

REPORT ON EXAMINATION
OF
FIRST PROTECTIVE INSURANCE
COMPANY
LAKE MARY, FLORIDA

AS OF
DECEMBER 31, 2005

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

November 8, 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:

**FIRST PROTECTIVE INSURANCE COMPANY
200 COLONIAL CENTER PARKWAY, SUITE 100
LAKE MARY, FLORIDA 32746**

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

SCOPE OF EXAMINATION

This examination covered the period from January 1, 2005 through December 31, 2005. This examination commenced with planning at the Florida Office of Insurance Regulation (Office) on June 20, 2006. The fieldwork commenced on July 17, 2006, and was concluded as of September 29, 2006. Additional offsite work was concluded on November 8, 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, 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 verified the integrity of the balances of the Company's assets and liabilities as reported in its annual statement as of December 31, 2005, as those balances affect the financial solvency of the Company.

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

The Company was last examined by representatives of the Office as of December 31, 2004. The following is a summary of adverse findings contained in the Office's prior examination report along with the resulting action taken by the Company.

General

The Company established an audit committee on May 19, 2005 comprised of four of its directors actively involved in the daily operations. Section 624.424(8)(c), Florida Statutes, requires that the audit committee be comprised solely of members who are free from any relationship that, in the opinion of its Board of Directors, would interfere with the exercise of independent judgment as committee member.

Resolution: The Company's Board of Directors appointed a new audit committee on May 19, 2005. However, the Board did not provide documentation supporting the determination of compliance with the independence requirements of Section 624.424(8)(c), Florida Statutes.

The Company did not maintain written minutes documenting the annual shareholders meeting.

Resolution: The Company did not maintain written minutes documenting the 2005 annual shareholders meeting. However, minutes documenting the 2006 annual shareholders meeting were maintained by the Company.

The Company did not disclose conflicts of interests on an annual basis.

Resolution: The Company disclosed conflicts of interest in 2005.

The Board of Directors did not annually appoint the Company officers as required by the Company bylaws.

Resolution: In 2005 and 2006, the Board of Directors appointed the Company officers as required by the Company bylaws.

There was no documentation in the Board minutes that the prior examination report was reviewed.

Resolution: Documentation of Board review and acceptance of the December 31, 2004 examination report was documented in the 2005 Board minutes.

The Company did not maintain the suggested amount of fidelity bond coverage as recommended by the NAIC.

Resolution: In 2005, the Company increased its fidelity bond coverage above the suggested amount of fidelity bond coverage as recommended by the NAIC.

The Company did not have a custodial agreement with Charles Schwab, who held their securities at year-end. The Company indicated they transferred their securities to a new custodian but did not provide the examiner with the name, address and executed custodial agreement.

Resolution: The Company transferred its securities from Charles Schwab to Lexington Asset Management, Ltd. during 2005. The Company did not have a custodial agreement with Lexington Asset Management, Ltd. as of year-end 2005. However, in 2006, the Company transferred its securities to Bank of America. The Company's custodial agreement with Bank of America has been filed with, and approved by, the Office.

The Company's tax allocation agreement did not provide for the method of allocation between the Company and the parent and was not properly executed or approved by the Office. The Company failed to disclose in the annual statement that the federal income tax recoverable was due from their parent.

Resolution: The Company amended its intercompany tax allocation agreement to provide for the method of allocation between the Company and its parent. The agreement was filed with, and approved by, the Office. The Company properly disclosed in its 2005 Annual Statement that the federal income tax recoverable was due from its parent.

The Information Technology (IT) evaluation noted several significant areas of concern. Backup file provisions need to be improved for data files and computer programs. Logical and physical access review should be performed for all functions in the computer system. An acceptable Use Policy should be published and signed by each employee. The Company should develop and document a business contingency plan and a disaster recovery plan.

Resolution: The Company implemented improved backup file provisions for data files and computer programs. The Company performed a review of logical and physical access and

implemented new controls over the same. The Company published an acceptable Use Policy which all employees are required to sign annually. The Company has also developed and documented a business contingency plan and a disaster recovery plan.

The claims review noted several significant areas of concern as regards deficiencies in the claims practices and condition of the claims files. The open claim reserves were not reflective of case values and not consistent with general observed industry practice. The case reserves independently calculated were \$704,704 greater than that calculated by the Company. The open claim expense reserves were not reflective of case values and not consistent with general observed industry practice. The Company reserves were lower than an independent calculation by \$98,472. There was no consistency between the reserves stated in the adjuster's file activity notes and reports and loss runs. The hard copy claims files did not contain claim reserve histories or current reserve documentation. Indemnity or expense payment history did not exist in the claims files, and loss date information was not consistent. Payment documentation for closed claims was inconsistent. Correspondence from the Company to Specialty Claims did not exist regarding initial report information. Reserve adjustments were made on closed files to align the reserves to payments already made. Nine instances of offsetting reserves to payments not entered resulted in a negative balance on the loss runs. Nine claim files could not be located. None of the claim copy hard copies were stamped with the date received. Adjuster file activity notes in many files were stale or incomplete. No follow-up diary of an inside adjuster, supervisor or manager were noted in the claim files. The indemnity and expense case reserves on the open claim files reviewed were inadequate to meet current exposures. There were significant delays in the payment of claims.

Resolution: The Company implemented significant improvements in its claims practices during 2005. During the current examination, it was noted that claim file documentation was more

complete and that case reserves were more reflective of actual claim values. In addition, no significant delays were noted in the payment of claims in the examination testing performed.

The Office's independent actuarial review noted several areas of concern as regards Schedule P and the Company actuary's methodology. The amounts carried by the Company were significantly inadequate on both a direct and assumed basis and on a net basis. Schedule P did not match to any claim files, for any year. Adjustments by the Company remain unexplained. Amounts used for combined lines and combined loss and allocated LAE fluctuated between reports. The Fire/Allied Lines Schedule P has been in error since the inception of the Company. Hurricane catastrophe data provided had several problems. Significant reserves were held for hurricane claim files designated as "closed" by the Company. Catastrophe losses were allocated incorrectly in Schedule P. Different number of claims exist in various data files, which made it difficult to determine the number of catastrophe claims made. The office's independent actuary disagrees with the estimated ultimate catastrophe amount estimation approach by the Company's actuary.

Resolution: During the current examination, the examination actuary concluded that the methodology and approach used by the Company's appointed actuary were reasonable. As discussed elsewhere in this report, the actuarial review concluded that the reserves carried by the Company at December 31, 2005 were redundant on a direct and assumed basis but deficient on a net basis. Although data problems remain for prior years, the Company implemented improvements in data collection and reporting in 2005 and Schedule P was reconciled to the Company's underlying data for the current year. Nevertheless, some allocation problems still continue to exist. These problems have been addressed in additional communications with the Company.

The Company's accounting records were not in order, were not accurate, not complete and supporting detail did not exist for many summary ledger balances.

Resolution: No material issues were noted during the current examination.

Financial

The Company's agents' balances aging schedule did not exist.

Resolution: The Company provided an aging schedule as part of the current examination.

Prepayments of fees to Frontline Insurance Managers, Inc. (Frontline), a related-party MGA, and lease security deposits are not admitted assets.

Resolution: No fees to Frontline were prepaid by the Company as of December 31, 2005. In addition, the Company did not reflect any lease security deposits as admitted assets at December 31, 2005.

The Company made a journal adjustment of \$856,017 to advanced premiums without supporting detail.

Resolution: The Company provided the examiners with supporting detail for all requested journal entries during the current examination.

The Office's independent actuary concluded there was a deficiency of \$4,660,000 in the loss and loss adjustment expense reserves.

Resolution: The Company recognized approximately \$2,663,000 of the \$4,660,000 deficiency in 2005 through negative loss and loss adjustment expense development. As discussed in this report, a \$743,000 adjustment to the December 31, 2005 net loss and loss adjustment expense reserves is recommended as a result of the current examination.

HISTORY

General

The Company was incorporated on March 16, 1998, under the laws of the State of Florida, as a stock property and casualty insurer. The Company commenced business on April 30, 1998, with the name of First Protective Insurance Company. The Company is a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code.

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
Homeowners multi Peril
Mobile Home Multi Peril

Allied Lines
Other Liability
Mobile Home Physical Damage

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	500,000
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, PWC Financial, Inc. (PWC), which owned 100 percent of the stock issued by the Company. As of December 31, 2005, PWC was collectively owned by 44 shareholders, with the following persons owning in excess of 10%: Willis Thomas King, Jr. (18.000%); Lanier Miles Porter (11.500%); and John Francis Cosgrove (10.375%).

Profitability of Company

The following table shows the profitability (in dollars) of the Company for the period of examination, as reported in the filed Annual Statement.

	2005
Premiums Earned	14,449,991
Net Underwriting Gain/(Loss)	(4,177,451)
Net Income	(3,383,217)
Total Admitted Assets	21,913,181
Total Liabilities	16,452,347
Surplus As Regards Policyholders	5,460,833

Dividends to Stockholders

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

Management

The annual shareholder 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	Principal Occupation
Leman Miles Porter Lake Mary, Florida	President First Protective Insurance Company
Lanier Miles Porter Maitland, Florida	Chief Executive Officer First Protective Insurance Company
Dwayne Richard Williams Oviedo, Florida	Executive Vice President First Protective Insurance Company
Harold Mack Humphrey Miami, Florida	Vice President First Protective Insurance Company
Willis Thomas King, Jr. Summit, New Jersey	Chairman of the Board PWC Financial, Inc.
Emily Roberts McDonald Summit, New Jersey	Director First Protective Insurance Company
John Francis Cosgrove (a) Miami, Florida	Attorney First Protective Insurance Company

(a) Deceased in 2006.

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

Senior Officers

Name	Title
Leman Miles Porter	President & Secretary
Lanier Miles Porter	Chief Executive Officer
Harold Mack Humphrey	Vice President
Dwayne Richard Williams	Executive Vice President, Treasurer & Assistant Secretary
Benjamin Andrew Treuil	Chief Financial Officer

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

Audit Committee	Investment Committee	Financial Examination Committee
John F. Cosgrove ¹	Willis T. King ¹	Willis T. King ¹
Emily R. McDonald	Leman M. Porter	Emily R. McDonald
John Laurie	Benjamin A. Treuil	Dwayne R. Williams
Dwayne R. Williams ²	Dwayne R. Williams	
¹ Chairman		
² ex-Officio Member		

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, Florida Statutes.

Corporate Records

The recorded minutes of the meetings of the Board of Directors and certain internal committees adequately documented the meetings and approval of Company transactions in accordance with Section 607.1601, Florida Statutes.

However, in 2005, the minutes of the Board of Directors meeting did not document authorization of investments as required by Section 625.304, Florida Statutes. Subsequently, in 2006, the Board of Directors appointed an Investment Committee to review and authorize investment transactions. The minutes of the Investment Committee for 2006 documented authorization of investments as required by Section 625.304, Florida Statutes.

In addition, the Company did not maintain written minutes documenting the 2005 annual shareholders meeting. However, minutes documenting the 2006 annual shareholders meeting were maintained by the Company.

On May 19, 2005, the Board of Directors appointed an audit committee comprised of four of its directors actively involved in the daily operations of the Company. Section 624.424(8)(c), Florida Statutes, requires that the audit committee be comprised solely of members who are free from any relationship that, in the opinion of its Board of Directors, would interfere with the exercise of independent judgment as a committee member. On November 11, 2005, the Board of Directors appointed an audit committee made up of three voting and one non-voting member. Although none of the voting members were actively involved in the daily operations of the Company, all three of the voting members had relationships with the Company, including ownership in the Company. The Board of Directors did not document its determination of how the audit

committee met the independence requirements of Section 624.424(8)(c), Florida Statutes, as required by the Office.

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

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

Surplus Debentures

As of December 31, 2005, the Company had three surplus debentures outstanding totaling \$5,767,500. Surplus debentures were issued to PWC in the amounts of \$1,000,000 and \$1,500,000 on August 1, 2003 and December 31, 2003, respectively. In addition, the Company issued a surplus debenture to Frontline in the amount of \$3,267,500 on December 31, 2005.

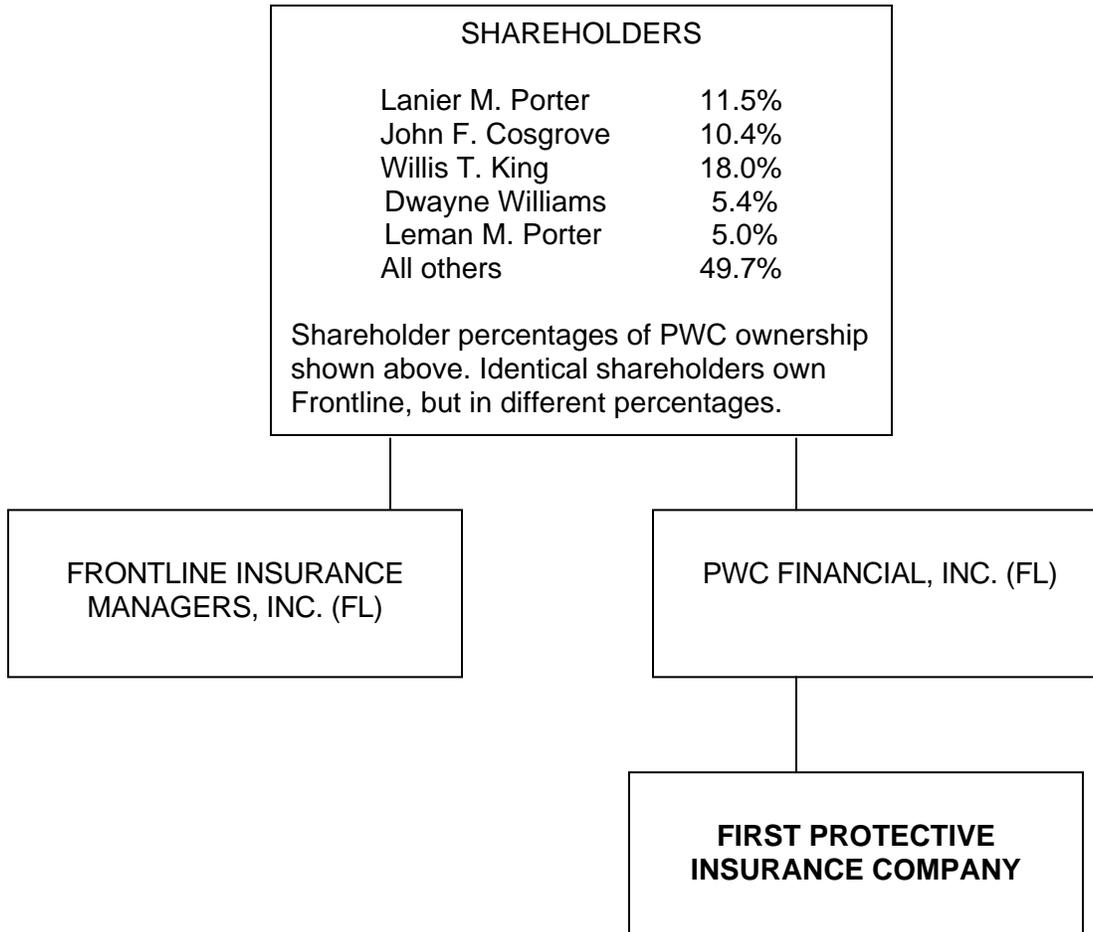
AFFILIATED COMPANIES

An organizational chart as of December 31, 2005, reflecting the holding company system, is shown below.

FIRST PROTECTIVE INSURANCE COMPANY

Organizational Chart

DECEMBER 31, 2005



The latest holding company registration statement was filed with the Office on March 3, 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:

Management Agreement

The Company entered into a management agreement with PWC, effective August 1, 2003, whereby PWC agreed to provide certain managerial and administrative services for the Company. PWC duties under the management agreement included: corporate organization; investment management; financial management; accounting and tax services; legal advice; corporate management services; human resources services; corporate expense oversight; benefit plan management; actuarial services; regulatory liaison services; marketing assistance; use of information systems; and other ministerial functions. In exchange for the services provided, the Company paid PWC, as compensation, an amount equal to 5% of the Company's "net direct written premium" (gross written premium, less return premium). During 2005, the Company paid PWC \$2,158,159 under the terms of the management agreement.

Subsequent Event: The Company entered into a new management agreement with PWC, effective January 1, 2006. The new management agreement was intended to reflect actual services provided to the Company by PWC and also to reflect the new corporate structure of the Company. Under the terms of the new management agreement, PWC duties include: corporate organization; investment management; financial management; accounting and tax services; legal advice; corporate management services; human resource services; corporate expense

oversight; benefit plan management; actuarial services; regulatory liaison services; reinsurance services; and other ministerial functions. In exchange for the services provided, PWC received a fee from the Company equal to 5% of the Company's "net written premium" (gross written premium, less return premium). The new management agreement was filed with the Office for prior approval, as is required by Rule 69O-143.047, Florida Administrative Code.

Managing General Agency Agreement

The Company entered into an Amended and Restated Managing General Agency (MGA) Agreement with Frontline, effective September 14, 2001, whereby Frontline agreed to manage certain of the Company's insurance operations. Duties under this agreement included: underwriting; premium collection; marketing and agent relations; reinsurance negotiation; regulatory liaison services; consulting regarding loss prevention and analysis, retention of accountants and actuaries, and business and strategic decisions; and other ministerial functions. In exchange for the services provided, the Company paid Frontline, as compensation, an amount equal to 10% of the Company's "net written premiums" (gross written premiums written or assumed, less cancellations and return premiums). In addition, Frontline also received a \$25 per policy servicing fee, which was collected from the policyholders. During 2005, the Company paid Frontline \$5,370,042, which included \$1,061,725 in per policy servicing fees collected from the policyholders, under the terms of the MGA Agreement

Subsequent Event: The Company entered into a new MGA agreement with Frontline, effective January 1, 2006. The new agreement was intended to reflect actual services provided to the Company by Frontline and also to reflect the new corporate structure of the Company. Under the terms of the new MGA agreement, duties included: development of underwriting guidelines and marketing and sales materials; solicitation and evaluation of policy applications; premium billing

and collection; policy cancellation; appointment of sub-producers; and claims servicing. In exchange for the underwriting, marketing, and administration services provided, Frontline received a fee from the Company equal to 10% of the Company's "net written premium" (gross written premium, less return premium). In addition, for payment of agent commissions, Frontline received a fee from the Company equal to 10.5% of the Company's "net written premium". Frontline was also entitled to a \$25 per policy servicing fee, which was collected from the policyholders. In exchange for the claims servicing and administration services provided, Frontline would receive a fee from the Company equal to 15.5% of the Company's "gross incurred loss" (the net amount of losses paid, recoveries, and the change in outstanding loss reserves for the month). In addition, Frontline would be entitled to 30% of any recoveries from subrogation claims brought by the Company. The new MGA agreement was filed with the Office for prior approval, as required by Rule 69O-143.047, Florida Administrative Code.

Claims Agreement

The Company entered into a claims agreement with Frontline, effective October 1, 2005, whereby Frontline agreed to provide certain adjusting services (field claims adjusting but not claims processing) with respect to catastrophes that occurred between October 1, 2005 and December 1, 2005. The intent of this claims agreement was to provide field claims adjusting services for the Company's claims pertaining to Hurricane Wilma. In exchange for the services provided, the Company was required to pay Frontline, as compensation, a fee based on the gross amount of loss as determined by a schedule that was included in Appendix 1 to the claims agreement. The minimum amount payable under the claims agreement is \$475 per loss (for a gross loss at, or below \$2,500) and the maximum amount payable is \$7,800 per loss (for a gross loss above \$200,000). Based on detail provided by the Company, it paid Frontline \$3,742,308 during 2005 under the terms of the claims agreement. The claims agreement was not filed with the Office for

prior approval, as required by Rule 69O-143.047, Florida Administrative Code. In addition, the claims agreement was not disclosed in the Company's Annual Statement, as required by NAIC SSAP No. 25, or in the Company's Holding Company Registration Statement, as required by Rule 69O-143.046, Florida Administrative Code.

Cost Sharing Agreement

The Company entered into a cost sharing agreement with PWC and Frontline, effective January 1, 2005, to allocate the costs of services incurred by one of the parties on behalf of one or both of the other parties in accordance with generally accepted cost allocation principles. The cost sharing agreement was not filed with the Office for prior approval, as required by Rule 69O-143.047, Florida Administrative Code. In addition, SSAP No. 25 requires disclosures pertaining to affiliated agreements in the annual statement. The cost sharing agreement was not disclosed in the Company's annual statement.

Tax Allocation Agreement

The Company, along with its parent, filed a consolidated federal income tax return. The method of allocation between the Company and its parent, which is set forth in the amended Federal Income Tax Allocation Agreement entered into between the Company and PWC as of December 16, 2005 and effective retroactively to include tax year 2004, was based on separate return calculations with current credit for net losses. The tax allocation agreement was filed with the Office, as required by Rule 69O-143.047(4), Florida Administrative Code. Amounts owed by the Company to PWC under the terms of the tax allocation agreement were required to be paid to PWC within 30 days of receiving notice from PWC of the amount due. In the event the Company's incurred losses generated an income tax recoverable, that portion attributed to the Company was to be remitted to the Company within 30 days after receipt by PWC from the IRS.

FIDELITY BOND

At December 31, 2005, the Company maintained fidelity bond coverage up to \$500,000, with a deductible of \$25,000, which adequately covered the suggested minimum amount of coverage for the Company, as recommended by the NAIC.

PENSION AND INSURANCE PLANS

The Company offered a 401k plan, healthcare, dental, group life, and disability insurance for their employees.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes:

State	Description	Par Value	Market Value
Florida	Cash	<u>\$1,163,941</u>	<u>\$1,163,941</u>
Total Special Deposits		<u>\$1,163,941</u>	<u>\$1,163,941</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

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

The Company marketed and sold its products through the use of non-exclusive licensed agents.

Treatment of Policyholders

The Company has 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 Company's reinsurance agreements were reviewed and were found to comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines. However, none of the letters of credit that collateralized the Company's recoverables from unauthorized reinsurers at December 31, 2005 fully complied with all of the provisions pertaining to letters of credit as required by Section 624.610, Florida Statutes, and Rule 69O-144.005, Florida Administrative Code.

The Company utilized the services of RFIB Group Limited, as its reinsurance intermediary broker on all of the Company's commercial catastrophe reinsurance agreements. However, RFIB Group Limited was not licensed in the State of Florida, as required by Section 626.7492(3)(a)1, Florida Statutes. In addition, the Company did not have a contract with RFIB Group Limited, as required by Section 626.7492(4), Florida Statutes, and the Company did not comply with certain duties for insurers using the services of a reinsurance intermediary broker, as required by Section 626.7492(6), Florida Statutes.

Assumed

In 2004, the Company assumed a book of business from Argus Fire and Casualty Insurance Company (Argus) through an assumption agreement. Upon renewal, the Argus policies were transferred to Company policies. At December 31, 2005, the Company had no assumed reinsurance.

Ceded

The Company ceded catastrophe risks on an excess of loss basis to certain Lloyd's syndicates and other commercial reinsurers. Under the catastrophe excess of loss agreements, the Company had a retention of \$3 million and coverage of up to \$82 million, with the provision for one reinstatement. In addition, the Company purchased reinstatement premium protection. The Company also entered into a reimbursement contract with the Florida Hurricane Catastrophe Fund (FHCF), which provided 90% coverage of up to \$71 million of losses per catastrophe. Combined, the Company had \$153 million of catastrophe loss reinsurance coverage.

During 2005, the Company ceded non-catastrophe risks on a 50% quota share basis to Transatlantic Reinsurance Company, limited to property values no greater than \$1 million and

comprehensive personal liability limits of \$500,000. However, the Company wrote policies with property limits greater than \$1 million during 2005. To protect itself against further loss on policies issued with policy limits in excess of \$1 million, the Company had a per risk excess of loss agreement with certain Lloyd's syndicates.

Subsequent Event: The 50% quota share agreement with Transatlantic Reinsurance Company was terminated effective May 31, 2006. The Company negotiated a new 50% quota share reinsurance agreement with Greenlight Reinsurance, Ltd., a Cayman Islands reinsurer, effective June 1, 2006.

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

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 Lake Mary, Florida, where this examination was conducted.

An independent CPA audited the Company's 2005 statutory basis financial statements 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 did not have a custodial agreement with Lexington Asset Management, Ltd. at December 31, 2005 as required by Rule 69O-143.042, Florida Administrative Code. Subsequent to year-end, the Company moved its securities to Bank of America under a custodial agreement that met the requirements of Rule 69O-143.042, Florida Administrative Code.

Independent Auditor Agreement

The Company had an independent auditor agreement with Thomas Howell Ferguson as of December 31, 2005.

Risk-Based Capital

At December 31, 2005, the Company reported its risk-based capital at the Regulatory Action Level. The Company filed a Risk-Based Capital Corrective Action Plan dated March 6, 2006 with the Office.

Subsequent Event: As a result of the examination adjustments, the Company's risk-based capital level was recalculated and resulted in the Company falling into the Mandatory Control Level. However, at June 30, 2006 the Company reported risk-based capital in excess of statutory action levels.

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."

FIRST PROTECTIVE INSURANCE COMPANY
Assets

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Bonds	\$5,724,893		\$5,724,893
Cash and Short-term investments	4,209,908		4,209,908
Investment income due & accrued	107,961		107,961
Agents' Balances:			
Uncollected premium	1,797,612		1,797,612
Reinsurance:			
Recoverable	8,165,332		8,165,332
Other amounts receivable	700,000		700,000
Net deferred tax asset	496,439		496,439
Aggregate write-in for other than invested assets	711,036	\$69,077	780,113
Totals	\$21,913,181	\$69,077	\$21,982,258

FIRST PROTECTIVE INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Losses	\$3,096,987	\$544,000	\$3,640,987
Loss adjustment expenses	879,149	199,000	1,078,149
Commissions payable	408,554		408,554
Other expenses	165,678		165,678
Taxes, licenses and fees	120,459		120,459
Unearned premiums	9,994,585	1,849,025	11,843,610
Advance premiums	1,283,113		1,283,113
Remittances and items not allocated	102,677		102,677
Payable to parent, subsidiaries and affiliates	835		835
Aggregate write-ins for liabilities	400,311	658,348	1,058,659
Total Liabilities	\$16,452,348	\$3,250,373	\$19,702,721
Common capital stock	\$100,000		\$100,000
Surplus Notes	5,767,500		5,767,500
Gross paid in and contributed surplus	4,900,000		4,900,000
Unassigned funds (surplus)	(5,306,667)	(\$3,181,296)	(8,487,963)
Surplus as regards policyholders	\$5,460,833	(\$3,181,296)	\$2,279,537
Total liabilities, capital and surplus	\$21,913,181	\$69,077	\$21,982,258

FIRST PROTECTIVE INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2005

Underwriting Income	
Premiums earned	\$14,449,991
DEDUCTIONS:	
Losses incurred	9,120,341
Loss expenses incurred	3,360,659
Other underwriting expenses incurred	6,146,442
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$18,627,442</u>
Net underwriting gain or (loss)	(\$4,177,451)
Investment Income	
Net investment income earned	\$308,339
Net realized capital gains or (losses)	(4,308)
Net investment gain or (loss)	<u>\$304,031</u>
Other Income	
Net gain or (loss) from agents' or premium balances charged off	\$0
Finance and service charges not included in premiums	9,453
Aggregate write-ins for miscellaneous income	10,374
Total other income	<u>\$19,827</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$3,853,593)
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$3,853,593)
Federal & foreign income taxes	<u>(470,375)</u>
Net Income	(\$3,383,218)
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	\$4,220,800
Gains and (Losses) in Surplus	
Net Income	(\$3,383,218)
Change in net deferred income tax	\$408,418
Change in non-admitted assets	947,333
Change in provision for reinsurance	0
Change in surplus notes	3,267,500
Examination Adjustment	(3,181,296)
Change in surplus as regards policyholders for the year	<u>(\$1,941,263)</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$2,279,537</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Asset

Aggregate write-ins for other than invested assets **\$780,113**

The above amount is \$69,077 more than the amount reported by the Company. The \$69,077 represented additional income tax recoverables from PWC based on the actual 2005 tax returns filed in 2006.

Liabilities

Losses **\$3,640,987**
Loss adjustment expenses **\$1,078,149**

The above amounts are a cumulative \$743,000 more than the amount reported by the Company. The increase in the liabilities for losses and loss adjustment expenses was based on the results of the examination actuarial review as of December 31, 2005, performed by Charles Bryan, FCAS, MAAA. The examination actuarial review determined loss and loss adjustment expense reserves to be overstated by \$511,000 on a direct and assumed basis (gross basis) and understated by \$743,000 on a net basis. The understatement of net loss and loss adjustment expense reserves was primarily caused by additional conservatism calculated into the reserves as a result of inadequate data for pre-2005 reserves, actual paid claim results through June 30, 2006 and the inclusion of additional loss adjustment expenses related to a claims servicing agreement that was not provided to the opening actuary by Company and, therefore, was not included in the opening actuary's calculation of December 31, 2005 loss adjustment expense reserves.

Unearned premiums **\$11,843,610**

The above amount is \$1,849,025 more than the amount reported by the Company. The difference was the result of incorrect amortization of unearned ceded reinsurance premiums by

the Company during 2005. The incorrect amortization of the unearned ceded reinsurance premiums was the result of premiums being amortized by the Company over periods different than the coverage periods in the reinsurance agreements and the use by the Company of incorrect monthly amortization amounts.

Subsequent event: Although the incorrect amortization by the Company resulted in an adjustment of \$1,849,025 to unearned premiums as of December 31, 2005, this was a timing difference only. The Company stated that the full amount of the adjustment was expected to be reversed by June 30, 2006.

Aggregate write-ins for liabilities

\$1,058,658

The above amount is \$658,348 more than the amount reported by the Company. SSAP No. 62, concerning Property and Casualty Reinsurance states that if the ceding commission paid under a reinsurance agreement exceeds the anticipated acquisition cost of the business ceded, the ceding entity shall establish a liability, equal to the difference between the anticipated acquisition cost and the reinsurance commissions received, to be amortized pro rata over the life of the reinsurance agreement. The Company calculated acquisition costs to be in excess of the ceding commission on its quota-share agreement by approximately 24%. However, the Company incorrectly included catastrophe reinsurance premiums as a portion of the acquisition costs used to calculate excess ceding commissions. By removing the ceded catastrophe premiums, and making an additional adjustment to more accurately reflect the acquisition costs related to the management agreement with PWC, the Company's ceding commission exceeds acquisition costs by approximately 11.50%. The result was an examination adjustment of \$658,348 to establish a liability for excess ceding commissions, which will be earned pro-rata over the life of the quota-share reinsurance agreement.

Capital and Surplus

The Company's Surplus as regards policyholders was \$2,279,537 as of December 31, 2005, which was below the minimum required Surplus as regards policyholders amount required in Section 624.408, Florida Statutes. **We recommend that the Company immediately comply with the surplus requirement in Section 624.408, Florida Statutes.**

Subsequent Event: The Company entered into a \$4 million subordinated surplus debenture dated September 30, 2006. The debenture was approved by the Office in accordance with SSAP No.72, paragraph 8. The September 30, 2006 quarterly statement reflected a surplus amount of \$10,140,254.

A comparative analysis of changes in surplus is shown below.

FIRST PROTECTIVE 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 \$ 5,460,833

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
Aggregate Write-in for other than invested assets	\$ 711,036	\$ 780,113	\$ 69,077
LIABILITIES:			
Losses	\$3,096,987	\$3,640,987	(\$544,000)
Loss adjustment expenses	879,149	1,078,149	(199,000)
Unearned premiums	9,994,585	11,843,610	(1,849,025)
Aggregate write-ins for liabilities	400,310	1,058,658	(658,348)
Net Change in Surplus:			<u>(3,181,296)</u>
Surplus as Regards Policyholders December 31, 2005, Per Examination			<u>\$ 2,279,537</u>

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken actions to substantially comply with the comments made in the 2004 examination report issued by the Office. For additional detail, see the Status of Adverse Findings from Prior Examination section of this 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.

On May 19, 2005, the Board of Directors appointed an Audit Committee of 4 members. Although none of the voting members were actively involved in daily operations, 3 of the voting members had relationships with the Company, including ownership. **We recommend that the Company provide documentation to confirm that members of the Audit Committee meet the independence requirements of Section 624.424 (8)(c), Florida Statutes.**

The Company failed to file the Claims Agreement with Frontline, effective October 1, 2005, with the Office for prior approval, as required by Rule 69O-143.047, Florida Administrative Code. **We recommend the Company file the Claims Agreement with the Office, requesting approval.**

The Company failed to disclose the Claims Agreement in the Company's December 31, 2005 Holding Company Registration Statement, as required by Rule 69O-143.046, Florida Administrative Code. **We recommend the Company disclose the Claims Agreement in all future Holding Company Registration Statements filed with the Office.**

The Company failed to file the Cost Sharing Agreement with PWC and Frontline, effective January 1, 2005, with the Office for prior approval, as required by Rule 69O-143.047, Florida Administrative Code. **We recommend the Company file the Cost Sharing Agreement with the Office, requesting approval.**

None of the Company's letters of credit used to collateralize the Company's reinsurance recoverables from unauthorized reinsurers at December 31, 2005 fully complied with all of the provisions pertaining to letters of credit as required by Section 624.610, Florida Statutes, and Rule 69O-144.005, Florida Administrative Code. **We recommend the Company obtain letters of credit that fully comply with the requirements of Section 624.610, Florida Statutes, and Rule 69O-144.005, Florida Administrative Code.**

The reinsurance intermediary broker utilized by the Company was not licensed in the State of Florida, as required by Section 626.7492(3)(a)1, Florida Statutes. **We recommend the Company use only properly licensed reinsurance intermediary brokers.**

The Company did not have a contract with its reinsurance intermediary broker, as required by Section 626.7492(4), Florida Statutes. **We recommend the Company enter into a contract with its reinsurance intermediary broker that contains the provisions required by Section 626.7492(4), Florida Statutes.**

The Company did not comply with certain duties for insurers using the services of a reinsurance intermediary broker, as required by Section 626.7492(6), Florida Statutes. **We recommend the Company comply with all of the duties for insurers using the services of a reinsurance intermediary broker required by Section 626.7492(6), Florida Statutes.**

Rule 69O-137.001(4), Florida Administrative Code, requires insurers to follow the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions in completing annual and quarterly statements. The Company failed to disclose the Claims Agreement and Cost Sharing Agreement in the Company's Annual Statement, as required by SSAP No. 25 – Accounting for and Disclosure about Transactions with Affiliates and Other Related Parties. **We recommend the Company follow the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions in completing all future annual and quarterly statements filed with the Office, as required by Rule 69O-137.001(4), Florida Administrative Code, including required disclosures pertaining to the Claims and Cost Sharing Agreements.**

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **First Protective 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 \$2,279,537, which was not in compliance with Section 624.408, Florida Statutes, and places the Company in an impaired financial position at December 31, 2005.

In addition to the undersigned, the following members of Rector and Associates, Bruce E. Schowengerdt, Examiner-in-Charge, Edward A. Dinkel, Senior Financial Examiner and Charles A. Bryan, FCAS, MAAA participated in the examination.

Respectfully submitted,

John Berry
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation