

**REPORT ON EXAMINATION**  
**OF**  
**CASTLEPOINT FLORIDA INSURANCE**  
**COMPANY**

**FORT LAUDERDALE, FLORIDA**

**AS OF**

**DECEMBER 31, 2011**

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

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October 9, 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 as of December 31, 2011, of the financial condition and corporate affairs of:

**CASTLEPOINT FLORIDA INSURANCE COMPANY  
500 WEST CYPRESS CREEK ROAD  
FORT LAUDERDALE, FLORIDA 33309**

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, 2011, through December 31, 2011. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2010. This examination commenced with planning at the Office from June 18, 2012 to June 21, 2012. The fieldwork commenced on June 25, 2012, and concluded as of October 9, 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**

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during this examination.

#### **General**

The Company's loss and loss adjustment expense reserves were determined to be deficient in the amount of \$497,000 as of December 31, 2011.

### **Prior Exam Findings**

There were no material findings or exceptions noted during the prior examination as of December 31, 2010.

## **HISTORY**

### **General**

The Company was incorporated in Florida on January 6, 2009, and commenced business on February 19, 2009, as CastlePoint Florida Insurance Company.

The Company was authorized to transact workers compensation and commercial automobile liability insurance coverage in Florida on February 19, 2009 and continues to be authorized as of December 31, 2011.

The Company was party to Consent Order 100214-08-CO filed December 12, 2008, regarding the application for the issuance of a Certificate of Authority. The Company was in compliance with this order.

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

|  |           |
|--|-----------|
| Number of authorized common capital shares | 100,000   |
| Number of shares issued and outstanding    | 100,000   |
| Total common capital stock                 | \$100,000 |
| Par value per share                        | \$1.00    |

Control of the Company was maintained by its parent, CastlePoint Insurance Company ("Parent"), who owned 100% of the stock issued by the Company, who in turn was 50% owned by CastlePoint Management Corp. ("Management Corp."), a Delaware corporation, and 50% owned by CastlePoint Reinsurance Company, Ltd. (CPRe), a Bermuda corporation. The ultimate parent was Tower Group, Inc.

### **Surplus Notes**

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

## **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 unanimous written consents of the shareholder, Board of Directors (Board), and certain internal committees were reviewed for the period under examination. The unanimous written consents 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**

Michael H. Lee  
New York, New York

#### **Principal Occupation**

Director, President and CEO,  
Tower Group, Inc.

William E. Hitselberger  
West Windsor, New Jersey

Director, CFO,  
Tower Group, Inc.

Gary S. Maier  
Tenafly, New Jersey

Director, SVP and Chief Underwriting  
Officer, Tower Group, Inc.

Joel S. Weiner **(a)**  
New Hope, Pennsylvania

Director, SVP, Chief Actuary,  
Tower Group, Inc.

Elliot S. Orol  
New York, New York

Director, SVP, Secretary and General  
Counsel, Tower Group, Inc.

**(a)** As of the September 30, 2012 Quarterly Statement Joel S. Weiner was no longer a director of the Company. William F. Dove was appointed as a new director of the Company.

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

#### **Senior Officers**

| <b>Name</b>             | <b>Title</b>                          |
|-------------------------|---------------------------------------|
| Michael H. Lee          | President and CEO                     |
| William E. Hitselberger | EVP and CFO                           |
| Elliot S. Orol          | Sr. VP, Secretary and General Counsel |

The Company's Board did not appoint internal committees. The Company's Board adopted the Audit Committee of its ultimate parent, Tower Group Inc., as the Company's Audit Committee.

The following was the principal board committee and its members as of December 31, 2011.

#### **Audit Committee**

Austin P. Young III, CPA <sup>1</sup>  
Charles A. Bryan  
William W. Fox, Jr.  
William A. Robbie

<sup>1</sup> Chairman

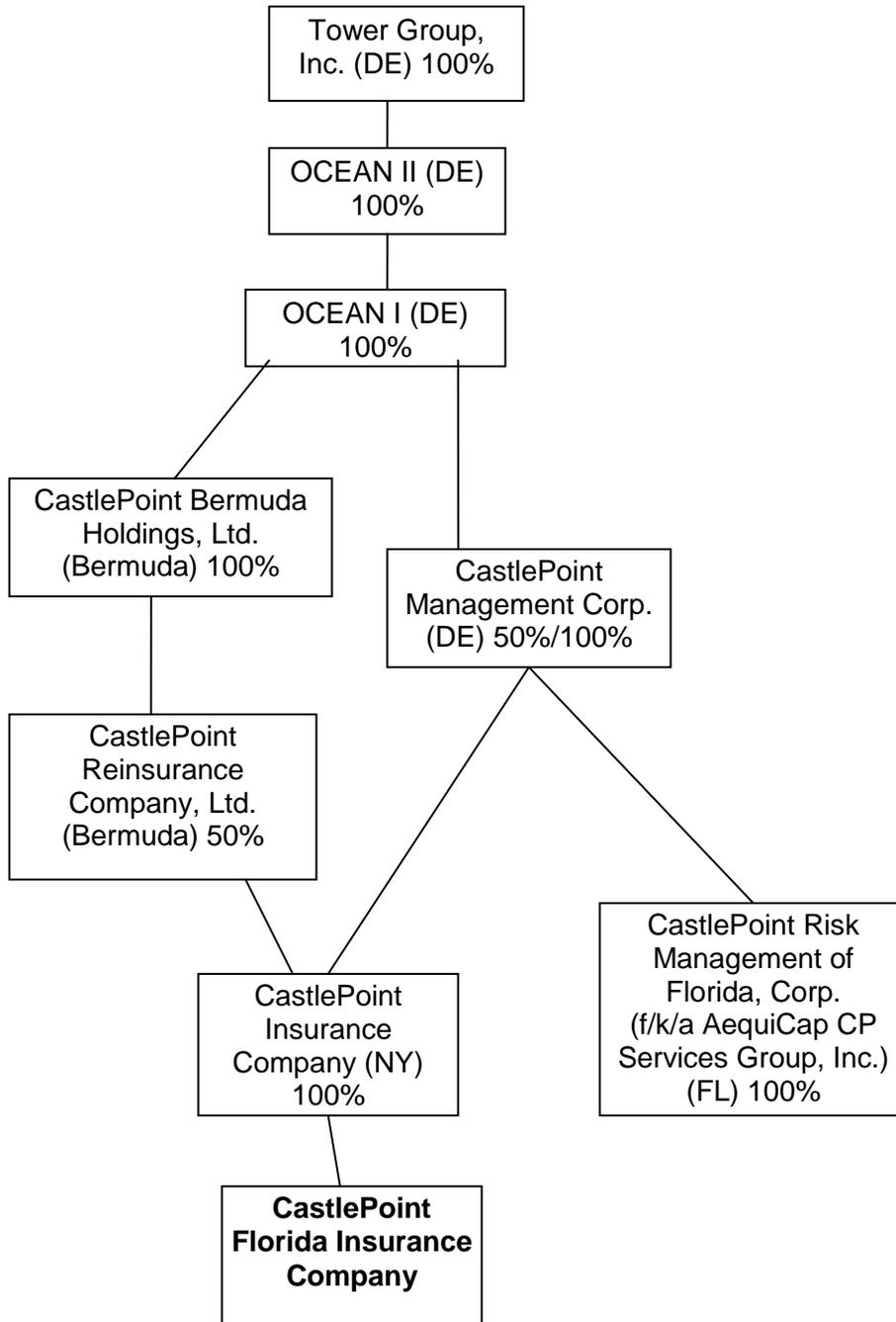
## **Affiliated Companies**

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The most recent holding company registration statement was filed with the State of Florida on March 31, 2011, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

An 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.

# CASTLEPOINT FLORIDA INSURANCE COMPANY ORGANIZATIONAL CHART

DECEMBER 31, 2011



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

### **Tax Allocation Agreement**

The Company entered into a Tax allocation agreement with its Parent. The agreement was dated and executed on September 12, 2008. On December 31, 2011, the method of allocation between the Company and its parent was on the Percentage Method. The Company shall pay to the Parent its share of each installment within ten (10) days of receiving notice of payment due, but in no event later than two (2) days before the due date for each installment.

### **Cost Allocation Agreement**

The Company entered into a Services Agreement with Management Corp. on January 14, 2009, to maintain data processing systems and equipment, an office or offices, and a staff of employees sufficient in number and qualifications to perform the duties set forth in the agreement. Management Corp. was reimbursed for its actual expenses, including salaries of its employees, and other expenses typically included within the term 'other underwriting expenses' in performing the services for the Company. Amounts were due and payable within 45 days of the end of each calendar quarter. Fees incurred under this agreement during 2011 were \$1.7 million.

### **Managing General Agent Agreement**

The Company entered into a Program Underwriting Agency Agreement with its affiliate, CastlePoint Risk Management of Florida, Corp. on February 19, 2009. The agreement continues in force until cancelled or terminated according to the provisions of the contract. MGA fees were based on a provisional commission of 19.5% for Workers Compensation and 21% for Commercial Automobile, of direct written premium and included the \$25 policy fee. The commission expense incurred under this agreement during 2011 was \$10.9 million.

## **FIDELITY BOND AND OTHER INSURANCE**

The parent company maintained fidelity bond coverage up to \$7,500,000, which exceeded the suggested minimum as recommended by the NAIC. The Company also maintained Employment Practices Liability and Insurance Company Professional Liability insurance coverage up to \$10,000,000.

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

There were no pension, stock ownership or insurance plans in place at the Company during the period of this examination.

## **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 recorded significant growth through its affiliated insurance agency, CastlePoint Risk Management of Florida, Corp., which is a wholly owned subsidiary of CastlePoint Management Corp., a member of the holding company group. A 90% quota share agreement in place for all

premiums written by the Company, transfers risk to the Company's parent CastlePoint Insurance Company, which received a letter of approval as an Accredited Reinsurer on October 16, 2008.

### **Profitability of Company**

The following table shows the profitability trend (in dollars) of the Company for the period of operations, as reported in the filed annual statements.

|                                  | <b>2011</b> | <b>2010</b> | <b>2009</b> |
|----------------------------------|-------------|-------------|-------------|
| Premiums Earned                  | 5,027,213   | 2,958,143   | 264,135     |
| Net Underwriting Gain/(Loss)     | (245,091)   | (388,805)   | (1,200,366) |
| Net Income                       | 45,682      | (232,325)   | (839,840)   |
| Total Assets                     | 40,896,928  | 33,349,596  | 20,105,889  |
| Total Liabilities                | 32,321,508  | 24,703,189  | 10,947,729  |
| Surplus As Regards Policyholders | 8,575,420   | 8,646,407   | 9,158,160   |

### **LOSS EXPERIENCE**

During the current examination period, the Company reported unfavorable development overall. This was a result of more claims being reported for prior accident years than management anticipated. As of December 31, 2011, the one-year net loss development was unfavorable in the amount of \$203,000 and the two-year net loss development was favorable by (\$41,000).

## **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 multi-year net quota share reinsurance agreement with its Parent, an Accredited Reinsurer. The reinsurance agreement covers all new and renewal business of the Company from February 19, 2009, the effective date of the agreement. Under the terms of the reinsurance agreement, the Company cedes 90% of net premiums and losses to the Parent. The Company earns a ceding commission on all ceded business under the agreement.

Additionally, The Company entered into quota share, excess of loss, and catastrophe reinsurance agreements with various reinsurers. The Company limits exposure to a maximum loss on any one risk. For the period of January 1, 2011 through December 31, 2011, this limit was \$150,000.

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 Fort Lauderdale, Florida.

An independent CPA audited the Company's statutory basis financial statements annually for the year 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 the SunGard system.

The Company and non-affiliates had the following agreements:

### **Custodial Agreements**

The Company entered into a custodial agreement with The Northern Trust Company on October 25, 2011, and a safe keeping agreement with JP Morgan Chase on November 11, 2009. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

### **Managing General Agent Agreement**

The Company utilized an affiliated managing general agent (MGA) to produce insurance business. The MGA was responsible for quoting policies to customers, and billing and collecting premiums on behalf of the insurer. The Company retained the right of binding authority and ensured all policies met Company underwriting guidelines.

### **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

INS Services, Inc. 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>\$ 317,627</u> | <u>\$ 317,627</u> |
| TOTAL SPECIAL DEPOSITS |             | <u>\$ 317,627</u> | <u>\$ 317,627</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."

**CASTLEPOINT FLORIDA INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2011**

|  | <b>Per Company</b>  | <b>Examination<br/>Adjustments</b> | <b>Per<br/>Examination</b> |
|--|---------------------|------------------------------------|----------------------------|
| Bonds  | \$17,463,534        |                                    | \$17,463,534               |
| Stocks:  |                     |                                    |                            |
| Common stocks  | 317,627             |                                    | 317,627                    |
| Cash and short term investments  | 276,174             |                                    | 276,174                    |
| Invested income due and accrued  | 24,498              |                                    | 24,498                     |
| Premiums and considerations:   |                     |                                    |                            |
| Uncollected premiums and agents'<br>balances in the course of collection                       | 3,933,976           |                                    | 3,933,976                  |
| Deferred premiums, agents'<br>balances and installments booked<br>but deferred and not yet due | 10,385,073          |                                    | 10,385,073                 |
| Amounts recoverable from reinsurers  | 5,326,139           |                                    | 5,326,139                  |
| Current federal and foreign income<br>tax recoverable and interest thereon                     | 276,975             |                                    | 276,975                    |
| Aggregate write-in for other than<br>invested assets   | 2,892,932           |                                    | 2,892,932                  |
| Total  | <u>\$40,896,928</u> | <u>\$0</u>                         | <u>\$40,896,928</u>        |

**CASTLEPOINT FLORIDA INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2011**

|   | <b>Per Company</b>  | <b>Examination<br/>Adjustments</b> | <b>Per<br/>Examination</b> |
|---|---------------------|------------------------------------|----------------------------|
| Losses  | \$3,107,599         | \$471,385                          | \$3,578,984                |
| Loss adjustment expenses                                      | 197,869             | 25,615                             | 223,484                    |
| Other expenses  | 229,574             |                                    | 229,574                    |
| Taxes, licenses and fees                                      | 415,541             |                                    | 415,541                    |
| Unearned premium  | 2,209,554           |                                    | 2,209,554                  |
| Ceded reinsurance premiums payable                            | 24,181,893          |                                    | 24,181,893                 |
| Funds held by company under reinsurance treaties              | 148,606             |                                    | 148,606                    |
| Amounts withheld or retained by company for account of others | 50,532              |                                    | 50,532                     |
| Provision for reinsurance                                     | 156,000             |                                    | 156,000                    |
| Payable to parent, subsidiaries and affiliates                | 1,148,604           |                                    | 1,148,604                  |
| Aggregate write-ins for liabilities                           | 475,736             |                                    | 475,736                    |
| <b>Total Liabilities</b>                                      | <b>\$32,321,508</b> | <b>\$497,000</b>                   | <b>\$32,818,508</b>        |
| Common capital stock  | \$100,000           |                                    | \$100,000                  |
| Gross paid in and contributed surplus                         | 9,900,000           |                                    | 9,900,000                  |
| Unassigned funds (surplus)                                    | (1,424,580)         | (\$497,000)                        | (1,921,580)                |
| Surplus as regards policyholders                              | <u>\$8,575,420</u>  | <u>(\$497,000)</u>                 | <u>\$8,078,420</u>         |
| <b>Totals</b>   | <b>\$40,896,928</b> | <b>\$0</b>                         | <b>\$40,896,928</b>        |

**CASTLEPOINT FLORIDA INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2011**

**Underwriting Income**

|                                      |                    |                    |
|--------------------------------------|--------------------|--------------------|
| Premiums earned                      |                    | \$5,027,213        |
|                                      | <b>Deductions:</b> |                    |
| Losses incurred                      |                    | \$3,137,997        |
| Loss adjustment expenses incurred    |                    | 402,162            |
| Other underwriting expenses incurred |                    | 1,732,145          |
| Total underwriting deductions        |                    | <u>\$5,272,304</u> |
| Net underwriting gain or (loss)      |                    | (\$245,091)        |

**Investment Income**

|  |  |                  |
|--|--|------------------|
| Net investment income earned           |  | \$415,136        |
| Net realized capital gains or (losses) |  | 229,364          |
| Net investment gain or (loss)          |  | <u>\$644,500</u> |

**Other Income**

|   |  |                    |
|---|--|--------------------|
| Net gain or (loss) from agents' or premium balances charged off |  | (\$105,925)        |
| Finance and service charges not included in premiums            |  | 0                  |
| Aggregate write-ins for miscellaneous income                    |  | 0                  |
| Total other income  |  | <u>(\$105,925)</u> |

|  |  |                        |
|--|--|------------------------|
| Net income before dividends to policyholders and<br>before federal & foreign income taxes  |  | \$293,484              |
| Dividends to policyholders   |  | 0                      |
| Net Income, after dividends to policyholders, but<br>before federal & foreign income taxes |  | <u>\$293,484</u>       |
| Federal & foreign income taxes   |  | 247,802                |
| Net Income   |  | <u><u>\$45,682</u></u> |

**Capital and Surplus Account**

|  |  |                           |
|--|--|---------------------------|
| Surplus as regards policyholders, December 31 prior year   |  | \$8,646,407               |
| Net Income   |  | \$45,682                  |
| Change in non-admitted assets                              |  | (2,669)                   |
| Change in provision for reinsurance                        |  | (114,000)                 |
| Examination change in loss and loss adjustment expense     |  | (497,000)                 |
| Change in surplus as regards policyholders for the year    |  | <u>(\$567,987)</u>        |
| Surplus as regards policyholders, December 31 current year |  | <u><u>\$8,078,420</u></u> |

A comparative analysis of changes in surplus is shown below.

**CASTLEPOINT FLORIDA 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<br>December 31, 2011, per Annual Statement | \$8,575,420 |
|---|-------------|

|  | <u>PER<br/>COMPANY</u> | <u>PER<br/>EXAM</u> | <u>INCREASE<br/>(DECREASE)<br/>IN SURPLUS</u> |
|--|------------------------|---------------------|---|
| ASSETS:  |                        |                     |   |
| No Adjustment  |                        |                     |   |
| LIABILITIES:   |                        |                     |   |
| Losses   | \$3,107,599            | \$3,578,984         | (\$471,385)                                   |
| Loss adjustment<br>expense   | 197,869                | 223,484             | (25,615)                                      |
| Net Change in Surplus:   |                        |                     | (497,000)                                     |
| Surplus as Regards Policyholders<br>December 31, 2011, Per Examination |                        |                     | \$8,078,420                                   |

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

**Loss and Loss Adjustment Expenses** \$3,802,488

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, Robert Gardner, FCAS, MAAA of INS Consultants, Inc., reviewed the loss and loss adjustment expense work papers provided by the Company and he was not in concurrence with this opinion. He concluded that the Company reserve for losses and loss adjustment expense were deficient by \$497,000

The total amount of net loss and loss adjustment expense reserve reported by the Company of \$3,305,468 was increased by \$497,000 to \$3,802,488.

### Capital and Surplus

The amount of capital and surplus per the examination of \$8,078,420, exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

## **SUMMARY OF RECOMMENDATIONS**

### **Loss and LAE Reserves**

We recommend that the Company adequately reserve for losses and loss adjustment expense reserves as required by Section 625.041(1) and Section 625.101, Florida Statutes.

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **CastlePoint Florida 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 \$8,078,420, which exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Peter Bliss, CFE, Examiner-In-Charge of INS Regulatory Insurance Services, Inc. participated in the examination. In addition, Robert Gardner, FCAS MAAA, consulting actuary INS Consultants, Inc., and Lawrence R. Lentini, CPA/CITP, CRISC, of INS Services, Inc. also participated in the examination. John Romano, CPA, CFE, Examination Manager, of ParenteBeard LLC also participated in the examination.

Respectfully submitted,

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