

**REPORT ON EXAMINATION**  
**OF**  
**FCCI INSURANCE COMPANY**  
**SARASOTA, FLORIDA**

**AS OF**  
**DECEMBER 31, 2005**

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

## TABLE OF CONTENTS

<b>LETTER OF TRANSMITTAL .....</b>	<b>-</b>
<b>SCOPE OF EXAMINATION.....</b>	<b>1</b>
<b>HISTORY .....</b>	<b>2</b>
GENERAL .....	2
CAPITAL STOCK.....	3
PROFITABILITY OF COMPANY.....	3
DIVIDENDS TO STOCKHOLDERS.....	3
MANAGEMENT.....	4
CONFLICT OF INTEREST PROCEDURES.....	5
ACQUISITIONS, MERGERS, DISPOSALS.....	6
SURPLUS DEBENTURES .....	6
<b>AFFILIATED COMPANIES.....</b>	<b>7</b>
TAX ALLOCATION AGREEMENT.....	8
MANAGEMENT AGREEMENT.....	8
<b>ORGANIZATIONAL CHART.....</b>	<b>9</b>
<b>FIDELITY BOND AND OTHER INSURANCE.....</b>	<b>10</b>
<b>PENSION, STOCK OWNERSHIP AND INSURANCE PLANS .....</b>	<b>10</b>
<b>STATUTORY DEPOSITS.....</b>	<b>10</b>
<b>INSURANCE PRODUCTS AND RELATED PRACTICES.....</b>	<b>11</b>
TERRITORY .....	11
TREATMENT OF POLICYHOLDERS.....	11
<b>ACCOUNTS AND RECORDS.....</b>	<b>12</b>
MANAGING GENERAL AGENCY AGREEMENT.....	13
CUSTODIAL AGREEMENT.....	15
INDEPENDENT AUDITOR AGREEMENT.....	15
ACTUARIAL AGREEMENT .....	15
RISK-BASED CAPITAL.....	16
<b>FINANCIAL STATEMENTS PER EXAMINATION.....</b>	<b>16</b>
ASSETS.....	17
LIABILITIES, SURPLUS AND OTHER FUNDS.....	18
STATEMENT OF INCOME.....	19
<b>COMMENTS ON FINANCIAL STATEMENTS .....</b>	<b>20</b>
ASSETS.....	20
LIABILITIES.....	20
<b>COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS.....</b>	<b>21</b>
<b>SUMMARY OF FINDINGS .....</b>	<b>22</b>

**SUBSEQUENT EVENTS .....27**  
**CONCLUSION.....28**

Tallahassee, Florida

September 1, 2006

Alfred W. Gross  
Chairman, NAIC Financial  
Condition (E) Committee  
Commissioner  
Virginia Bureau of Insurance  
State Corporation Commission  
1300 East Main Street  
Richmond, Virginia 23219

Honorable Eleanor Kitzman  
Secretary, Southeastern Zone, NAIC  
Director of Insurance  
300 Arbor Lake Drive, Suite 1200  
Columbia, South Carolina 29223

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, 2005, of the financial condition and corporate affairs of:

**FCCI INSURANCE COMPANY  
6300 UNIVERSITY PARKWAY  
SARASOTA, FL 34240**

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, 2003 through December 31, 2005. The Company was last examined by representatives of the Florida Office of Insurance (Office) as of December 31, 2002. This examination commenced, with planning at the Office, on March 27, 2006 through March 31, 2006. The fieldwork commenced on April 3, 2006, and was concluded as of September 1, 2006. 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 an association zone 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.

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.

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, 2005. Transactions subsequent to year-end 2005 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is 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.

## HISTORY

### General

The Company was organized in Florida on April 1, 1959 as Florida Construction Commerce & Industry Self Insurers Fund and converted in 1994 to FCCI Mutual Insurance Company. FCCI Mutual Insurance Company was converted in 1998 to FCCI Insurance Company, a stock company, which was wholly owned by FCCI Group, Inc.

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2005:

Fire	Allied Lines
Farmowners Multi Peril	Homeowners Multi Peril
Commercial Multi Peril	Inland Marine
Earthquake	Workers' Compensation
Other Liability -occurrence	Private Passenger Auto Liability
Commercial Automobile Liability	PPA Physical Damage
Commercial Auto Physical Damage	Fidelity
Surety	Glass
Burglary and Theft	Boiler and Machinery

The articles of incorporation and the bylaws were not amended during the period covered by this examination.

## Capital Stock

As of December 31, 2005, the Company's capitalization was as follows:

Number of authorized class A common capital shares	10,000,000
Number of shares class A issued and outstanding	5,000,000
Number of authorized class B common capital shares	500,000,000
Number of class B common capital shares issued and outstanding	0
Number of preferred stock authorized	10,000,000
Number of preferred stock issued and outstanding	0
Total common capital stock issued	\$5,000,000
Par value per share	\$1.00

The outstanding shares of common stock of the Company are owned by FCCI Group, Inc., an insurance holding company domiciled in the State of Florida.

## 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 statement of the Company.

	<b>2005</b>	<b>2004</b>	<b>2003</b>
Premiums Earned	557,996,457	416,399,894	381,473,189
Net Underwriting Gain/(Loss)	10,416,800	458,398	(1,486,048)
Net Income	19,423,233	7,108,581	1,592,632
Total Assets	1,242,396,494	1,052,121,475	1,011,577,335
Total Liabilities	894,879,210	724,956,589	698,525,565
Surplus As Regards Policyholders	347,517,284	327,164,886	313,051,770

## Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2004 and 2005.

## Management

The annual stockholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2005, were:

### Directors

<b>Name and Location</b>	<b>Principal Occupation</b>
John T. Stafford Sarasota, FL	Chairman Retired President, CEO and Director The Commercial Bank
William E. Getzen Sarasota, FL	Vice Chairman Retired partner of law firm
Robert W. Flanders Sarasota, FL	President and Owner of Quality Walls
Harvey R. Foxworthy Sarasota, FL	Chairman of Rusty Plumbing, Inc.
Charles R. Baumann Sarasota, FL	Tax Services and Litigation Support Shareholder in Kerkering, Barberio & Company
Marvin S. Haber Sarasota, FL	President of Savon Furniture and Haber Management, Inc.
Timothy J. Clarke Sarasota, FL	President and Chairman of Clarke Advertising Company
Gordon W. Jacobs Sarasota, FL	President and CEO of FCCI Companies
Albert Conyers	West & Conyers Architects 1966 – 1999

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

### Senior Officers

<b>Name</b>	<b>Title</b>
Gordon W. Jacobs	President & CEO

Charles J. Bachand  
David L. Webber  
Debra H. Douglas  
Joseph A. Keene  
Craig Allan Johnson

Executive Vice President/CFO/Treasurer  
Executive Vice President/COO  
Executive Vice President /Secretary  
Executive Vice President  
Senior Vice President  
Asst. Treasurer/Controller

The Company's board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following are the principal internal board committees and their members as of December 31, 2005:

**Executive Committee**

John Stafford<sup>1</sup>  
William Getzen  
Albert Conyers  
Gordon Jacobs

**Audit Committee**

Ronald Foxworthy<sup>1</sup>  
Robert Flanders  
Charles Baumann  
Charles Stottlemeyer

**Investment Committee**

Albert Conyers<sup>1</sup>  
Ronald Foxworthy  
Charles Baumann  
Charles Stottlemeyer

<sup>1</sup>Chairman

**Conflict of Interest Procedure**

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in compliance with the Financial Condition Examiners Handbook.

**Corporate Records**

The recorded minutes of the Investment Committee, Audit Committee, Stockholder and Board of Directors were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

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

FCCI Claims Services, Inc., was merged into FCCI Insurance Company, effective at the close of business on March 31, 2004.

## **Surplus Debentures**

The Company had two surplus notes. The first note was in the amount of \$20,000,000 and was issued by the Company in exchange for cash, pursuant to Rule 144A under the Securities Act of 1933. The note was underwritten by FTN Financial Capital Markets, and Keefe, Bruyette and Woods, Inc. The administrator of the note was U.S. Bank National Association. The second note was in the amount of \$12,000,000 and was issued by FCCI Insurance Company in exchange for cash, pursuant to Rule 144A under the Securities Act of 1933. The note was underwritten by Sandler O'Neill & Partners, LP, and was administered by Wilmington Trust Company.

## **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 March 14, 2006, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

The Company did not timely report loans on their holding company registration statement to an affiliate for a real estate debt obligation for their home office. The Company did not disclose the pledging of assets totaling \$114,850,277 for a reinsurance treaty of an affiliate, National Trust

Insurance Company, in the holding company registration statement. The Company did not disclose the pledging of assets totaling \$21,505,560 for a line of credit with The Northern Trust Bank on their holding company registration statement. The Company did disclose these transactions in the filing of its current holding company registration statement.

The Company did not obtain prior approval for a loan totaling \$35 million in December of 2003 to FCCI Services, Inc. for real estate obligations for their home office. Rule 69O-143.047(4), Florida Administrative Code requires that loan transactions involving a domestic insurer and any person in its holding company system in an amount the lessor of three percent of the insurer's admitted assets or 25 percent of surplus as regards policyholders, may not be entered into unless the insurer has notified the Office in writing of its intention to enter into such a transaction at least thirty (30) days prior thereto, or such shorter period as the Office in its discretion may permit, and the Office has not disapproved it within such period. The Company did not maintain written loan documents.

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

### **Tax Allocation Agreement**

The Company had a tax allocation agreement with FCCI Mutual Insurance Holding Company (FMIHC) and its affiliates, entered into December 31, 2000. The parties were members of an affiliated group as defined in Section 1504(a) of the Internal Revenue Code of 1986. FMIHC was required to file a consolidated federal income tax return.

### **Management Services Agreement**

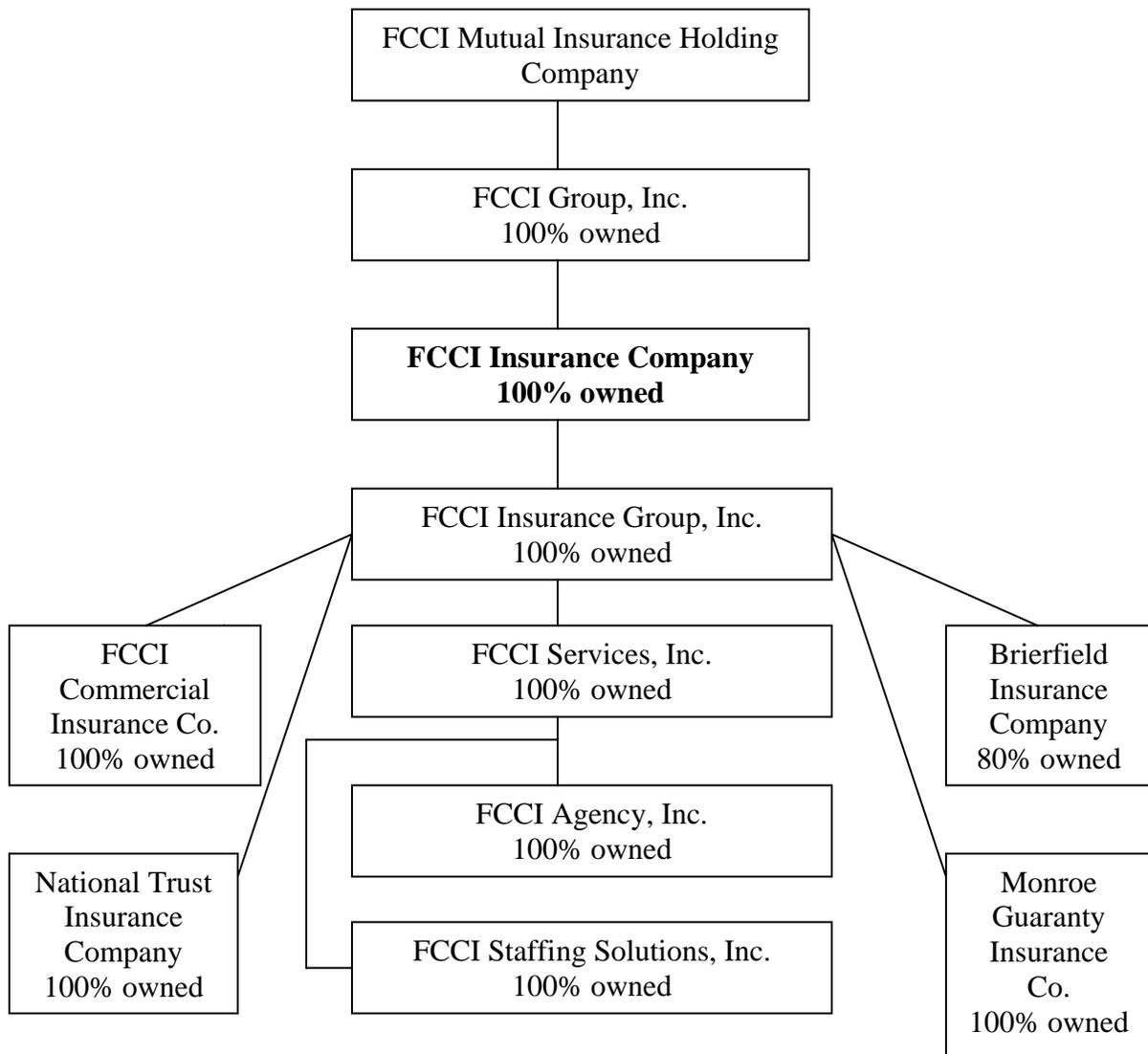
The Company maintained a management services agreement with FMIHC, for itself and on behalf of its affiliates, as of November 1, 2003. Services under this agreement included insurance and general management services, including policy and claims servicing.

### **Reinsurance Agreements**

The Company had reinsurance agreements with each of its insurance company affiliates. The Company was party to a Loss Portfolio Transfer Reinsurance Agreement with several affiliated insurers.

An organizational chart as of December 31, 2005, reflecting the holding company system, is shown below. Schedule Y of the Company's 2005 annual statement provided a list of all related companies of the holding company group.

**FCCI INSURANCE COMPANY  
ORGANIZATIONAL CHART  
DECEMBER 31, 2005**



## FIDELITY BOND

The Company maintained fidelity bond coverage with Hartford Fire Insurance Company for up to \$4,500,000 in coverage, with a deductible of \$550,000, which adequately covered the suggested minimum amount of coverage of \$2,000,000 for the Company as recommended by the NAIC.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no pension, stock ownership or employee insurance plans.

## 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.

<u>State</u>	<u>Description</u>	<u>Par Value</u>	<u>Market Value</u>
FL	US T Note, 3.0%, Feb 2008	<u>\$2,250,000</u>	<u>\$2,186,640</u>
TOTAL FLORIDA DEPOSITS		\$2,250,000	\$2,186,640
GA	US T Note 3.0%, Feb 2008	\$ 100,000	\$ 100,188
OH	US T Note 3.0%, Nov 2007	250,000	243,770
AZ	US T Note, 3.375%, Nov 2008	120,000	116,779
OT	US T Note, 4.9%, May 2014	1,100,000	1,126,774
NC	Evergreen Inst Treasury MMF	<u>579,680</u>	<u>579,680</u>
TOTAL OTHER DEPOSITS		<u>\$2,149,680</u>	<u>\$2,140,417</u>
TOTAL SPECIAL DEPOSITS		<u>\$4,399,680</u>	<u>\$4,327,057</u>

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory

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

Alabama	Illinois	Michigan	Ohio
Arizona	Indiana	Mississippi	Oklahoma
Connecticut	Iowa	Missouri	Pennsylvania
Florida	Kansas	Nebraska	South Carolina
Georgia	Kentucky	North Carolina	Tennessee

### 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)3,a, Florida Statutes.

## 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 risk from the following affiliates: Brierfield Insurance Company, FCCI Commercial Insurance Company, Monroe Guaranty Insurance Company and National Trust

Insurance Company. The Company assumed business from mandatory pools in Alabama, Georgia, Illinois, Indiana, Kentucky, Ohio, North Carolina and South Carolina.

The Company's letters of credit (LOC), which secured unauthorized reinsurance balances, were not in compliance with the evergreen clause timeframe requirement as required in Rule 69O-144.005(6)(d), Florida Administrative Code. The Rule requires that the evergreen clause shall provide for a period of no less than 60 days notice prior to the expiration date or non-renewal.

### **Ceded**

The Company ceded risk on an excess of loss and quota share basis to various authorized and unauthorized reinsurers as listed on Schedule F, Part 3 of the annual statement. The three top authorized reinsurers and their respective percentage of the total assumed premiums were: Employers Reinsurance Corp. (21%), GE Reinsurance Corp. (46%) and General Reinsurance Corp. (12%). The top three unauthorized reinsurers and their respective percentages of the total assumed premium by unauthorized reinsurers were: Axis Specialty Limited (35%), Endurance Specialty Insurance Limited (18%) and Montpelier Reinsurance Ltd. (20%).

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

## **ACCOUNTS AND RECORDS**

An independent CPA audited the Company's statutory basis financial statements annually for the years 2003, 2004 and 2005, in accordance with Section 624.424(8), Florida Statutes. Supporting

work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Company maintained its principal operational office in Sarasota, Florida, where this examination was conducted.

## **General**

### **IT Report**

The Company's IT examination resulted in several significant findings and issues requiring immediate correction including:

#### **Program Change Control**

An inspection of the AS/400 Implementor functional authorities noted that, out of fifteen programmers that can compile code, all but two can also move code to the production libraries. The AS/400 contains the Midwest Point Insurance system, Worker's Comp system and Infinium General Ledger (Infinium) system, all of which are financially significant applications. This is a segregation of duties weakness that cannot be justified in an operation this size.

#### **Processing Controls**

To automate the posting of journal entries, the Company developed Excel spreadsheets which

were systematically output from the SAS data warehouse and imported into the Infinium general ledger. Some type of interface file was necessary to pass those summary transactions between the SAS data warehouse and the AS/400, Infinium system. We were concerned with the use of Excel, a desktop application, as an enterprise solution for financial aggregation and posting. That approach added another layer of complexity and, more importantly, left the finance department open to challenge due to the ease at which pre-posted balances could be manipulated in the user-friendly Excel interface.

End-to-end reconciliation procedures were documented between Infinium and the source systems. Logical security controls were not utilized to segregate spreadsheet access and journal entry approval from individuals that also controlled the reconciliation process.

### **Systems and Program Development**

The Company's active development environment encompasses web, legacy AS/400 and SAS programming. Large-scale data conversions, in-house development and software purchases were in process or completed during the period under review. The Company has documented a systems development life cycle (SDLC) with appropriate policies and procedures. Since the Company has not implemented a streamlined approach for assuring that the SDLC was followed, project request, approval and testing documentation was maintained in various and disparate fashions between Word documents, Excel spreadsheets, Outlook messages, MS project server and a Help-desk system. As a result, the inspection of a sample of projects for compliance with the FCCI Project Checklist lead to the conclusion that various components of project control documentation were either not completed or stored in some other non-centralized location.

## **Logical and Physical Security**

Windows passwords must be at least eight characters long, which is appropriate. However, complexity requirements were not enforced by the Company. Based on these settings, “password” and “aaaaaaaa” would all be accepted as valid on the Windows platform.

The Company and non-affiliates had the following agreements:

### **Custodial Agreement**

The Company had a custodial agreement with The Northern Trust Bank in Chicago, Illinois. The Company’s custodial agreement did not contain the clause required by Rule 69O-143.042, (2)(o), Florida Administrative Code, which states that the agreement must be terminable by the insurance company on not more than 30 days notice. The Company’s agreement stated that it was terminable upon 90 days.

### **Independent Auditor Agreement**

The Company had an agreement with KPMG, LLP, Orlando, Florida, to perform the independent statutory audit of the Company for the years 2003, 2004 and 2005.

### **Independent Actuarial Agreement**

The Company had an agreement with Russell H. Greig, Jr. of Tillinghast, a Towers Perrin Company in Atlanta, Georgia, for actuarial services.

## **Investment Agreement**

The Company had an agreement with General Re-New England Asset Management, Inc. to provide investment accounting services and investment reports as well as portfolio management services.

## **Risk-Based Capital**

The Company reported its risk-based capital at an adequate level.

## **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2005, 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."

**FCCI INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2005**

	Per Company	Examination Adjustments	Per Examination
Bonds	\$903,935,132		\$903,935,132
Common Stocks	103,533,872		\$103,533,872
Real Estate	44,251,382		44,251,382
Cash:			
On hand	(4,029,402)		(4,029,402)
Cash equivalents	5,514,876		5,514,876
Short-term investments	1,291,649		1,291,649
Receivables for securities	1,572,795		1,572,795
Interest and dividend income due & accrued	8,893,790		8,893,790
Agents' Balances:			
Uncollected premium	30,008,020		30,008,020
Deferred premium	109,857,454		109,857,454
Accrued retrospective premium	4,139,531		4,139,531
Reinsurance recoverables	6,156,879		6,156,879
Funds held by reinsurers	43,022		43,022
Net deferred tax asset	22,460,653		22,460,653
Receivables from parents, subsidiaries and affiliates	4,766,841		4,766,841
Totals	<u>\$1,242,396,494</u>	<u>\$0</u>	<u>\$1,242,396,494</u>

**FCCI INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2005**

	Per Company	Examination Adjustments	Per Examination
Losses	\$479,972,634		\$479,972,634
Reinsurance payable on losses and loss adjustment expenses	66,428		66,428
Loss adjustment expenses	107,078,369		107,078,369
Commissions payable	20,058,005		20,058,005
Other expenses	17,148,328		17,148,328
Taxes, licenses and fees	10,456,860		10,456,860
Federal income taxes payable	7,835,026		7,835,026
Unearned premium	191,218,617		191,218,617
Advance premiums	7,560,563		7,560,563
Dividends declared and unpaid policholders	170,627		170,627
Ceded reinsurance premiums payable	5,760,354		5,760,354
Amounts withheld or retained by company for others	7,340,082		7,340,082
Provision for reinsurance	3,427,030		3,427,030
Payable to parent, subsidiaries and affiliates	28,878,133		28,878,133
Aggregate write-ins for liabilities	7,908,154		7,908,154
<b>Total Liabilities</b>	<b>\$894,879,210</b>		<b>\$894,879,210</b>
Common capital stock	\$5,000,000		5,000,000
Surplus notes	32,000,000		32,000,000
Unassigned funds (surplus)	310,517,284		310,517,284
<b>Surplus as regards policyholders</b>	<b>\$347,517,284</b>		<b>\$347,517,284</b>
<b>Total liabilities, capital and other funds</b>	<b>\$1,242,396,494</b>		<b>\$1,242,396,494</b>

**FCCI INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2005**

<b>Underwriting Income</b>	
Premiums earned	\$557,996,457
DEDUCTIONS:	
Losses incurred	297,697,592
Loss expenses incurred	77,169,808
Other underwriting expenses incurred	172,712,257
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$547,579,657</u>
Net underwriting gain or (loss)	\$10,416,800
<b>Investment Income</b>	
Net investment income earned	\$35,400,753
Net realized capital gains or (losses)	4,252,965
Net investment gain or (loss)	<u>\$39,653,718</u>
<b>Other Income</b>	
Net gain or (loss) from agents' or premium balances charged off	(\$5,764,941)
Finance and service charges not included in premiums	1,306,557
Aggregate write-ins for miscellaneous income	(86,115)
Total other income	<u>(\$4,544,499)</u>
Net income before dividends to policyholders and before federal & foreign income taxes	\$45,526,019
Dividends to policyholders	<u>9,058,368</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$36,467,651
Federal & foreign income taxes	<u>17,044,418</u>
Net Income	\$19,423,233
<b>Capital and Surplus Account</b>	
Surplus as regards policyholders, December 31 prior year	\$327,164,886
<b>Gains and (Losses) in Surplus</b>	
Net Income	\$19,423,233
Net unrealized capital gains or losses	(6,847,113)
Change in non-admitted assets	3,271,807
Change in provision for reinsurance	(1,003,949)
Change in net deferred income tax	5,508,420
Surplus adjustments: Paid in	0
Aggregate write-ins for gains and losses in surplus	0
Examination Adjustments	0
Change in surplus as regards policyholders for the year	<u>\$20,352,398</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$347,517,284</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Assets

**Bonds** \$903,935,132

The Company pledged securities totaling \$114,850,277 for a quota share reinsurance treaty for its affiliate, National Trust Insurance Company.

The Company pledged securities totaling \$21,505,560 for a line of credit with The Northern Trust Bank. The bank made a Uniform Commercial Code filing with the State of Florida against the debtor, the Company.

### Liabilities

**Losses and Loss Adjustment Expenses** \$587,051,003

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, 2005, 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 actuary reviewed work papers provided by the Company and was in agreement with the outside actuary's opinion.

**FCCI INSURANCE COMPANY**  
**Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2005**

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, 2005, Annual Statement	\$347,517,284
---	---------------

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment			
LIABILITIES:			
No adjustment.			
Net Change in Surplus:			\$0
Surplus as Regards Policyholders December 31, 2005, Per Examination			\$347,517,284

## **SUMMARY OF FINDINGS**

### **Compliance with previous directives**

There were no findings noted in the prior examination report.

### **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, 2005.

#### **General**

##### **IT Report**

The Company's IT examination resulted in several significant findings and issues requiring immediate correction including:

##### **Program Change Control**

An inspection of the AS/400 Implementor functional authorities noted that, out of fifteen programmers that can compile code, all but two can also move code to the production libraries. The AS/400 contains the Midwest Point Insurance system, Worker's Comp system and Infinium General Ledger system, all of which are financially significant applications. This is a segregation of duties weakness that cannot be justified in an operation this size.

**We recommend that the Company immediately segregate the AS/400 Implementor "compile" and "move" authorities between different individuals to provide more independence between these two functions. This level of authority increases the risk**

**that the Company's program change controls may be circumvented and may place the software developers in a position of culpability for fraudulent financial reporting.**

### **Processing Controls**

To automate the posting of journal entries, the Company designed Excel spreadsheets which were systematically output from the SAS data warehouse and imported into the Infinium general ledger. Some type of interface file was necessary to pass those summary transactions between the SAS data warehouse and the AS/400, Infinium system. However, we were concerned with the use of Excel, a desktop application, as an enterprise solution for financial aggregation and posting. That approach added another layer of complexity and, more importantly, left the finance department open to challenge due to the ease at which pre-posted balances could be manipulated in the user-friendly Excel interface.

End-to-end reconciliation procedures were documented between Infinium and the source systems. Logical security controls were not utilized to segregate spreadsheet access and journal entry approval from individuals that also controlled the reconciliation process.

**We recommend that the Company immediately develop independent reconciliation by one or more persons having no update capability to modify Infinium records, the Excel spreadsheets, SAS data warehouse, or source system records. The Excel interface spreadsheets should only be editable by a controlled system ID account as needed to automate their creation; or addressed by some other control mechanism. Company management must be able to demonstrate through systematic and procedural controls that these interface spreadsheets, as imported to Infinium, correctly aggregated the**

**detail transactions captured in the back-office insurance systems.**

**We also recommend that the Company implement a plan to eliminate the use of Excel spreadsheets as an interface between systems. The Company has the expertise and technology in-house to create a more robust and objective process without the use of desktop applications. The additional effort required by the Company to provide information for the state of Florida data requests, was symptomatic of an overtly complex process, and showed the lack of integration between the back-office systems and the general ledger, and also emphasized the need to better utilize the capabilities of the SAS data warehouse.**

### **Systems and Program Development**

The Company's active development environment encompasses Web, Legacy AS/400 and SAS programming. Large-scale data conversions, in-house development and software purchases were in process or completed during the period under review. The Company has documented a systems development life cycle (SDLC) with appropriate policies and procedures. Since the Company has not implemented a streamlined approach for assuring that the SDLC was followed, project request, approval and testing documentation was maintained in various and disparate fashions between Word documents, Excel spreadsheets, Outlook messages, MS project server and a Help-desk system. As a result, the inspection of a sample of projects for compliance with the FCCI Project Checklist lead to the conclusion that various components of project control documentation were either not completed or stored in some other non-centralized location.

**We recommend that the Company develop and enforce the centralized storage of all project documentation required by the Company's Project Checklists. The failure to maintain project documentation in an organized manner will minimize the control effectiveness of the Company's project management efforts and increase the risk that key project approvals may not be obtained.**

### **Logical and Physical Security**

Windows passwords must be at least eight characters long, which is appropriate. However, complexity requirements were not enforced by the Company. Based on these settings, "password" and "aaaaaaaa" would all be accepted as valid on the Windows platform.

**We recommend that the Company enforce password complexity on the Windows domain. If the Company's users agree to use complex passwords, then the requirement for password changes can be removed, which would greatly reduce the administrative overhead from password reset requests.**

### **General**

#### **Loans**

The Company loaned \$35 million in December of 2003 to FCCI Services, Inc. to pay off the debt of the home office owed to SunTrust Bank. The Company had no inter-company notes between the parties. The Company did not obtain approval from the Office for these loans and the Company did not maintain written loan documents.

**We recommend that in the future, the Company comply with Rule 69O-143.047(4)(a), Florida Administrative Code, which states that a loan transaction involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the Office in writing of its intention to enter into such a transaction at least thirty (30) days prior thereto, or shorter period as the Office in its discretion may permit, and the Office has not disapproved it within such period.**

### **Holding Company Registration Statement**

The Company did not have the following required disclosures in their holding company registration statements: (1) Pledged money of \$114,850,277 for the reinsurance treaty with an affiliate, National Trust Insurance Company (2) pledged money for \$21,505,560 of securities for the Company's line of credit with The Northern Trust Bank, and (3) a statement that loans to FCCI Services, Inc. were not done timely. The Company did disclose these transactions in the filing of its current holding company registration statement. **We recommend the Company continue to disclosure such in all future filings.**

### **Custodial Agreement**

The Company maintained a custodial agreement with The Northern Trust Bank which did not contain one of the required clauses in accordance with Rule 69O-143.042(2)(o), Florida Administrative Code, which requires a clause that states the agreement must be terminable by the insurance company on not more than a 30 day notice. **We recommend the Company comply with Rule 69O-143.042(2)(o), Florida Administrative Code.**

### **Provision for Reinsurance**

The Company was allowed a credit on their annual statement for unauthorized reinsurance for three letters of credit, which did not comply with the evergreen clause timeframe required in Rule 69O-144.005(b)(d), Florida Administrative Code and Section 624.610(4), Florida Statutes. **We recommend the Company comply with Rule 69O-144.005, Florida Administrative Code and Section 624.610(4), Florida Statutes.**

### **SUBSEQUENT EVENTS**

Effective August 24, 2006, Charles Bachand, Chief Financial Officer and Treasurer resigned. Craig Johnson was promoted to Executive Vice President, Chief Financial Officer and Treasurer. Chris Shoucair was promoted to Vice President, Controller and Assistant Treasurer.

## CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **FCCI INSURANCE COMPANY** as of December 31, 2005, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$347,517,284 which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned Maurice Fuller, Financial Examiner/Analyst II, Tracy Gates, CPA, CISA of Highland Clark LLC, Joe Boor, FCAS, Office Actuary and Tim Butler, Actuarial Assistant, participated in the examination.

---

Michael Hampton, CPA, CFE, DABFA, CFE, CPM  
Financial Examiner/Analyst Supervisor

---

Miriam Bleakley  
Financial Examiner/Analyst II