

REPORT ON EXAMINATION
OF
CAPACITY INSURANCE COMPANY
SUNRISE, FLORIDA

AS OF
DECEMBER 31, 2011

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION	1
SUMMARY OF SIGNIFICANT FINDINGS	2
CURRENT EXAM FINDINGS.....	2
PRIOR EXAM FINDINGS.....	2
HISTORY	2
GENERAL	2
DIVIDENDS TO STOCKHOLDERS.....	3
CAPITAL STOCK AND CAPITAL CONTRIBUTIONS.....	3
SURPLUS DEBENTURES.....	4
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASE OR SALES THROUGH REINSURANCE	4
CORPORATE RECORDS	4
CONFLICT OF INTEREST.....	4
MANAGEMENT AND CONTROL	5
MANAGEMENT	5
AFFILIATED COMPANIES	6
ORGANIZATIONAL CHART	7
TAX ALLOCATION AGREEMENT.....	8
CLAIMS SERVICING AGREEMENT	8
MANAGING GENERAL AGENCY AGREEMENT	8
MANAGEMENT SERVICES AGREEMENT	9
FIDELITY BOND AND OTHER INSURANCE	9
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS	10
TERRITORY AND PLAN OF OPERATIONS	10
TREATMENT OF POLICYHOLDERS	10
COMPANY GROWTH	10
PROFITABILITY OF COMPANY	11
LOSS EXPERIENCE	11
REINSURANCE	11
CEDED	12
ACCOUNTS AND RECORDS	12
CUSTODIAL AGREEMENT	13
INDEPENDENT AUDITOR AGREEMENT	13
INFORMATION TECHNOLOGY REPORT	13
STATUTORY DEPOSITS	13
FINANCIAL STATEMENTS PER EXAMINATION	14

ASSETS	15
LIABILITIES, SURPLUS AND OTHER FUNDS	16
STATEMENT OF INCOME	17
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS	18
COMMENTS ON FINANCIAL STATEMENTS.....	19
CAPITAL AND SURPLUS	19
CONCLUSION.....	20

August 17, 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, 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, 2011, of the financial condition and corporate affairs of:

**CAPACITY INSURANCE COMPANY
1300 SAWGRASS CORPORATE PARKWAY
SUNRISE, FL 33323-2804**

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 26, 2012, to March 30, 2012. The fieldwork commenced on April 9, 2012, and concluded as of August 17, 2012.

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

There were no material findings or exceptions noted during the examination as of December 31, 2011.

Prior Exam Findings

The Company's Audit Committee was comprised of management which is not independent in violation of Section 624.424(8) (c), Florida Statutes. Resolution: The Audit Committee members were replaced with independent members.

There were no other findings, exceptions or corrective action to be taken by the Company for the examination as of December 31, 2006.

HISTORY

General

The Company was incorporated in Florida on April 23, 1986, and commenced business on February 16, 1989, as Capacity Insurance Company.

The Company was authorized to transact insurance coverage in Florida on February 16, 1989 in the lines of business of Commercial multi peril, Other Liability, Inland marine, Glass, Burglary & theft, Fire and Allied Lines. In addition, the Company was authorized to transact insurance coverage on November 12, 1991 in the lines of business of Commercial automobile liability and Commercial auto physical damage. The Company continued to be authorized in all of the lines of business as of December 31, 2011.

The Articles of Incorporation and the Bylaws were amended during the period covered by this examination on June 30, 2009 due to the acquisition of the Company by Focus Holdings, LLC.

On July 2, 2009, Frances Buto, the sole owner of Capacity Insurance Company sold all of the issued and outstanding stock in the Company to Focus Holdings, LLC, pursuant to Consent Order 104205-09-CO. On August 23, 2011 the Office granted a waiver pursuant to Section 628.461(2), Florida Statutes, of an application filing for the transfer of the Company's outstanding shares from Focus Holdings, LLC to Focus Insurance Corp.

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, 2011, the Company's capitalization was as follows:

Number of authorized common capital shares	750,000
Number of shares issued and outstanding	750,000
Total common capital stock	\$750,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, Focus Insurance Corp, who owned 100% of the stock issued by the Company, and who in turn was 100% owned by Focus Holdings, LLC.

The parent (Focus Insurance Corp.) contributed \$1,550,000 in cash to the Company in 2011.

Surplus Debentures

The Company obtained no additional surplus debentures during the examination period. The Company repaid the existing \$2,300,000 surplus debenture during the 2009 fiscal year.

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

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

CORPORATE RECORDS

The recorded minutes of the Shareholders, 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 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
Douglas W. Bullington Sunrise, Florida	CEO, Capacity Insurance Company
Kevin M. Tromer Sunrise, Florida	President, Capacity Insurance Company
James W. Blake, Jr. Sunrise, Florida	CFO, Capacity Insurance Company
Thomas B. Rogan, Sr. Sunrise, Florida	Industry Consultant
Amy Galloway Fort Lauderdale, Florida	Attorney, Tripp Scott, P.A.
Ronald S. Terzer Sunrise, Florida	SVP, Capacity Insurance Company

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

Senior Officers

Name	Title
Douglas W. Bullington	CEO
Kevin M. Tromer	President
James W. Blake, Jr.	Treasurer/CFO
Michael A. Steinman	Executive Vice President/COO
Ronald S. Terzer	Secretary/Senior Vice President
Orion S. Whitlock	Senior Vice President
Will K. Brauer	Senior Vice President

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

Audit Committee

Ronald Terzer¹
Amy Galloway
Thomas Rogan

Investment Committee

James Blake¹
Douglas Bullington
Kevin Tromer

¹ Chairman

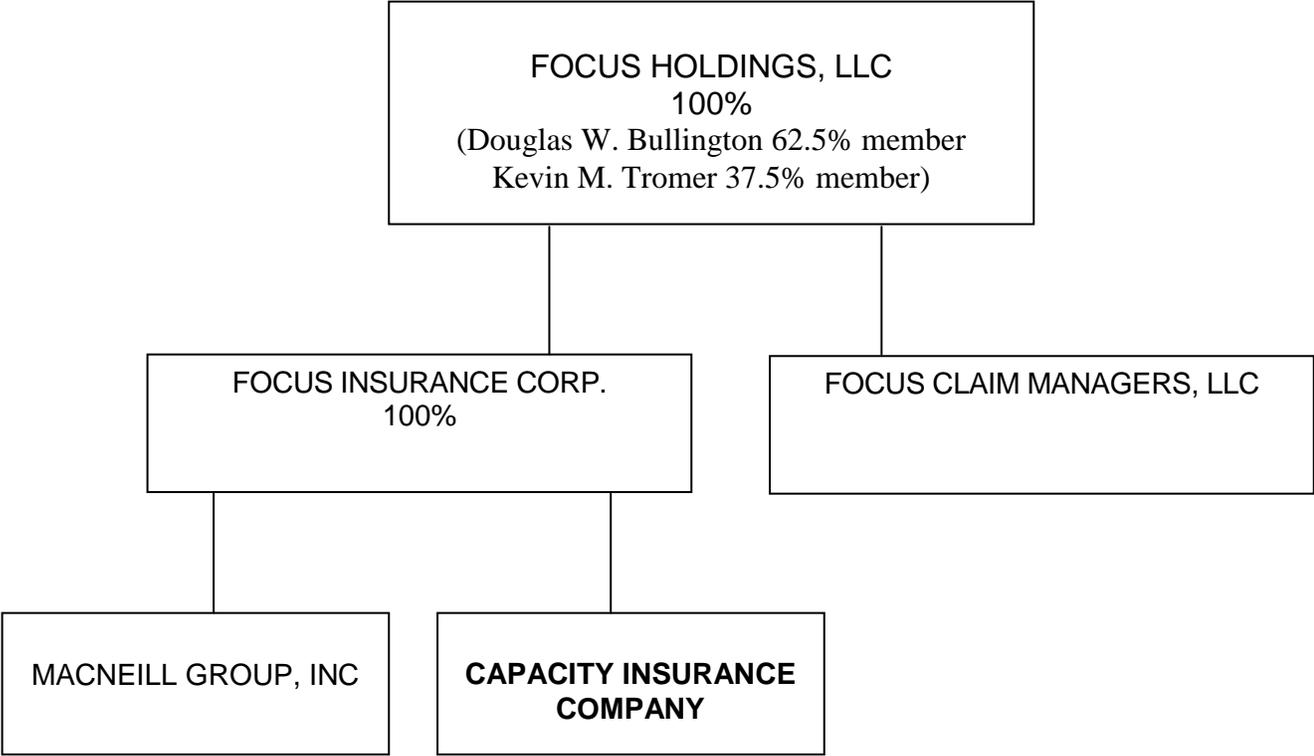
Affiliated Companies

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 July 3, 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.

**CAPACITY INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2011



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

Tax Allocation Agreement

The Company filed a consolidated federal income tax return with MacNeill Group, Inc. and Focus Insurance Corp. On December 31, 2011, the method of allocation between the Company and its parent and affiliate was on a separate entity basis.

Claims Servicing Agreement

The Company entered into a claims administration services agreement with Focus Claim Managers, LLC effective July 1, 2009. The agreement was for an initial 36 month period and shall be automatically renewed and extended for an indefinite number of successive one-year periods. Focus Claim Managers, LLC had the authority to fully investigate, evaluate, handle, adjust and settle each claim reported according to applicable state law. The Company paid claim servicing fees based on earned premiums and ranged from 3.5% - 4.0% depending on the number of policies in-force. The Company also paid 20.0% of all subrogation and salvage amounts recovered by Focus Claim Managers, LLC.

Managing General Agency Agreement

The Company entered into a managing general agency agreement with MacNeill Group, Inc (MGA) on July 1, 2009. The agreement was for an initial period of three years and is renewable for an additional three year period commencing after the initial three year period has expired. The MGA had the authority to accept applications to issue policies received through licensed insurance agents. The MGA also bears the sole responsibility to oversee the placement of business through agents. The MGA also had the authority to enter into agreements with premium finance companies. The MGA is also responsible for negotiating reinsurance on behalf

of the Company. The MGA was to receive 25% or less of the Company's monthly direct written premium as commission for services. The MGA was also eligible to receive 5% of the Company's pre-tax statutory earning for each calendar year as a profit sharing payment. This profit sharing payment was at the sole discretion of the Company.

Management Services Agreement

The Company entered into a management services agreement with Focus Holdings, LLC as of July 1, 2009. This agreement was in effect for an indefinite number of successive one-year periods until terminated by written notice by either party. Focus Holdings, LLC provided the following services for the Company: corporate organization, accounting and tax services, corporate management services, human resource services, corporate expense oversight and use of information systems. Focus Holdings, LLC received 1.5% of the Company's direct written premium on a monthly basis.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$1,050,000 with a deductible of \$50,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained Directors and Officers liability insurance coverage with a limit of \$5,000,000 and a deductible of \$50,000 and Errors and Omissions liability coverage with a limit of \$1,000,000 and a deductible of \$35,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The parent company, Focus Holdings, LLC, offered a 401 (k) plan that eligible employees of the Company were able to participate in.

TERRITORY AND PLAN OF OPERATIONS

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

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 was acquired by Focus Holdings, LLC in July of 2009 at which time the business objectives of the Company changed. The Company began writing more commercial liability policies and less co-habitational policies which reduced the Company's reinsurance costs and improved the Company's loss ratios and operating results.

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	1,814,424	724,484	2,057,798	2,647,500	3,197,459
Net Underwriting Gain/(Loss)	(1,294,462)	(1,887,650)	(904,081)	(510,280)	54
Net Income	(1,064,444)	(1,539,882)	(374,915)	(230,696)	129,916
Total Assets	13,467,864	7,883,428	8,543,135	10,006,482	10,709,055
Total Liabilities	7,443,040	2,652,129	3,167,424	4,960,105	5,326,582
Surplus As Regards Policyholders	6,024,825	5,231,299	5,375,711	5,046,377	5,382,473

LOSS EXPERIENCE

During the current examination period, the Company experienced adverse development related to sinkhole claims in the amounts of \$2,152,092 and \$3,754,084 for accident years 2008 and 2010, respectively. Lastly, the most significant uncertainty with regard to losses relates to the 2005 accident year. The Company experienced paid losses of approximately \$581,000 in 2011 related to the 2005 accident year.

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.

Ceded

The Company had a total of \$17.4 million of reinsurance coverage through its reinsurance program as of the examination date. The Company participated in the Florida Hurricane Catastrophe Fund ("FHCF") which provided 90% coverage for up to \$1.15 million of losses above \$449,000. The Company also had a Temporary Increase in Coverage Limits layer which provided coverage of 90% of \$406,000 excess of \$1.6 million. The Company had three additional layers of reinsurance which were as follows: \$2 million excess of \$500,000, \$4.50 million excess of \$2.5 million and \$9 million excess of \$7 million. The Company retained \$449,000 of risk per event.

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 Sunrise, 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 electronically.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with Morgan Stanley Trust executed on October 8, 2010. 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

InsFocus, LLC 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	DFS Stat Deposit Fund 2.072%	<u>\$ 300,000</u>	<u>\$ 300,000</u>
TOTAL FLORIDA DEPOSITS		\$ 300,000	\$ 300,000
TOTAL OTHER DEPOSITS		<u>\$ 0</u>	<u>\$ 0</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 300,000</u>	<u>\$ 300,000</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."

CAPACITY INSURANCE COMPANY

Assets

DECEMBER 31, 2011

	Per Company	Examination Adjustments	Per Examination
Bonds	\$8,640,824		\$8,640,824
Stocks:			
Common	233,635		233,635
Cash and Short-Term Investments	3,113,345		3,113,345
Agents' Balances:			
Uncollected premium	566,861		566,861
Reinsurance recoverable	104,124		104,124
Interest and dividend income due & accrued	75,865		75,865
Net deferred tax asset	726,010		726,010
Aggregate write-in for other than invested assets	7,200		7,200
	<hr/>		
Totals	<u>\$13,467,864</u>	<u>\$0</u>	<u>\$13,467,864</u>

CAPACITY INSURANCE COMPANY

Liabilities, Surplus and Other Funds

DECEMBER 31, 2011

	Per Company	Examination Adjustments	Per Examination
Losses	\$2,178,841		\$2,178,841
Loss adjustment expenses	339,220		339,220
Other expenses	28,701		28,701
Taxes, licenses and fees	62,206		62,206
Unearned premium	3,733,744		3,733,744
Ceded reinsurance premium payable	369,874		369,874
Funds held under reinsurance treaties	584,972		584,972
Amounts withheld	90,805		90,805
Payable to parent, subsidiaries and affiliates	54,676		54,676
Total Liabilities	<u>\$7,443,040</u>	<u>\$0</u>	<u>\$7,443,040</u>
Common capital stock	\$750,000		\$750,000
Gross paid in and contributed surplus	7,664,800		7,664,800
Unassigned funds (surplus)	(2,815,344)		(2,815,344)
Aggregate write-ins for special surplus	425,369		425,369
Surplus as regards policyholders	<u>\$6,024,825</u>	<u>\$0</u>	<u>\$6,024,825</u>
Total liabilities, surplus and other funds	<u><u>\$13,467,864</u></u>	<u><u>\$0</u></u>	<u><u>\$13,467,864</u></u>

CAPACITY INSURANCE COMPANY

Statement of Income

DECEMBER 31, 2011

Underwriting Income

Premiums earned		\$1,814,424
	Deductions:	
Losses incurred		\$526,723
Loss expenses incurred		530,418
Other underwriting expenses incurred		2,051,744
Total underwriting deductions		<u>\$3,108,886</u>
Net underwriting gain or (loss)		(\$1,294,462)

Investment Income

Net investment income earned		\$108,055
Net realized capital gains or (losses)		122,864
Net investment gain or (loss)		<u>\$230,920</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off		(\$902)
Finance and service charges not included in premiums		
Total other income		<u>(\$902)</u>

Net income before dividends to policyholders and before federal & foreign income taxes		(1,064,444)
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Net Income		<u><u>(\$1,064,444)</u></u>
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Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$5,231,299
Net Income		(\$1,064,444)
Net unrealized capital gains or losses		17,739
Change in non-admitted assets		(71,699)
Change in net deferred income tax		371,293
Surplus adjustments: Paid in		1,550,000
Aggregate write-ins for gains and losses in surplus		(9,363)
Change in surplus as regards policyholders for the year		<u>\$793,526</u>
Surplus as regards policyholders, December 31 current year		<u><u>\$6,024,825</u></u>

A comparative analysis of changes in surplus is shown below.

CAPACITY INSURANCE COMPANY
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	\$6,024,825
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	<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>\$6,024,825</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Losses and Loss Adjustment Expenses

\$2,518,061

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, George Turner, FCAS, MAAA of InsFocus, LLC, reviewed the loss and loss adjustment expense work papers provided by the Company and he was in concurrence with this opinion.

Capital and Surplus

The amount of capital and surplus reported by the Company of \$6,024,825, exceeded the minimum of \$5,000,000 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 **Capacity Insurance Company** 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 \$6,024,825, which exceeded the minimum of \$5,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Anthony DeLuca, CPA, Examiner-In-Charge, Marcus Ladd, CPA, Senior Examiner, and Bradley Carroll, CPA, Examiner, InsFocus, LLC participated in the examination. In addition, George Turner, FCAS MAAA, Consulting Actuary, Anh Vu, Actuary, Carlos Ruesta, IT Manager, and Nicholas Adimoolah, IT Examiner, of InsFocus, LLC, participated in the examination. Michael Tomes, Reinsurance/Financial Specialist, of the Office, also participated in the examination.

Respectfully submitted,

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