

REPORT ON EXAMINATION
OF
FCCI COMMERCIAL INSURANCE
COMPANY
SARASOTA, FLORIDA

AS OF
DECEMBER 31, 2005

BY THE
OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION.....	1
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION	2
HISTORY	2
GENERAL	2
CAPITAL STOCK	3
PROFITABILITY OF COMPANY	4
DIVIDENDS TO STOCKHOLDERS	4
MANAGEMENT	4
CONFLICT OF INTEREST PROCEDURE.....	6
CORPORATE RECORDS	6
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASE OR SALES THROUGH REINSURANCE.....	7
SURPLUS DEBENTURES	7
AFFILIATED COMPANIES	7
TAX ALLOCATION AGREEMENT.....	7
MANAGEMENT SERVICES/COST SHARING AGREEMENT.....	8
AGENCY AGREEMENT	8
ORGANIZATIONAL CHART	9
FIDELITY BOND	10
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS	10
STATUTORY DEPOSITS.....	10
INSURANCE PRODUCTS AND RELATED PRACTICES.....	11
TERRITORY	11
TREATMENT OF POLICYHOLDERS.....	11
REINSURANCE	11
ASSUMED.....	11
CEDED	11
ACCOUNTS AND RECORDS.....	12
CUSTODIAL AGREEMENT	12
INDEPENDENT ACTUARY AGREEMENT.....	13
INDEPENDENT AUDITOR AGREEMENT.....	13
PORTFOLIO MANAGEMENT	13
INVESTMENT MANAGEMENT.....	13
RISK-BASED CAPITAL.....	13
INFORMATION TECHNOLOGY	14

FINANCIAL STATEMENTS PER EXAMINATION.....	14
ASSETS	15
LIABILITIES, SURPLUS AND OTHER FUNDS	16
STATEMENT OF INCOME.....	17
COMMENTS ON FINANCIAL STATEMENTS.....	18
ASSETS	18
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS.....	19
SUMMARY OF FINDINGS	20
SUBSEQUENT EVENTS.....	21
CONCLUSION	22

Tallahassee, Florida

September 1, 2006

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 COMMERCIAL INSURANCE COMPANY
6300 UNIVERSITY PARKWAY
SARASOTA, FLORIDA 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 Regulation (Office) as of December 31, 2002. This examination commenced, with planning at the Office, on March 27, 2006, to March 31, 2006. The fieldwork commenced on April 3, 2006, and was concluded on November 14, 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 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.

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, 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.

Status of Adverse Findings from Prior Examination

There were no significant adverse findings contained in the Office's prior examination report as of December 31, 2002.

HISTORY

General

In 1999, the Trustees of FCCI Commercial Insurance Fund submitted an application for a plan of reorganization to the Office. On February 18, 2000, a consent order was issued allowing the FCCI Commercial Insurance Fund to convert to a stock property and casualty company. In accordance with the plan of reorganization and the consent order, a certificate for the stock of FCCI Property and Casualty Insurance Company was issued to its parent, FCCI Insurance Group, Inc. FCCI Property and Casualty Insurance Company was incorporated in Florida on March 7, 2000.

In accordance with Section 624.401(1), Florida Statutes, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2005:

Fire
Commercial Multi Peril
Inland Marine
Other Liability - Occurrence
Burglary and Theft
Commercial Automobile Liability
Commercial Auto Physical Damage

Allied Lines
Farm-owners Multi Peril
Workers' Compensation
Glass
Boiler and Machinery
Fidelity

The Company wrote earthquake insurance coverage without authorization. This was in violation of Section 624.401(1), Florida Statutes which states, no person shall act as an insurer, and no insurer or its agents, attorneys, subscribers, or representatives shall directly or indirectly transact insurance, in this state except as authorized by a subsisting certificate of authority issued to the insurer by the office, except as to such transactions as are expressly otherwise provided for in this code.

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 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, FCCI Insurance Group, Inc., who owned 100 percent of the stock issued by the Company, who in turn was 100 percent owned by FCCI Insurance Company, a Florida corporation.

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.

	2005	2004	2003
Premiums Earned	(5,984,888)	4,896,433	4,661,058
Net Underwriting Gain/(Loss)	86,243	(1,203,623)	(303,416)
Net Income	614,723	(756,880)	(334,290)
Total Assets	7,257,207	27,472,060	22,663,813
Total Liabilities	(5,396,943)	21,442,046	17,881,191
Surplus As Regards Policyholders	12,654,150	6,030,014	4,782,622

Dividends to Stockholders

The Company neither paid nor declared dividends to its stockholder during the period covered by this examination.

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

Name and Location

Charles Robert Baumann
Sarasota, Florida

Timothy Joseph Clarke
Longboat Key, Florida

Principal Occupation

Shareholder
Kerkering, Barberio, & Company

Owner
Clarke Advertising & Public Relations

Robert Winthrop Flanders Sarasota, Florida	President/Owner Quality Walls
Harvey Ronald Foxworthy Sarasota, Florida	Retired Chairman Rusty Plumbing
William Eugene Getzen Sarasota, Florida	Retired Partner Williams, Parker, Harrison, Dietz, & Getzen
Marvin Stephen Haber Sarasota, FL	Retired President Haber Management
Gordon William Jacobs Sarasota, FL	Insurance Executive FCCI Mutual Insurance Company
John Thomas Stafford Sarasota, FL	President Suncoast National Bank
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

Name	Title
Gordon W. Jacobs	President
David L. Webber	Executive Vice President
Joseph A. Keene	Executive Vice President
Craig A. Johnson	Senior Vice President
Charles J. Bachand	Treasurer
Debra H. Douglas	Secretary

The Company's board utilized 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 Stafford¹
William Getzen
Albert Conyers
Gordon Jacobs

¹ Chairman

Audit Committee

Harvey Foxworthy¹
Robert Flanders
Charles Baumann
Charles Stottlemeyer

Investment Committee

Albert Conyers¹
Harvey Foxworthy
Charles Baumann
Charles Stottlemeyer

The Company also had a Marketing & Underwriting Committee, Internal Operations Committee, Compensation Committee, Claims & Reserving Committee, Long Range Planning Committee, Budget Committee, and a Nominating Committee.

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in compliance with Section 607.0832, Florida Statutes. No exceptions were noted during this examination period.

Corporate Records

The recorded minutes of the stockholder, Board of Directors, and Investment Committee meetings 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

The Company had no acquisitions, mergers, disposals, dissolutions, purchases, or sales through reinsurance during the period of the examination.

Surplus Debentures

The Company had no surplus debentures.

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 February 28, 2006 for the year 2006, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

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

Tax Allocation Agreement

The Company, along with its parent, filed a consolidated federal income tax return. On December 31, 2005, the method of allocation between the Company and its parent was the separate return method described in Code Section 1552 (a) (2) and Treasury Regulation 1.1552-1 (a) (2) on the basis of the percentage of the total tax, which the tax of each member (if computed on a separate return) would bear to the total taxes for all members.

Management Services/Cost Sharing Agreement

The Company, along with its parent and affiliates, had a management/cost sharing agreement with FCCI Services, Inc., which provided insurance and general management services including but not limited to: underwriting, premium formulation, collection services, loss control, claims management, portfolio investment management, actuarial services, accounting services, internal auditing, treasury and banking services, legal services, regulatory affairs, internal operations, personnel, information systems, marketing, facilities management, tax services, reinsurance services, corporate governance, and other services related to the effective management of the FCCI insurance business. The costs incurred by FCCI Services, Inc. were apportioned and became the obligation of the appropriate affiliate. Payments to FCCI Services, Inc. for cost reimbursements were made on a monthly basis or based upon the general business requirements of FCCI Services, Inc.

Agency Agreement

The Company and its insurance company affiliates had an agreement with FCCI Agency, Inc., also an affiliate, which authorized the agent to solicit and accept proposals for contracts of insurance in those states the agent and the Company were authorized to do business. Premiums were remitted to the Company in gross without deduction of commission along with a complete application for insurance. As full compensation, the Company agreed to pay the agent a commission.

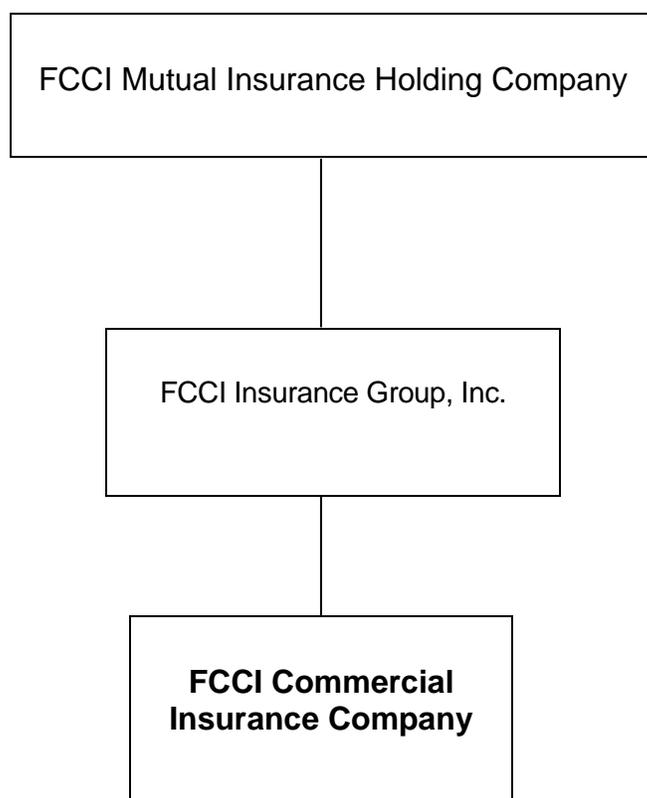
Reinsurance Agreements

The Company had a reinsurance agreement with FCCI Insurance Company. The Company was party to a Loss Portfolio Transfer Reinsurance Agreement with FCCI Insurance Company and other affiliated insurers, effective January 1, 2005.

A simplified 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 COMMERCIAL INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2005



FIDELITY BOND

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

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company with FCCI Services Inc., an affiliated company along with certain affiliated insurance companies, were members of a retirement and savings plan in which all employees were eligible to participate. Employees, at their option, could contribute to the 401K Plan up to 6% of their eligible earnings limited to amounts in the IRS regulations; and the companies match up to 50% of such contributions. In addition, at the board of directors' discretion, the companies made a profit sharing contribution to the 401K Plan. The Company's portion of the expense was ceded to an affiliate under an inter-company reinsurance contract.

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	USTNTS, 4.25%, 08/15/14	<u>\$325,000</u>	<u>\$316,777</u>
TOTAL SPECIAL DEPOSITS		<u>\$325,000</u>	<u>\$316,777</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

The Company was authorized to transact insurance 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)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 did not assume any risk.

Ceded

The Company ceded risk on a quota share basis. The Company ceded 100% of written premium to an upstream parent, FCCI Insurance Company. The Company also had a Loss Portfolio Transfer reinsurance agreement with the same affiliate. In this agreement, the

reinsurer, FCCI Insurance Company, would indemnify the Company of 100% of the Company's losses under the Company's policies.

The Company incorrectly computed and reported the amount of reinsurance recoverable. No adjustment was made to surplus due to immateriality.

ACCOUNTS AND RECORDS

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

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

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 and non-affiliates had the following agreements:

Custodial Agreement

The Company had a custodial agreement with The Northern Trust Company dated July 1, 2005 for the safekeeping of its securities at December 31, 2005. This agreement was not in compliance with

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 thirty (30) days' notice.

The Company also had a custodial agreement with Bank of New York dated November 4, 2004 for the safekeeping of its securities on deposit with the State of Florida.

Independent Actuary Agreement

The Company had an independent actuary agreement with Towers, Perrin, and Tillinghast.

Independent Auditor Agreement

The Company had an independent auditor agreement with KPMC LLP to audit the statutory financial statements.

Portfolio Management Agreement

The Company had a portfolio management agreement with Wells, Canning, and Associates to provide the following services: performance review, portfolio audit, peer analysis, educational programs, asset manager evaluation, asset allocation analysis, and consultation as needed.

Investment Management Agreement

The Company had an investment management agreement with General Re – New England Asset Management, Inc. for its security account.

Risk-Based Capital

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

Information Technology (IT)

The Company had an IT audit performed by Highland Clark LLC. The following deficiency was noted: The Company had a segregation of duty weakness in its IT Department between AS/400 implementers. Segregation between the “compile” and “move” authorities is needed between different individuals to provide more independence.

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 COMMERCIAL INSURANCE COMPANY
Assets

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Bonds	\$7,855,034		\$7,855,034
Cash:			
On deposit	(1,823,775)		(1,823,775)
Short-term investments	7,717		7,717
Investment income due & accrued	110,739		110,739
Reinsurance recoverable	196,285		196,285
Federal taxes recoverable	365,249		365,249
Net deferred tax asset	42,023		42,023
Receivable from PSA	249		249
Aggregate write-in for other than invested assets	503,686		503,686
Totals	\$7,257,207	\$0	\$7,257,207

FCCI COMMERCIAL INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Commissions payable	\$2,278,320		\$2,278,320
Other expenses	1,905		1,905
Taxes, licenses and fees	1,035,601		1,035,601
Advanced premium	600,332		600,332
Ceded reinsurance premiums payable	(9,551,490)		(9,551,490)
Amounts withheld	30,307		30,307
Aggregate write-ins for liabilities	<u>208,082</u>		<u>208,082</u>
Total Liabilities	(\$5,396,943)		(\$5,396,943)
Common capital stock	\$100,000		\$100,000
Gross paid in and contributed surplus	14,150,000		14,150,000
Unassigned funds (surplus)	<u>(1,595,850)</u>		<u>(1,595,850)</u>
Surplus as regards policyholders	<u>\$12,654,150</u>		<u>\$12,654,150</u>
Total Liabilities, Surplus and Other Funds	<u><u>\$7,257,207</u></u>	<u><u>\$0</u></u>	<u><u>\$7,257,207</u></u>

FCCI COMMERCIAL INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2005

Underwriting Income

Premiums earned	(\$5,984,888)
DEDUCTIONS:	
Losses incurred	(5,083,656)
Loss expenses incurred	(901,232)
Other underwriting expenses incurred	(86,243)
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>(\$6,071,131)</u>
Net underwriting gain or (loss)	\$86,243

Investment Income

Net investment income earned	\$158,656
Net realized capital gains or (losses)	(24,034)
Net investment gain or (loss)	<u>\$134,622</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off	(\$612,366)
Finance and service charges not included in premiums	467,271
Aggregate write-ins for miscellaneous income	186,039
Total other income	<u>\$40,944</u>
Net income before dividends to policyholders and before federal & foreign income taxes	\$261,809
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$261,809
Federal & foreign income taxes	<u>(352,914)</u>
Net Income	\$614,723

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$6,030,014
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Gains and (Losses) in Surplus

Net Income	\$614,723
Net unrealized capital gains or losses	0
Change in non-admitted assets	566,010
Change in net deferred income tax	(556,597)
Surplus adjustments: Paid in	6,000,000
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$6,624,136</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$12,654,150</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Reinsurance Recoverable \$196,285

The Company reported reinsurance recoverable on paid losses at \$196,285 in its annual statement. However, this was not the amount recoverable at December 31, 2005. The accurate amount was \$148,966 which was \$47,319 less than reported. This amount was below materiality and no adjustment was made to surplus.

Capital and Surplus

The Company met the minimum surplus requirement pursuant to Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown on the following page.

FCCI COMMERCIAL 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 December 31, 2005, per Annual Statement	\$12,654,150
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustments			
LIABILITIES:			
No adjustments			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2005, Per Examination			\$12,654,150

SUMMARY OF FINDINGS

Compliance with previous directives

There were no significant adverse findings contained in the Office's prior examination report as of December 31, 2002.

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

The Company wrote earthquake insurance coverage without authorization. **We recommend that the Company discontinue writing business in any line in which it is not authorized to comply with Section 624.401 (1), Florida Statutes.**

Reinsurance Recoverable

The Company did not accurately compute and report the amount of reinsurance recoverable. **We recommend that the Company correctly compute and accurately report the amount of reinsurance recoverable in accordance with NAIC Quarterly and Annual Statement Instructions as adopted by Rule 69O-137.001 (4), Florida Administrative Code.**

Bonds

The Company's custodial agreement with The Northern Trust Company was not in compliance with Rule 69O-142.043(2) (o), Florida Administrative Code which state that the agreement must be terminable by the insurance company on not more than thirty (30) days' notice. **We recommend**

that the Company amend its custodial agreement to comply with all parts of Rule 690-143.042, Florida Administrative Code.

Information Technology

According to the IT Report, the Company had a segregation of duty weakness in its IT Department between AS/400 implementers. **We recommend that the Company comply with recommendations from the IT Report and segregate the AS/400 implementers' "compile" and "move" authorities between different individuals to provide more independence between these two functions. This level of authority increases the risk that FCCI's program change controls will be circumvented and places the developers in a position of culpability for fraudulent financial reporting.**

SUBSEQUENT EVENTS

There have been changes in the management of the Company subsequent to the examination date. Effective August 24, 2006, Charles Bachand resigned as Chief Financial Officer. Craig Johnson was promoted to Executive VP, Chief Financial Officer and Treasurer. Chris Shoucair was promoted to VP, 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 Commercial 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 \$12,654,150, which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Miriam Bleakley, Financial Examiner/Analyst II, Michael Hampton CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor, and Joe Boor, FCAS, Office Actuary, participated in the examination. Tracy Gates, CPA, CISA of Highland Clark LLC also participated in the examination.

Respectfully submitted,

Maurice Fuller
Financial Examiner/Analyst II
Florida Office of Insurance Regulation