

REPORT ON EXAMINATION
OF
FLORIDA HOSPITALITY MUTUAL
INSURANCE COMPANY
JACKSONVILLE, FLORIDA

AS OF
DECEMBER 31, 2004

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

December 16, 2005

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 (FS), 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, 2004, of the financial condition and corporate affairs of:

**FLORIDA HOSPITALITY MUTUAL INSURANCE COMPANY
9485 REGENCY SQUARE BLVD., SUITE 415
JACKSONVILLE, FLORIDA 32225**

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, 2002 through December 31, 2004. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2001. This examination commenced, with planning at the Office, on October 17, 2005. The fieldwork commenced on October 20, 2005, and was concluded as of December 16, 2005. 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 (FAC), 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 Company's independent audit reports and certain work papers prepared by KPMG, LLC, 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, 2004. Transactions subsequent to year-end 2004 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.

Based on the review of the Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPAs, after verifying the statutory requirements, for the following accounts: Earned and unearned premiums, federal income taxes, and deferred tax asset.

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2001, along with resulting action taken by the Company in connection therewith.

Custodian Agreement

The custodian agreement was with Morgan Stanley Investment Company (Morgan Stanley). Since Morgan Stanley was not a national bank, state bank or trust company, the agreement was in violation of Rule 69O-143.041(2), FAC. **Resolution:** Amendments to the Florida Statutes and two applicable Rules in the Florida Administrative Code regarding brokers/dealers acting as custodians are pending.

HISTORY

General

The Company was organized and commenced business on January 15, 1954, as a trust under the Florida Workers' Compensation Act of the State of Florida with the name of Florida Hotel-Motel Self-Insurer's Fund. Pursuant to a plan of reorganization, the Company was incorporated on October 1, 1996, under the laws of the State of Florida, as an authorized domestic mutual insurer, with the name of Florida Hotel-Motel Insurance Company. Subsequently, the Company changed its name to Florida Hospitality Mutual Insurance Company on October 21, 1996.

In accordance with Section 624.401(1), FS, the Company was authorized to transact workers' compensation insurance coverage in the State of Florida, on December 31, 2004.

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

The Company is a non-assessable mutual insurance company and is 100% owned by its policyholders. The Company has no stock, stockholders, or any subsidiaries. The Company had a management services contract with FHM Management Corporation (FHM), which provided the Company with all necessary insurance management, financial reporting, and administrative services. The Company and FHM had the same Board of Directors. However, no equity ownership existed between the two entities.

Profitability of Company

The following table shows the probability trend (in dollars) of the Company for the period of examination, as reported in the filed annual statement of the Company.

	2004	2003	2002
Premiums Earned	36,576,715	47,829,787	49,717,161
Net Underwriting Gain/(Loss)	1,449,544	(4,246,107)	(4,354,010)
Net Income	3,486,045	890,939	332,384
Total Assets	134,000,042	136,115,339	132,932,700
Total Liabilities	99,688,247	107,505,204	105,587,553
Surplus As Regards Policyholders	34,311,795	28,610,135	27,345,147

Dividends to Policyholders

In accordance with Section 628.371, FS, the Company declared and paid dividends to its policyholders in 2002, 2003, and 2004 in the amounts of \$1,475,000, \$1,370,000, and \$790,000, respectively.

Management

The annual policyholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. Directors serving as of December 31, 2004, were:

Directors

Name and Location

Principal Occupation

James Edward Brock
St. Augustine, Florida

Chairman

William Bond, Jr.
St. Petersburg, Florida

President

Ruel Lester Bradley, Jr.
Tallahassee, Florida

Treasurer

George DeSaussure Gabel, Jr.
Jacksonville, Florida

General Counsel

Jack Bernard Healan, Jr.
Amelia, Florida

Assistant Treasurer

Mary Ann Richardson
Daytona Beach, Florida

Secretary

Joseph Gurley Seay
Jacksonville, Florida

Tax Consultant

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

Senior Officers

Name	Title
William Bond, Jr.	President
Mary Ann Richardson	Secretary
Ruel Lester Bradley, Jr.	Treasurer
John Albert Lemine	Chief Operating Officer

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. Following were the principal internal board committees and their members as of December 31, 2004:

Finance/Budget Committee

Jack Healan, Jr.¹
Ruel Bradley, Jr.
Joe Seay

Audit Committee

George Gabel, Jr.¹
Joe Seay
Mary Ann Richardson

Investment Committee

Ruel Bradley, Jr.¹
Jack Helan, Jr.
Joe Seay
Heather McCoy

¹ Chairman

Conflict of Interest Procedure

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

Corporate Records

The recorded minutes of meetings of the policyholders, Board of Directors, 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 in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS. The Company's directors reviewed the previous examination report in accordance with NAIC guidelines.

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

There were no acquisitions, mergers, disposals, dissolutions, or purchase and sales through reinsurance during this examination period.

Surplus Debentures

The Company entered into a Subordinate Surplus Debenture Agreement with FHM on December 19, 2002, issuing a surplus note to FHM in the amount of \$3,800,000 in exchange for cash.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on August 30, 2004, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

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

Management Services Agreement

The Company had a management services contract with FHM, an affiliate, to provide the Company with all necessary insurance management, financial reporting, and administrative services.

Effective September 1, 2003, this agreement was amended to allow the fee to be applied on written premium that would have been recognized had not a high deductible policy been selected. Effective December 19, 2003, the agreement was amended to provide for a rolling five-year term unless terminated as provided for in the agreement.

The incurred management service fee has been allocated to various expense categories in accordance with the NAIC annual statement instructions.

A simplified organizational chart as of December 31, 2004, reflecting the holding company system, is shown below. Schedule Y of the Company's 2004 annual statement provided a list of all related companies of the holding company group.

**FLORIDA HOSPITALITY MUTUAL INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2004



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$800,000 with a deductible of \$2,500, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS, and with various state officials as required or permitted by law:

State	Description	Par Value	Market Value
FL	GE Bond, 5.875%, 2/15/12	\$2,000,000	\$2,164,040
FL	USTB, 3%, 11/15/07	<u>\$ 500,000</u>	<u>\$ 496,915</u>
TOTAL SPECIAL DEPOSITS		<u>\$2,500,000</u>	<u>\$2,660,955</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company's workers' compensation coverage was sold through independent agencies that maintained current relationships with the managing general agent (MGA). A continual marketing effort was made to remove inactive agencies and replace them with others that actively focused on the industries and quality of workers' compensation risks sought by the Company.

Primary markets included hotels, motels, restaurants, resorts, country club and related businesses. Also, there were several skilled trade classes that were targeted by the Company as potentially profitable.

Territory

The Company was authorized to transact insurance in the state of Florida in accordance with Section 624.401(2), FS.

Treatment of Policyholders

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS.

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

The reinsurance agreements reviewed were found to comply 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 risk.

Ceded

The Company ceded risk on a quota share and excess of loss basis to various reinsurance companies with most of the ceded reinsurance going to American Reinsurance Company.

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 2002, 2003 and 2004, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, FAC.

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 Jacksonville, Florida, where this examination was conducted.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company utilized the services of Wachovia Bank, Jacksonville, FL, and Morgan Stanley, Jacksonville, FL. The safekeeping agreements between the Company and the respective

custodians contained the appropriate safeguards and controls indemnifying the Company as provided by Rule 69O-143.042, FAC.

MGA Agreement

The Company entered into an agreement with United Self Insured Services (USIS), located in Orlando, Florida, to provide the general business activities of the Company. Effective October 1, 1996, this agreement was assigned to FHM who, on behalf of the Company, appointed Sam R. Boone, Jr. as the MGA.

Independent Auditor Agreement

The Company engaged KPMG, LLP, of Jacksonville, FL, for the purpose of annually auditing and reporting on the statutory basis financial statements at year-end.

Risk-Based Capital

The Company reported its risk-based capital at an adequate level. There was no adjustment to the Company's surplus that would affect its risk-based capital.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2004, 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."

FLORIDA HOSPITALITY MUTUAL INSURANCE COMPANY
Assets

DECEMBER 31, 2004

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$84,301,615		\$84,301,615
Stocks:			
Preferred	3,000,000		3,000,000
Common	3,518,720		3,518,720
Cash:			
On deposit, and cash equivalents	20,908,986		20,908,986
Investment income due & accrued	971,180		971,180
Premiums and considerations			
Uncollected premium	1,098,974		1,098,974
Deferred premium	458,918		458,918
Accrued retrospective premiums	15,892,971		15,892,971
Amounts recoverable from reinsurers	964,227		964,227
Net deferred tax asset	2,236,105		2,236,105
Receivable from parent, subsidiaries and affiliates	113,538		113,538
Aggregate write-in for other than invested assets	534,808		534,808
Totals	\$134,000,042	\$0	\$134,000,042

FLORIDA HOSPITALITY MUTUAL INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2004

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$61,831,999		\$61,831,999
Loss adjustment expenses	18,082,045		18,082,045
Commissions payable, contingent commissions	447,820		447,820
Other expenses	45,403		45,403
Taxes, licenses and fees	3,017,677		3,017,677
Current federal and foreign income taxes	1,150,000		1,150,000
Unearned premium after deducting unearned premiums for ceded reinsurance	4,026,796		4,026,796
Advance premiums	2,235,804		2,235,804
Dividends declared and unpaid: Policyholders	6,795		6,795
Ceded reinsurance premiums payable (net of ceding commissions)	626,454		626,454
Amounts withheld	120,098		120,098
Aggregate write-ins for liabilities	<u>8,097,356</u>		<u>8,097,356</u>
Total Liabilities	\$99,688,247		\$99,688,247
Surplus Notes	\$3,800,000		\$3,800,000
Gross paid in and contributed surplus	10,391,310		10,391,310
Unassigned funds (surplus)	<u>20,120,485</u>		<u>20,120,485</u>
Surplus as regards policyholders	<u>\$34,311,795</u>		<u>\$34,311,795</u>
Total liabilities, capital and surplus	<u>\$134,000,042</u>	<u>\$0</u>	<u>\$134,000,042</u>

FLORIDA HOSPITALITY MUTUAL INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2004

Underwriting Income

Premiums earned	\$36,576,715
DEDUCTIONS:	
Losses incurred	15,940,259
Loss expenses incurred	9,668,243
Other underwriting expenses incurred	9,518,669
Total underwriting deductions	<u>\$35,127,171</u>
Net underwriting gain or (loss)	\$1,449,544

Investment Income

Net investment income earned	\$4,241,566
Net realized capital gains or (losses)	521,145
Net investment gain or (loss)	<u>\$4,762,711</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off	(\$550,604)
Finance and service charges not included in premiums	112,354
Aggregate write-ins for miscellaneous income	4,497
Total other income	<u>(\$433,753)</u>
Net income before dividends to policyholders and before federal & foreign income taxes	\$5,778,502
Dividends to policyholders	<u>790,000</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$4,988,502
Federal & foreign income taxes	<u>1,502,457</u>
Net Income	\$3,486,045

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$28,610,135
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Gains and (Losses) in Surplus

Net Income	\$3,486,045
Change in net unrealized capital gains or losses	128,523
Change in net deferred income tax	(197,027)
Change in non-admitted assets	2,284,119
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$5,701,660</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$34,311,795</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$79,914,044

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, 2004, 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 concurrence with this opinion.

FLORIDA HOSPITALITY MUTUAL INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2004

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, 2004, Annual Statement	\$34,311,795
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment			
LIABILITIES:			
No adjustment			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2004, Per Examination			\$34,311,795

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2001 examination report issued by the Office.

Current examination comments and corrective action

There are no items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2004.

SUBSEQUENT EVENTS

The Company contracted with FHM Insurance Services, Inc., for management services, which assumed some of the functions formerly performed by FHM. There was no equity ownership between the three companies.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Florida Hospitality Mutual Insurance Company** as of December 31, 2004, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$34,311,795, which was in compliance with Section 624.408, FS.

In addition to the undersigned, the following personnel participated in the examination: Michael Hampton, CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor, Bettina Hancock, Financial Examiner/Analyst I, and Joe Boor, FCAS, Office Actuary.

Respectfully submitted,

James D. Collins
Financial Examiner/Analyst II
Florida Office of Insurance Regulation