

**REPORT ON EXAMINATION**  
**OF**  
**CAPITOL PREFERRED INSURANCE**  
**COMPANY, INC.**  
**TALLAHASSEE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2013**

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

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November 7, 2014

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, Rule 69O-138.005, Florida Administrative Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2013, of the financial condition and corporate affairs of:

**CAPITOL PREFERRED INSURANCE COMPANY, INC.  
2255 KILLEARN CENTER BLVD  
TALLAHASSEE, FLORIDA 32309**

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, and was conducted simultaneously with examinations for Southern Fidelity Insurance Company, Inc. and Southern Fidelity Property & Casualty, Inc., which are affiliated through common management pursuant to Section 624.10(1)(b), Florida Statutes. 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 July 21, 2014, to July 25, 2014. The fieldwork commenced on July 28, 2014, and concluded as of November 7, 2014.

This financial examination was a multi-state examination conducted in accordance with the NAIC 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**

The following is the significant adverse finding contained in the Office's prior examination report as of December 31, 2009, along with resulting action taken by the Company in connection therewith.

The Company had not written insurance coverage in the surety or bail bonds lines of business.

Resolution: The Company assumed insurance coverage in the surety line of business and removed the bail bonds line of business from its certificate of authority.

## **SUBSEQUENT EVENTS**

In November 2014, the Company participated in an assumption of Citizens Property Insurance Corporation (Citizen's) policies. The Company was approved for up to a total of 30,000 assumed policies for the November take-out under Consent Order 159614-14-CO.

## **HISTORY**

### **General**

The Company was incorporated in Florida on April 9, 1998, and commenced business on May 24, 1998, as Capitol Preferred Insurance Company, Inc.

The Company was party to Consent Order 138816-13-CO filed August 1, 2013, regarding the sale of common stock between two shareholders subject to a Stock Purchase and Debenture Assignment Agreement. The Company was in compliance with the provisions of this consent order.

The Company was authorized to transact the following insurance coverage in Florida on various dates beginning in 1998 and continued to be authorized as of December 31, 2013:

Homeowners multi peril	Fire
Allied lines	Surety
Mobile home physical damage	Mobile home multi peril

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

## **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	20,000
Number of shares issued and outstanding	18,750
Total common capital stock	\$1,875,000
Par value per share	\$100.00
Number of authorized preferred capital shares	100,000
Number of shares issued and outstanding	0
Total preferred capital stock	\$0.00
Par value per share	\$100.00

Control of the Company was maintained by its parent, Preferred Holding Company, Inc. (Preferred Holding), a Florida corporation, who owned eighty percent of the stock issued by the Company, who in turn was seventy two percent owned by J.A. Pattco Private Investments, LLC, a privately held corporation and twenty percent by James A. Gragenella.

## **Surplus Notes**

On January 1, 2009, the Company consolidated and exchanged several surplus notes and debentures issued in 2004 and 2005 with certain of the Company's investors. Effective December 6, 2012, the surplus note in the amount of \$625,000 with Robert Fishback was assigned to Van Fishback. As of December 31, 2013, there were \$17,350,000 surplus notes issued to Preferred Holding (\$7,240,000), J.A. Pattco, Inc. (\$6,000,000), Van Fishback (\$3,860,000), and Alan Baker (\$250,000). The Company received cash funds for the issuance of these surplus notes. The interest rates were amended to the long term applicable federal rates in effect of 3.57 percent, which was more favorable to the Company than the original interest rates. The maturity of all the surplus notes was set to October 31, 2029.

## **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 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 shareholders 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

<b>Name and Location</b>	<b>Principal Occupation</b>
James Anthony Graganella Tallahassee, Florida	President/CEO, Capital Preferred Insurance Company
Byron Hamelin Wells Tallahassee, Florida	Vice President, Capital Preferred Insurance Company
Keith Edward Martin Tallahassee, Florida	Vice President/CFO, Capital Preferred Insurance Company
Alan Joseph Baker Brookings, South Dakota	CFO/Director, Fishback Financial Corp.
Thomas Anthony Dieruf Louisville, Kentucky	Vice President, PATTCO, LLC Company

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

#### Senior Officers

<b>Name</b>	<b>Title</b>
James Anthony Graganella	President, CEO
Byron Hamelin Wells	Vice President
Keith Edward Martin	Vice President, Treasurer and Secretary

The Company's Board appointed an internal committee. Following was the principal internal Board committee and its members as of December 31, 2013:

**Audit Committee**

Thomas Anthony Dieruf <sup>1</sup>  
Alan Joseph Baker

<sup>1</sup> Chairman

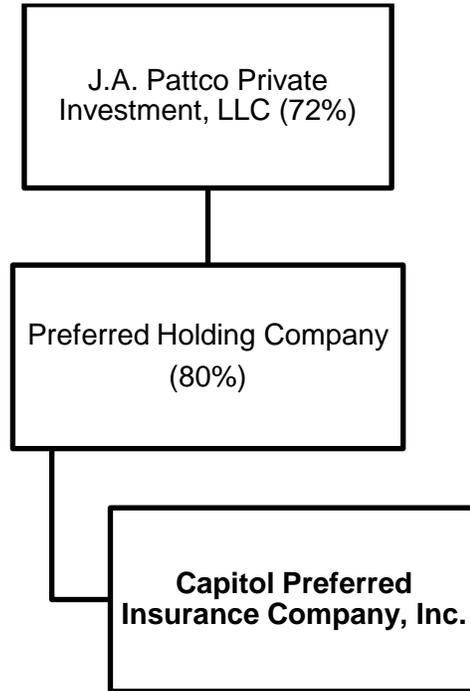
**Affiliated Companies**

The most recent holding company registration statement was filed with the State of Florida on February 26, 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.

**CAPITOL PREFERRED INSURANCE COMPANY  
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 parent, Preferred Holding, filed a consolidated federal income tax return. On December 31, 2013, the method of allocation between the Company and its parent was based upon separate return calculations with current credit for net losses.

**Managing General Agent Agreement**

The Company entered into a managing general agent (MGA) with its affiliate through common ownership, Preferred Managing Agency, Inc. (Preferred Managing), on January 1, 1998, for the

insurance policies covering homeowners and fire. Preferred Managing provided underwriting and claims handling services and charged a \$25 policy fee. Preferred Managing had the authority to assist with negotiation of reinsurance; however, Preferred Managing did not bind reinsurance.

The Company was authorized to pay to Preferred Managing thirty one percent of the earned premiums for the services rendered. Also, the Company, at the sole discretion of the Board, was authorized to pay an additional four percent of the earned premiums when the Company reached appropriate loss ratio and expense levels. There were annual addendums to the MGA agreement since the prior examination. The commissions were reduced (below thirty one percent of earned premiums). The forgiveness of commission was provided by Preferred Managing to allow the Company the opportunity to increase surplus following the adverse effects of the storm seasons during the prior examination. The agreement continues in force for a term of five years and will automatically renew for successive five-year periods, unless otherwise terminated within the guidelines of the agreement. Fees incurred under this agreement during 2013 amounted to \$14,907,217.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained fidelity bond coverage up to \$3,000,000 with a deductible of \$25,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained management liability insurance and professional liability insurance with coverage with limits of \$2,000,000 and deductibles ranging from \$0 to \$250,000, as well as commercial property, workers' compensation and commercial umbrella liability coverages.

## **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Company's employees were eligible to participate in a 401k plan sponsored by PATTCO, LLC, the ultimate parent company. Employees were authorized to contribute up to \$17,500 per year with the Company matching up to four percent of the participants' compensation.

## **TERRITORY AND PLAN OF OPERATIONS**

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

Florida  
Georgia

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**

The Company experienced steady growth in gross premiums during the examination period, but net premiums have fluctuated due largely to the cost of reinsurance. The increases in underwriting gains in the last two years has been the result of improvements in sinkhole incurred losses, reduced reinsurance costs and a lack of catastrophic weather events. Over the examination period underwriting gains and net income increased steadily, with the exception of 2011, which

experienced an underwriting loss due to both a decrease in earned premiums and an increase in incurred losses and loss adjustment expenses. Surplus grew approximately \$8.1 million over the examination period.

### **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.

	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
Premiums Earned	7,980,478	10,000,173	10,864,424	11,423,817	12,030,002
Net Underwriting Gain/(Loss)	1,810,752	1,701,257	(50,735)	476,588	11,490
Net Income	2,493,794	2,343,977	567,221	1,166,249	690,071
Total Assets	37,903,146	44,161,843	41,057,326	36,755,752	35,039,202
Total Liabilities	18,271,901	27,505,432	27,175,541	24,061,889	23,517,406
Surplus As Regards Policyholders	19,631,245	16,656,411	13,881,785	12,693,863	11,521,796

### **LOSS EXPERIENCE**

During the current examination period, the Company showed favorable development overall. The one and two-year net loss developments at the end of the current examination period were both favorable at \$309 thousand and \$1.2 million, respectively.

## **REINSURANCE**

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

### **Assumed**

The Company assumed \$294,000 during 2013 from unaffiliated companies.

### **Ceded**

As of December 31, 2013, the Company's ceded reinsurance program consisted of excess of loss, quota share and catastrophe reinsurance provided by agreements with various commercial reinsurers through reinsurance intermediaries Towers Watson. The Company also participated in the Florida Hurricane Catastrophe Fund (FHCF).

The Company's quota share agreement provides fifty percent coverage on all liability risks, each and every policy, subject to \$1,000,000 each and every risk for all residential property insurance and up to \$500,000 each and every risk for any one residential liability.

The Company's per risk excess reinsurance agreement provided coverage of \$1,650,000 in excess of \$350,000 on each loss, subject to a per loss occurrence limit of \$1,650,000.

The Company had the following catastrophe excess of loss coverage through commercial reinsurers and the FHCF as of December 31, 2013, resulting in coverage of ultimate net losses of \$148,516,726 for the first event:

- First Catastrophe Excess of Loss Reinsurance - \$11,250,000 in private reinsurance coverage with a retention limit of \$4,000,000
- Second Catastrophe Excess of Loss Reinsurance - \$45,000,000 in private reinsurance coverage with a retention limit \$15,250,000
- Third Catastrophe Excess of Loss Reinsurance - \$30,000,000 in private reinsurance coverage with a retention limit of \$60,250,000
- Fourth Catastrophe Excess of Loss Reinsurance - \$22,250,000 in private reinsurance coverage with a retention limit of \$90,250,000
- Florida Catastrophe Hurricane Fund - \$40,016,726 payout limit with an attachment point of \$15,265,444

The Company executed reinsurance premiums protection agreements to reinsure the reinstated premium payment obligations which accrued to the Company under the commercial catastrophe excess of loss agreements. The coverage was limited to one hundred percent of the original contracted reinsurance placement.

The Company reinsured third event with retention of \$4,000,000, up to \$56,250,000 in coverage.

There were no ceded incurred losses during the year ended December 31, 2013.

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 Tallahassee, Florida. 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 custodial agreements with the Suntrust Bank amended on February 1, 2010 and Merrill Lynch, Pierce, Fenner & Smith Incorporated executed on August 11, 2011. The agreements were 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 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**

Scott Langstein, CISA, IT Manager, of Cerebres, 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 and with various state officials as required or permitted by law:

STATE	Description	Par Value	Market Value
FL	Cash	<u>\$ 300,000</u>	<u>\$ 300,000</u>
TOTAL FLORIDA DEPOSITS		\$ 300,000	\$ 300,000
GA	US BANK, CD, 0.10%, 09/24/15	\$ 100,053	\$ 100,053
LA	J P MORGAN, CD, 0.20%,	100,000	100,000
SC	USTNTS, 0.25%, 02/15/15	<u>255,000</u>	<u>255,179</u>
TOTAL OTHER DEPOSITS		<u>\$ 455,053</u>	<u>\$ 455,232</u>
TOTAL SPECIAL DEPOSITS		<u><u>\$ 755,053</u></u>	<u><u>\$ 755,232</u></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."

**CAPITOL PREFERRED INSURANCE COMPANY, INC.**

**Assets**

**DECEMBER 31, 2013**

	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Bonds	\$17,493,696		\$17,493,696
Cash and short-term investments	14,060,975		14,060,975
Agents' balances:			
Uncollected premium	438,438		438,438
Deferred premium	2,774,415		2,774,415
Reinsurance fund held by or deposited	223,840		223,840
Interest and dividend income due & accrued	106,387		106,387
Net deferred tax asset	2,578,475		2,578,475
Aggregate write-in for other than invested assets	226,920		226,920
	<hr/>		
Totals	\$37,903,146	\$0	\$37,903,146
	<hr/> <hr/>		

**CAPITOL PREFERRED INSURANCE COMPANY, INC.**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2013**

	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Losses	\$4,882,678		\$4,882,678
Loss adjustment expenses	622,216		622,216
Commissions payable	3,635		3,635
Other expenses	66,000		66,000
Taxes, licenses and fees	971,549		971,549
Current federal/foreign income taxes	53,467		53,467
Unearned premium	5,559,200		5,559,200
Advance premium	1,765,242		1,765,242
Ceded reinsurance premiums payable	4,145,012		4,145,012
Amounts withheld or retained by company	18,167		18,167
Provision for reinsurance	1,000		1,000
Aggregate write-ins for liabilities	183,735		183,735
<b>Total Liabilities</b>	<b>\$18,271,901</b>	<b>\$0</b>	<b>\$18,271,901</b>
Aggregate Write-ins for special surplus funds	\$625,794		\$625,794
Common capital stock	1,875,000		1,875,000
Surplus notes	17,350,000		17,350,000
Gross paid in and contributed surplus	3,629,988		3,629,988
Unassigned funds (surplus)	(3,849,537)		(3,849,537)
<b>Surplus as regards policyholders</b>	<b>\$19,631,245</b>	<b>\$0</b>	<b>\$19,631,245</b>
<b>Total liabilities, surplus and other funds</b>	<b>\$37,903,146</b>	<b>\$0</b>	<b>\$37,903,146</b>

**CAPITOL PREFERRED INSURANCE COMPANY, INC.**  
**Statement of Income**

**DECEMBER 31, 2013**  
**Underwriting Income**

Premiums earned		\$7,980,478
	<b>Deductions:</b>	
Losses incurred		\$10,718,091
Loss expenses incurred		2,747,570
Other underwriting expenses incurred		(7,295,935)
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$6,169,726
Net underwriting gain		\$1,810,752

**Investment Income**

Net investment income earned		\$551,794
Net realized capital gains or (losses)		0
Net investment gain		\$551,794

**Other Income**

Net gain from agents' or premium balances charged off		\$55,562
Finance and service charges not included in premiums		129,153
Aggregate write-ins for miscellaneous income		0
Total other income		\$184,715

Net income before dividends to policyholders and before federal & foreign income taxes		\$2,547,261
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$2,547,261
Federal & foreign income taxes		53,467
Net Income		\$2,493,794

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year		\$16,656,411
Net Income		\$2,493,794
Change in net deferred income tax		487,407
Change in non-admitted assets		(35,367)
Change in provision for reinsurance		29,000
Change in excess statutory over statement reserves		0
Surplus adjustments: Paid in		0
Aggregate write-ins for gains and losses in surplus		0
Examination Adjustment		0
Change in surplus as regards policyholders for the year		\$2,974,834
Surplus as regards policyholders, December 31 current year		\$19,631,245

A comparative analysis of changes in surplus is shown below.

**CAPITOL PREFERRED INSURANCE COMPANY, INC.  
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 the examination.

Surplus as regards policyholders  
December 31, 2013, per Annual Statement \$19,631,245

	<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, 2013, per examination			<u><u>\$19,631,245</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

**Losses and Loss Adjustment Expenses** \$5,504,894

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, Greg Wilson, FCAS, MAAA, and Patrick Glenn, ACAS, ASA, MAAA, of Lewis & Ellis, Inc., 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 \$19,631,245 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 **Capitol Preferred Insurance Company, Inc.** 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 \$19,631,245, which exceeded the minimum of \$5,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Patricia Casey Davis, CFE, CPA, INSRIS, Exam Manager; Sarah Lucibello, CPA, CFE, Examiner-In-Charge, Lewis and Ellis, Inc., Amy Carter, AFE, CPA, Participating Examiner, Lewis and Ellis, Inc., David Palmer, CFE, Participating Examiner, Lewis and Ellis, Inc., and Kate Bolbas, CPA, CFE, Participating Examiner, Lewis and Ellis, Inc. participated in the examination. Greg Wilson, FCAS, MAAA, consulting actuary of Lewis & Ellis, Inc., Patrick Glenn, ACAS, ASA, MAAA, consulting actuary of Lewis & Ellis, Inc., and Scott Langstein, CISA, IT Manager of Cerebres, LLC also participated in the examination. In addition, Mikhael Goldgisser, Reinsurance Financial Specialist, of the Office participated in the examination.

Respectfully submitted,

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Robin Brown, CFE  
Chief Examiner  
Florida Office of Insurance Regulation