

REPORT ON EXAMINATION

OF

FLORIDA RURAL ELECTRIC SELF INSURER'S FUND

TALLAHASSEE, FLORIDA

AS OF

DECEMBER 31, 2003

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida
February 15, 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, 2003, of the financial condition and corporate affairs of:

**FLORIDA RURAL ELECTRIC SELF INSURER'S FUND
2916 APALACHEE PARKWAY
TALLAHASSEE, FLORIDA 32302**

Hereinafter referred to as the "Fund". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2001 through December 31, 2003. The Fund was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2000. This examination commenced, with planning at the Office, on September 6, 2004, to September 10, 2004. The fieldwork commenced on September 13, 2004, and was concluded as of February 15, 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 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 Fund.

The examination included a review of the corporate records and other selected records deemed pertinent to the Fund's operations and practices. In addition, the Fund's independent audit reports and certain work papers prepared by the Fund'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 Fund's assets and liabilities as reported by the Fund in its annual statement as of December 31, 2003. Transactions subsequent to year-end 2003 were reviewed where relevant and deemed significant to the Fund'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 Fund's control environment and the materiality level set for this examination, reliance was placed on work performed by the Fund's CPAs, after verifying the statutory requirements, for the following accounts:

- Amounts recoverable from reinsurers
- Taxes, licenses and fees
- Current foreign and federal income taxes

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, 2000, along with resulting action taken by the Fund in connection therewith.

Custodian Agreement

The Fund utilized several custodians for the safekeeping of its securities; however, it had entered into a custodial agreement with only one of the custodians, First Union Bank (currently known as Wachovia Bank). It was recommended that the Fund enter into a custodial agreement with all of its custodians.

Resolution: The Fund is now utilizing only one custodian, Wachovia Bank. The Fund entered into a custodial agreement with Wachovia, and the agreement was in compliance with Rule 690-143.042, FAC.

Losses and Loss Adjustment Expenses

The Fund failed to properly complete Schedule P of the 1999 and 2000 annual statements. It was recommended that the Fund correctly complete Schedule P by including loss data in all future filings with the Office.

Resolution: The Fund has been correctly completing Schedule P by including loss data in its annual statement filings with the Office.

Provision for Reinsurance

The Fund should have booked a provision for reinsurance in the amount of \$53,360 for overdue reinsurance recoverables. It was recommended that the Fund record a provision for reinsurance when it has overdue reinsurance recoverables for all future filings with the Office.

Resolution: The fund has been properly recording a provision for reinsurance when it has overdue reinsurance recoverables.

HISTORY

General

The Fund was established in Florida on January 1, 1979 under the name Florida Rural Electric Self Insurer's Fund, to operate as a self-insurer in accordance with Section 624.4621, FS. The Fund was authorized to transact workers compensation insurance coverage to members of the Florida Electric Cooperatives Association (Association). The Fund had approximately 16 members as of

December 31, 2003, and produced annualized premiums of approximately \$2,700,000. The Fund's office location was in Tallahassee, Florida. The Fund did not have any employees. Ray Trusik, Director of Accounting and William Willingham, Fund Administrator, were employees of the Association, and carried out the administration and management of the day-to-day business of the Fund.

The bylaws were not amended during the period covered by this examination.

Profitability of Fund

The Fund had net underwriting gains (losses) of (\$588,363), (\$3,895) and \$567,437 and an overall net income (loss) of (\$600,205), \$185,119 and \$427,234 for years ending December 31, 2001, 2002 and 2003, respectively. The Fund had a net investment gain of \$226,173, \$180,560 and \$220,931 for years ending December 31, 2001, 2002 and 2003, respectively. The Fund stated that they continued to be selective in its members and emphasized safety practices as a means to generate profits.

Management

The annual meeting for the election of Trustees was held in accordance with Sections 607.1601 and 628.231, FS. The trustees serving as of December 31, 2003, were:

Trustees

Name and Location

Principal Occupation

Clay Campbell
Jay, Florida

Escambia River Electric Coop.

Ed Rickertson
Chiefland, Florida

Central Electric Coop.

Ron Bass
Madison, Florida

Tri-County Electric Coop.

Wayne Thompson
Defuniak Springs, Florida

Choctawhatchee Electric Coop.

William Willingham
Tallahassee, Florida

Florida Electric Coop. Assn.

Tim Planner
Tavernier, Florida

Florida Keys Electric Coop.

Tommy Todd, Vice President
Moore Haven, Florida

Glades Electric Coop.

Roy Barnes
Wewahitchka, Florida

Gulf Coast Electric Coop.

John Middleton
Nahunta, Georgia

Okefenokee Electric Coop.

Roberta Harrison
Wauchula, Florida

Peace River Electric Coop.

Don Stockton
Tallahassee, Florida

Cooperative Computer Center

Rich Midulla
Tampa, Florida

Seminole Electric Coop.

Jerry Martin, Secretary/Treasurer
Live Oak, Florida

Suwannee Valley Electric Coop.

Gary Stallons
Quincy, Florida

Talquin Electric Coop.

Bill Rimes, President
Graceville, Florida

West Florida Electric Coop.

Billy Brown
Dade City, Florida

Withlacoochee River Electric

The Board of Trustees in accordance with the Fund's bylaws appointed the following senior officers:

Senior Officers

| Name | Title |
|--------------------|---------------------|
| Bill Rimes | President |
| Tommy Todd | Vice President |
| Jerry Martin | Secretary/Treasurer |
| William Willingham | Administrator |

The Fund's board appointed an Audit Committee and the following were members of the Audit Committee as of December 31, 2003:

Audit Committee

Ed Rickertson¹
Jerry Martin
Clay Campbell

¹ Chairman

Conflict of Interest Procedure

The Fund had 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 the Board of Trustees and Audit Committee meetings were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Fund transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

There was no documentation in the minutes reviewed that the Fund's Trustees reviewed the previous examination report.

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

As of December 31, 2003, the Fund had no acquisitions, mergers, disposals, dissolutions, and purchases or sales through reinsurance.

Surplus Debentures

The Fund had no surplus debentures for the year ending December 31, 2003

AFFILIATED COMPANIES

The Fund had no affiliated companies and was not a member of an insurance holding company system as defined by Rule 690-143.045(3), FAC. The Fund shared the use of the telephone system and copier with the Association; and the expenses were allocated based on use.

FIDELITY BOND AND OTHER INSURANCE

The Fund maintained fidelity bond coverage up to \$500,000 with a deductible of \$1,000 as of December 31, 2003, which adequately covered the suggested minimum amount of coverage for the Fund as recommended by the NAIC.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Fund had no pension, stock ownership, or insurance plans as of December 31, 2003.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida and exceeded the amount required by Rule 690-190.060(2), FAC.

| State | Description | Par Value | Market Value |
|------------------------|---------------------------|---------------------|---------------------|
| FL | USTNT, 5.750%, 11/15/2005 | \$ 200,000 | \$ 214,760 |
| FL | USTNT, 2.000%, 05/15/2006 | 300,000 | 300,372 |
| FL | USTNT, 2.625%, 11/15/2006 | <u>1,200,000</u> | <u>1,210,500</u> |
| TOTAL FLORIDA DEPOSITS | | \$ 1,700,000 | \$ 1,725,632 |
| Total Special Deposits | | <u>\$ 1,700,000</u> | <u>\$ 1,725,632</u> |

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

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

Treatment of Policyholders

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

The Fund maintained a claims procedure manual that included detailed procedures for handling each type of claim, through their claims servicing company, United Self-Insured Services (USIS).

REINSURANCE

Assumed

The Fund assumed no risk from other insurers.

Ceded

The Fund ceded risk through an excess insurance policy to Federated Rural Electric Insurance Exchange with specific retentions of \$500,000. The workers' compensation limits for year 2003 were the statutory limits. The employer liability for year 2003 was \$500,000.

The excess insurance policy was reviewed by the Fund's appointed actuary and was utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

An independent CPA audited the Fund's statutory basis financial statements annually for the years 2001, 2002 and 2003, in accordance with Section 624.424(8), FS. Audited statutory financial statements and supporting work papers were prepared by the CPA as required by Rule 690-137.002, FAC.

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

The Fund maintained its principal operational offices in Tallahassee, Florida, where this examination was conducted.

The Fund and non-affiliates had the following agreements:

Custodial Agreement

The Fund entered into a custodial agreement with Wachovia Bank on August 5, 2002. Wachovia Bank was a national bank as set forth in the definition of an “Agent” or “Custodian”. The custodial agreement with Wachovia Bank was in compliance with Rule 69O-143.042, FAC.

Claims Servicing Agreement

The Fund had an agreement with USIS to provide claims handling services. The agreement was entered into on January 1, 2003. The agreement stipulated that USIS provide administrative services, claims services, loss prevention services and data management services to the policies on behalf of the Fund. The agreement may be terminated by either party, at anytime, through January 1, 2004. The agreement outlined these services for a fee of \$131,500.

Independent Auditor Agreement

The Fund engaged Thomas Howell Ferguson, P. A. for the purpose of auditing and reporting on the balance sheet and statutory financial statement of the Fund.

Consultation Agreement

The Fund entered into a consultation agreement with Arthur J. Gallagher & Company (Gallagher) on January 1, 2003. The agreement stipulated that Gallagher was engaged in the business of advising the Fund in its insurance needs and providing professional consultation services in the area of workers compensation insurance services. The agreement was effective for one year and can be terminated at anytime, by either party with 30 days prior written notice.

The agreement provided for this service at a fee of \$60,000, payable in three equal payments of \$20,000 on July 1st, September 1st and November 1st 2003.

Risk-Based Capital

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

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Fund's financial position as of December 31, 2003, 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 RURAL ELECTRIC SELF INSURER'S FUND
Assets

DECEMBER 31, 2003

| Classification | Per Company | Examination Adjustments | Per Examination |
|--|-------------|----------------------------|-----------------|
| Bonds | \$5,693,189 | | \$5,693,189 |
| Stocks: | | | |
| Common | 267,413 | | 267,413 |
| Cash: | | | |
| On hand | 979,477 | | 979,477 |
| Investment income due and accrued | 42,699 | | 42,699 |
| Agents' Balances: | | | |
| Uncollected premium | 82,764 | | 82,764 |
| Reinsurance Recoverable | 205,632 | | 205,632 |
| Net deferred tax asset | 35,943 | | 35,943 |
| Aggregate write-in for other than invested assets | 566,709 | | 566,709 |
| | <hr/> | | |
| Totals | \$7,873,826 | \$0 | \$7,873,826 |
| | <hr/> <hr/> | | |

FLORIDA RURAL ELECTRIC SELF INSURER'S FUND
Liabilities, Surplus and Other Funds

DECEMBER 31, 2003

| Liabilities | Per Company | Examination Adjustments | Per Examination |
|--|--------------------|------------------------------------|----------------------------|
| Losses | \$4,368,629 | | \$4,368,629 |
| Loss adjustment expenses | 144,289 | | 144,289 |
| Other expenses | 118,697 | | 118,697 |
| Taxes, licenses and fees | 52,334 | | 52,334 |
| Current federal and foreign income taxes | 309,163 | | 309,163 |
| Funds held under reinsurance treaties | 91,054 | | 91,054 |
| Provision for reinsurance | <u>93,200</u> | | <u>93,200</u> |
| Total Liabilities | \$5,177,366 | | \$5,177,366 |
| Aggregate write-ins for other than special surplus | 926,536 | | \$926,536 |
| Unassigned funds (surplus) | <u>1,769,924</u> | | <u>\$1,769,924</u> |
| Surplus as regards policyholders | <u>2,696,460</u> | | <u>2,696,460</u> |
| Total liabilities, capital and surplus | <u>\$7,873,826</u> | \$0 | <u>\$7,873,826</u> |

FLORIDA RURAL ELECTRIC SELF INSURER'S FUND
Statement of Income

DECEMBER 31, 2003

Underwriting Income

| | |
|---|--------------------|
| Premiums earned | \$2,976,978 |
| DEDUCTIONS: | |
| Losses incurred | 1,683,973 |
| Loss expenses incurred | 196,244 |
| Other underwriting expenses incurred | 529,324 |
| Aggregate write-ins for underwriting deductions | 0 |
| Total underwriting deductions | <u>\$2,409,541</u> |
| Net underwriting gain or (loss) | \$567,437 |

Investment Income

| | |
|--|------------------|
| Net investment income earned | \$226,598 |
| Net realized capital gains or (losses) | (5,667) |
| Net investment gain or (loss) | <u>\$220,931</u> |

Other Income

| | |
|--|----------------|
| Aggregate write-ins for miscellaneous income | \$715 |
| Total other income | <u>\$715</u> |
| Net income before dividends to policyholders and before federal & foreign income taxes | \$789,083 |
| Dividends to policyholders | 0 |
| Net Income, after dividends to policyholders, but before federal & foreign income taxes | \$789,083 |
| Federal & foreign income taxes | <u>361,849</u> |
| Net Income | \$427,234 |

Capital and Surplus Account

| | |
|--|-------------|
| Surplus as regards policyholders, December 31 prior year | \$2,160,197 |
|--|-------------|

Gains and (Losses) in Surplus

| | |
|--|---------------------------|
| Net Income | \$427,234 |
| Net unrealized capital gains or losses | (18,316) |
| Change in net deferred tax income | (28,560) |
| Change in non-admitted assets | 21,652 |
| Change in provision for reinsurance | (6,400) |
| Aggregate write-ins for gains and losses in surplus | 140,653 |
| Examination Adjustment | 0 |
| Change in surplus as regards policyholders for the year | <u>\$536,263</u> |
| Surplus as regards policyholders, December 31 current year | <u><u>\$2,696,460</u></u> |

COMMENTS ON FINANCIAL STATEMENTS

Assets

Bonds and Stocks

The Fund did not record the purchases of securities as of their trade date as is required by SSAP No. 26, paragraph 4.

Liabilities

Losses and Loss Adjustment Expenses \$4,512,918

An outside actuarial firm, which was appointed by the Board of Trustees rendered an opinion that the amounts carried on the balance sheet as of December 31, 2003, make a reasonable provision for all unpaid loss and loss expense obligations of the Fund under the terms of its policies and agreements. The Office Actuary reviewed work papers provided by the Fund and was in concurrence with this opinion.

**FLORIDA RURAL ELECTRIC SELF INSURER'S FUND
Comparative Analysis of Changes in Surplus**

DECEMBER 31, 2003

The following is a reconciliation of surplus as regards policyholders between that reported by the Fund and as determined by the examination.

| | |
|---|-------------|
| Surplus as Regards Policyholders per December 31, 2003, Annual Statement | \$2,696,460 |
|---|-------------|

| | <u>PER</u> <u>COMPANY</u> | <u>PER</u> <u>EXAM</u> | <u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u> |
|--|------------------------------|---------------------------|---|
| ASSETS: | | | |
| No adjustment necessary. | | | |
| LIABILITIES: | | | |
| No adjustment necessary. | | | |
| Net Change in Surplus: | | | 0 |
| Surplus as Regards Policyholders December 31, 2003, Per Examination | | | \$2,696,460 |

SUMMARY OF FINDINGS

Compliance with previous directives

The Fund has taken the necessary actions to comply with the comments made in the 2000 examination report issued by the Office.

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Fund regarding findings in the examination as of December 31, 2003.

Securities

The Fund, in purchasing new securities, did not record the purchases as of their trade date as required by SSAP No. 26, paragraph 4.

It is recommended that the Fund comply with SSAP No. 26, paragraph 4 and record all new purchases and/or disposals of securities as of their trade dates in all future annual and quarterly statement filings.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **FLORIDA RURAL ELECTRIC SELF INSURER'S FUND** as of December 31, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Fund's Surplus as regards policyholders was \$2,696,460, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Lou Sobers, Financial Examiner/Analyst Supervisor, Jay Ambler, Financial Examiner/Analyst I and Joe Boor, Actuary, participated in the examination.

Respectfully submitted,

Owen A. Anderson
Financial Examiner/Analyst II
Florida Office of Insurance Regulation