,000</u>	<u>537,970</u>
TOTAL FLORIDA DEPOSITS		\$2,050,000	\$2,196,138
FL	USTN, 4.875%, 02/15/12 (held for the U.S. Department of Labor)	\$ 600,000	\$ 635,438
GA	USTN, 5.875%, 11/15/05	<u>100,000</u>	<u>107,594</u>
TOTAL OTHER DEPOSITS		\$ 700,000	\$ 743,032
TOTAL SPECIAL DEPOSITS		<u><u>\$2,750,000</u></u>	<u><u>\$2,939,170</u></u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

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

At December 31, 2003, the Company was authorized to transact insurance in the following states, in accordance with Section 624.401(2), FS:

Alabama  
Florida  
Georgia  
Mississippi

### **Treatment of Policyholders**

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS. The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim.

## **REINSURANCE**

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

### **Assumed**

During 2003, the Company did not assume risk.

**Quota Share Agreement**

The Company ceded \$105,444,148 of written premiums to various reinsurers on a modified 55% quota share basis, which covered all business written during 2003. The participants on this treaty were Imagine Insurance Company Limited (27.50% of the 55% quota share agreement); New Jersey Re-Insurance Company (4.95%) and PMA Capital Insurance Company (22.55%).

**Excess of Loss Agreement**

The Company ceded earned premiums on an excess of loss basis to various reinsurers. For policies with an effective date of December 31, 2002 and prior, the Company ceded 5% of earned premiums on an excess of loss basis to American Home Assurance Company. For policies with an effective date of January 1, 2003 and after, the Company ceded 7.307% of earned premiums on an excess of loss basis to various reinsurers. The lead reinsurers on this program were PMA Capital Insurance Company and MIC Property and Casualty Insurance Corporation. The Company utilized a reinsurance intermediary, JLT Re Solutions, Inc. for their reinsurance arrangement.

**Loss Portfolio Transfer with OPRé**

During 1996, the Company ceded to OPRé its entire liability for losses and loss adjustments expenses as of December 31, 1995 totaling \$78,288,028, excluding one discounted disability claim. OPRé was an unrelated party in 1996. The Company paid \$60,777,000 for the agreement. The Company transferred retroactive gains to special surplus when the cash recoveries from OPRé exceeded the consideration paid by the Company. The loss portfolio transfer agreement with OPRé was commuted during 2003 at actuarially determined values and the commutation of this agreement was approved by the Office.

### **Commutation of Excess of Loss Treaties during 2003**

During 2003, the Company commuted several ceded excess of loss reinsurance treaties with Lloyd's Syndicates at actuarially determined values. The treaties covered losses that occurred during the time period October 1, 1993 through December 31, 1994 and January 1, 1995 through December 31, 1995.

### **Commutation of Quota Share Treaties during 2003**

During 2003, the Company commuted several ceded quota share reinsurance treaties with OPRé at actuarially determined values. The treaties covered losses that occurred during the time period January 1, 1996 through December 31, 1997, January 1, 1998 through March 31, 1999, April 1, 1999 through December 31, 2000 and January 1, 2001 through December 31, 2001.

All of the reinsurers were authorized with the exception of Imagine Insurance Company Limited and Renaissance Reinsurance Ltd. The Imagine quota share agreement was secured with three irrevocable evergreen letters of credit totaling \$35,403,000. The Company had no amounts recoverable from Renaissance Reinsurance.

### **Other Retroactive Reinsurance (Loss Portfolio Transfer)**

Effective December 31, 2003, the Company entered into a retroactive reinsurance agreement with Eagle & Crown Limited through a reinsurance broker. Under this agreement, the reinsurer assumed certain liabilities of the Company related to nine claims that occurred in 1993-1994.

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

Rudmose & Noller Advisors, LLC were contracted by the Office to analyze the 2002 and 2003 reinsurance agreements for transfer of risk. The agreements were deemed to provide transfer of risk in accordance with NAIC guidelines.

## **ACCOUNTS AND RECORDS**

An independent CPA audited the Company's statutory basis financial statements annually for the years 2000, 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.

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

The Company and non-affiliates had the following agreements:

### **Custodial Agreement**

The Company amended its custodial agreement with SunTrust Bank on September 23, 2001. The amended agreement met the requirements of Rule 69O-143.042, FAC.

**Investment Management Agreement**

On August 14, 2001, the Company entered into an asset management agreement with Conning Asset Management Company, Inc. for investment advice, portfolio management, and investment accounting and reporting services for an annual fee, paid quarterly in arrears. The annual fees payable by the Company were calculated on the basis points assessed to asset value at the close of the billing period, subject to a quarterly minimum fee of \$18,750.

**Risk-Based Capital (RBC)**

The Company's calculated RBC was 1.29, which was less than the 2.0 minimum required by Section 624.4085, FS. The Company filed an RBC plan with the OIR.

**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."

# ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.

## Assets

DECEMBER 31, 2003

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$117,147,887		\$117,147,887
Stocks:			
Common	2,214,472		2,214,472
Real Estate:			
Properties held for sale	1,490,348		1,490,348
Cash:			
On deposit	22,637,243		22,637,243
Short-term investments	4,094,164		4,094,164
Other investments	1,340,909		1,340,909
Investment income due and accrued	1,256,728		1,256,728
Agents' Balances:			
Uncollected premium	70,979		70,979
Deferred premium	92,406,556		92,406,556
Accrued retroactive premiums	3,401,519		3,401,519
Reinsurance recoverable	15,807,374		15,807,374
Federal income tax recoverable	1,685,507		1,685,507
Net deferred tax asset	2,404,098		2,404,098
Totals	\$265,957,784	\$0	\$265,957,784



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

**DECEMBER 31, 2003**

<b>Liabilities</b>	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Losses	\$94,274,291		\$94,274,291
Loss adjustment expenses	28,766,562	2,100,000	30,866,562
Commissions payable, contingent commissions	2,634,670		2,634,670
Other expenses	9,341,764		9,341,764
Taxes, licenses and fees	4,492,913		4,492,913
Unearned premium	31,134,359		31,134,359
Advance premiums	5,026,150		5,026,150
Ceded reinsurance premiums payable	11,766,602		11,766,602
Provision for reinsurance	40,805		40,805
Aggregate write-ins for liabilities	54,975,289		54,975,289
<b>Total Liabilities</b>	<b>\$242,453,405</b>	<b>2,100,000</b>	<b>244,553,405</b>
Common capital stock	\$2,000,000		\$2,000,000
Gross paid in and contributed surplus	7,769,666		7,769,666
Aggregate write-ins for special surplus funds	750,000		750,000
Unassigned funds (surplus)	12,984,713	(2,100,000)	10,884,713
Surplus as regards policyholders	\$23,504,379	(2,100,000)	21,404,379
<b>Total liabilities, capital and surplus</b>	<b>\$265,957,784</b>	<b>\$0</b>	<b>\$265,957,784</b>

**ASSOCIATED INDUSTRIES INSURANCE COMPANY, INC.**  
**Statement of Income**

**DECEMBER 31, 2003**

**Underwriting Income**

Premiums earned	\$87,379,585
DEDUCTIONS:	
Losses incurred	46,728,898
Loss expenses incurred	17,594,290
Other underwriting expenses incurred	36,946,224
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$101,269,412</u>
Net underwriting gain or (loss)	(\$13,889,827)

**Investment Income**

Net investment income earned	\$4,306,093
Net realized capital gains or (losses)	328,964
Net investment gain or (loss)	<u>\$4,635,057</u>

**Other Income**

Net gain or (loss) from agents' or premium balances charged off	(\$1,248,420)
Finance and service charges not included in premiums	0
Aggregate write-ins for miscellaneous income	489,455
Total other income	<u>(\$758,965)</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$10,013,735)
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$10,013,735)
Federal & foreign income taxes	<u>(322,733)</u>
Net Income	(\$9,691,002)

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year	\$36,113,457
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**Gains and (Losses) in Surplus**

Net Income	(\$9,691,002)
Change in net unrealized capital gains or losses	213,939
Change in non-admitted assets	(7,108,018)
Change in provision for reinsurance	142,033
Change in deferred income tax	3,833,970
Examination Adjustment	(2,100,000)
Change in surplus as regards policyholders for the year	<u>(\$14,709,078)</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$21,404,379</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

<b>Losses and Loss Adjustment Expenses</b>	<b><u>\$125,140,853</u></b>
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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, 2003 make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office Actuary has performed an actuarial analysis on the Company's loss and LAE reserve. The Office Actuary's conclusion shows a deficit of \$2,100,000 in the adjusting and other reserve to that reported by the Company on its 2003 Annual Statement. The outside actuarial firm used a claim count run-off method to compute its adjusting and other reserve and concluded the aforementioned reserves should be \$1,950,000 higher than reported by the Company in the 2003 annual statement.

Subsequent event: The Office Actuary performed an actuarial analysis on the Company's loss and LAE reserves as of December 31, 2004 and found a redundancy developed in the loss reserves and the defense and cost containment reserves that was sufficient to offset the deficiency in the adjusting and other reserves. As such, the Company's reserves were reasonably stated in total as of December 31, 2004.

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

**DECEMBER 31, 2003**

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 per December 31, 2003, Annual Statement	\$23,504,379
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
<b>ASSETS:</b>			
No adjustment necessary.			
<b>LIABILITIES:</b>			
Loss Adjustment Expenses	\$28,766,562	30,866,562	(2,100,000)

Net Change in Surplus:	<u>(2,100,000)</u>
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Surplus as Regards Policyholders December 31, 2003, Per Examination	<u><u>\$21,404,379</u></u>
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## **SUMMARY OF FINDINGS**

### **Compliance with previous directives**

The Company has taken the necessary actions to comply with the comments made in the 1999 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.

### **LAE Reserve**

The Company had a deficit of \$2,100,000 in its adjusting and other reserves as of December 31, 2003. **It is recommended that the Company utilize an actuarially accepted method to calculate the adjusting and other reserves in all future annual and quarterly statement filings.**

### **Profitability**

The Company's gross and net premium writing ratios were in excess of the ratios allowed by Section 624.4095, FS. **It is recommended that the Company bring its writing ratios down to the required levels of 10:1 for gross premiums and 4:1 for net premiums. Pursuant to the annual statement for 2004, the Company was in compliance with the gross and net writing ratios of Section 624.4095, FS.**

## **Risk Based Capital**

The Company's RBC level was less than the level allowed by Section 624.4085, FS. The Company filed a plan with the Office to address the RBC level. **It is recommended that the Company increase its RBC level above the 2.0 minimum level required.**

## **IT Evaluation**

The Company had the following exceptions regarding the IT evaluation. **It is recommended that the Company respond to these exceptions in writing within 90 days of receiving this report.**

- The Company was not storing back-up tapes of data off-site.
- No internal audit function existed within the Company.
- The IT Department should update job descriptions.
- Implement the planned provisions of the SDLC.
- Establish a project team to identify minimum documentation standards and review current documentation.
- Establish a plan and budget for the installation of a network IDPS.
- Consider using automated tools to manage and monitor its network.

## **SUBSEQUENT EVENTS**

The Company submitted to the Office a plan to bring its RBC level and writing ratios to satisfactory levels.

The Company responded to the exceptions noted in the IT evaluation as performed by Computer Aid, Inc.

- Offsite backup storage will be evaluated in conjunction with continued on-site storage in a fireproof safe.
- The IT strategic plan will be updated to align with overall corporate business strategy. Management will review the recommendations to consider implementing an internal audit function or obtaining independent review of the IT department.
- All job descriptions will be reviewed and updated to reflect current responsibilities and duties.
- AIIIS marketing representatives will be encouraged to continue informal satisfaction surveys with agents to obtain feedback on potential system modifications. The SDLC documentation will be reviewed and additional emphasis placed on documentation standards and maintenance.
- Minimum documentation standards will be identified and a review of current documentation conducted. Documentation found to be below the standard would be updated.
- The 2005 capital budget includes funds for the implementation of IDPS in the upcoming budget year.
- Management will review the implementation of a privacy policy to be placed on both web sites. As future phases of the APPS system are implemented adequate security measures will be implemented.

## **CONCLUSION**

The customary 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, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$21,404,379, which was in compliance with Section 624.408, FS; however, the Company's RBC was below the minimum required by Section 624.4085, F.S.

In addition to the undersigned, Joe Boor, FCAS, Actuary, and Computer Aid, Inc., participated in the examination.

Respectfully submitted,

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James D. Collins  
Financial Examiner/Analyst II  
Florida Office of Insurance Regulation

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Michael Hampton, CPA, CFE, DABFA, CFE, CPM  
Financial Examiner/Analyst Supervisor  
Florida Office of Insurance Regulation



