

**REPORT ON EXAMINATION**

**OF**

**FLORIDA RURAL ELECTRIC SELF**

**INSURER'S FUND**

**TALLAHASSEE, FLORIDA**

**AS OF**

**DECEMBER 31, 2006**

**BY THE**

**OFFICE OF INSURANCE REGULATION**

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Tallahassee, Florida

December 20, 2007

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 624.4621, 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, 2006, of the financial condition and corporate affairs of:

**FLORIDA RURAL ELECTRIC SELF INSURER'S FUND  
2916 APALACHEE PARKWAY  
TALLAHASSEE, FLORIDA 32301**

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, 2004 through December 31, 2006. The Fund was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2003. This examination commenced, with planning at the Office, on June 11, 2007, to June 15, 2007. The fieldwork commenced on June 18, 2007, and was concluded as of December 20, 2007.

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 of assets and the determination of liabilities, as those balances affect the financial solvency of the Fund as of December 31, 2006. Transactions subsequent to year-end 2006 were reviewed where relevant and deemed significant to the Fund's financial condition.

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 NAIC IRIS ratio reports, the Fund's independent audit reports and certain work papers prepared by the Fund's independent certified public accountant (CPA) and other reports as considered necessary were reviewed and utilized where applicable within the scope of this examination.

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:

- Other amounts receivable under reinsurance contracts
- Other expenses
- Taxes, licenses and fees

### **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, 2003, along with the resulting action taken by the Fund in connection therewith.

### **Securities**

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

**Resolution:** The Fund recorded securities purchases as of the trade date.

## HISTORY

### General

The Fund was established in Florida on January 16, 1979 under the name Florida Rural Electric Self Insurer's Fund, to operate as a self-insurer in accordance with Section 624.4621, Florida Statutes. It was authorized to transact worker's compensation insurance coverage to members of the Florida Electric Cooperatives Association (Association). The Fund had 17 members as of December 31, 2006 and produced annualized premiums of approximately \$3,400,000. The Fund's office 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 Fund was authorized to transact the following insurance coverage in Florida on December 31, 2006:

Worker's compensation

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

### Profitability of Fund

The following table shows the profitability trend (in dollars) of the Fund for the period of examination, as reported in the filed annual statements.

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Premiums Earned	2,511,161	2,969,506	2,866,002
Net Underwriting Gain/(Loss)	(526,973)	11,853	1,231,728
Net Income	(757,935)	(521,480)	1,059,083
Total Assets	11,070,877	9,770,175	9,245,025
Total Liabilities	7,961,149	6,134,757	5,516,556
Surplus As Regards Policyholders	3,109,728	3,635,408	3,728,469

### **Dividends to Stockholders**

In accordance with Section 624.4621, Florida Statutes, the Fund requested and received Office approval to declare and pay dividends to its members in 2006 in the amount of \$1,000,000.

### **Management**

The annual shareholder meeting for the election of trustees was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Trustees serving as of December 31, 2006, were:

#### **Trustees**

##### **Name and Location**

##### **Principal Occupation**

Gary Bartlett  
Lakeland, Florida

Peace River Electric Coop.

Ron Bass  
Pinetta, Florida

Tri County Electric Coop.

Billy Brown  
Dade City, Florida

Withlacoochee River Coop.

Clay Campbell  
Pace, Florida

Escambia River Electric Coop.

Mike Campbell  
Chiefland, Florida

Central Florida Electric Coop.

John Hewa  
Tallahassee, FL

Talquin Electric Coop.

John Martz  
Live Oak, FL

Suwannee Valley Coop

John Middleton  
Hoboken, Georgia

Okefenokee Electric Coop.

Bill Rimes  
Graceville, Florida

West Florida Electric Coop.

Don Stockton  
Tallahassee, FL

Cooperative Computer Center

Wayne Thompson  
Defuniak Springs, Florida

Choctawhatchee Electric Coop.

Tommy Todd  
Lake Placid, Florida

Glades Electric Coop.

Mike White  
Wewahitchka, FL

Gulf Coast Electric Coop.

William B. Willingham  
Tallahassee, Florida

Florida Electric Coop. Assn.

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

#### Senior Officers

##### Name

##### Title

Bill Rimes  
Tommy Todd  
John Martz  
William Willingham

President  
Vice President  
Secretary/Treasurer  
Administrator

Following are the principal internal board committees and their members as of December 31, 2006:

## **Internal Audit Committee**

Ron Bass  
Ken Cowen  
Gary Stallons<sup>1</sup>

<sup>1</sup> Chairman

### **Conflict of Interest Procedure**

The Fund adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook. The Fund did not provide executed conflict of interest statements for the year ending December 31, 2006.

### **Fund Records**

The recorded minutes of the shareholder, Board of Trustees, and certain internal committees were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Fund transactions and events in accordance with Section 607.1601, Florida Statutes. Authorization of investments by the Board of Trustees in the minutes as required by Section 625.304, Florida Statutes was not recorded.

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

As of December 31, 2006, the Fund had no acquisitions, mergers, disposals, dissolutions, or purchases or sales through reinsurance.

## **Surplus Debentures**

The Fund had no surplus debentures for the year ended December 31, 2006.

## **AFFILIATED COMPANIES**

The Fund had no affiliated companies and was not a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. Therefore no organizational chart was presented. The Fund shared the use of the telephone system and copier with the Association; and the expenses were allocated based on use.

## **FIDELITY BOND**

The Fund maintained fidelity bond coverage up to \$500,000 with a deductible of \$2,500, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC, but did not name as insured the individual trustees on the fidelity bond as required by Rule 69O-187.005(5), Florida Administrative Code.

The Fund also maintained Trustees' errors and omissions and Directors and officers liability insurance for associations with self insurance funds coverage with limits of \$2,000,000 and deductibles ranging from \$10,000 to \$60,000.

## **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Fund had no pension, stock ownership, or insurance plans as of December 31, 2006.

## 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
FL	US Treasury Notes, 6.500%, 2/15/2010	\$1,200,000	\$1,261,320
FL	US Treasury Notes, 4.125%, 8/15/2008	200,000	198,360
FL	US Treasury Notes, 4.875%, 5/15/2009	<u>300,000</u>	<u>301,650</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 1,700,000</u>	<u>\$1,761,330</u>
TOTAL SPECIAL DEPOSITS		<u>\$1,700,000</u>	<u>\$1,761,330</u>

## INSURANCE PRODUCTS

### Territory

The Fund was authorized to transact insurance in the state of Florida.

### Treatment of Policyholders

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

The Fund maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1)(i)3a, Florida Statutes.

## **REINSURANCE**

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard arbitration clause, transfer of risk, reporting and settlement information deadlines. The reinsurance agreements reviewed did not comply with SSAP No. 62, Paragraph (8)(a), with respect to the insolvency clause.

### **Assumed**

The Fund assumed no risk from other insurers.

### **Ceded**

The Fund ceded risk on a quota share and excess of loss basis to the Federated Rural Electric Insurance Exchange, a reinsurer to the electric cooperatives, with specific retentions of \$300,000 per each employee.

## **ACCOUNTS AND RECORDS**

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

An independent CPA audited the Fund's statutory basis financial statements annually for the years 2004, 2005 and 2006, 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 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 and non-affiliates had the following agreements:

### **Custodial Agreement**

The Fund entered into a custodial agreement with US Bank on June 22, 2007. US Bank was a national bank as set forth in the definition of an Agent or Custodian. The custodial agreement with US Bank was in compliance with Rule 69O-143.042, Florida Administrative Code.

### **Claims Servicing Agreement**

The Fund had an agreement with United Self Insured Services (USIS) to provide claims handling services. The agreement was entered into on January 1, 2006. 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 with ninety days written notice through January 1, 2007.

### **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 and Company (Gallagher) on January 1, 2006. 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 could be terminated at anytime, by either party, with 30 days prior written notice.

## **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Fund's financial position as of December 31, 2006, 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, 2006**

	Per Company	Examination Adjustments	Per Examination
Bonds	\$7,695,953		\$7,695,953
Stocks:			
Common	238,107		238,107
Cash:	1,205,636		1,205,636
Reinsurance recoverable	185,985		185,985
Other amounts receivable under reinsurance contracts	10,015		10,015
Amounts receivable relating to uninsured plans	42,257		42,257
Interest and dividend income due & accrued	103,072		103,072
Current federal and foreign income tax recoverable and interest thereon	324,046		324,046
Aggregate write-in for other than invested assets	1,265,806		1,265,806
Totals	\$11,070,877		\$11,070,877

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

**DECEMBER 31, 2006**

	Per Company	Examination Adjustments	Per Examination
Losses	\$6,559,292		\$6,559,292
Loss adjustment expenses	1,057,579		1,057,579
Other expenses	37,411		37,411
Taxes, licenses and fees	13,002		13,002
Net deferred tax liability	61,839		61,839
Dividends declared and unpaid: Policyholders	83,426		83,426
Provision for reinsurance	<u>148,600</u>		<u>148,600</u>
Total Liabilities	\$7,961,149		\$7,961,149
Aggregate write-ins for other than special surplus	\$1,713,912		\$1,713,912
Unassigned funds (surplus)	<u>1,395,816</u>		<u>1,395,816</u>
Surplus as regards policyholders	<u>\$3,109,728</u>		<u>\$3,109,728</u>
Total liabilities, surplus and other funds	<u><u>\$11,070,877</u></u>		<u><u>\$11,070,877</u></u>

**FLORIDA RURAL ELECTRIC SELF INSURER'S FUND**  
**Statement of Income**

**DECEMBER 31, 2006**

**Underwriting Income**

Premiums earned		\$2,511,161
	<b>Deductions:</b>	
Losses incurred		2,166,610
Loss expenses incurred		504,474
Other underwriting expenses incurred		367,050
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$3,038,134
Net underwriting gain or (loss)		(\$526,973)

**Investment Income**

Net investment income earned		\$328,474
Net realized capital gains or (losses)		(514)
Net investment gain or (loss)		\$327,960

**Other Income**

Aggregate write-ins for miscellaneous income		\$112,336
Total other income		\$112,336
Net income before dividends to policyholders and before federal & foreign income taxes		(\$86,677)
Dividends to policyholders		1,000,000
Net Income, after dividends to policyholders, but before federal & foreign income taxes		(\$1,086,677)
Federal & foreign income taxes		(328,742)
Net Income		(\$757,935)

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year		\$3,635,408
Net Income		(\$757,935)
Net unrealized capital gains or losses		(9,171)
Change in net deferred income tax		(47,410)
Change in non-admitted assets		868
Change in provision for reinsurance		(44,283)
Aggregate write-ins for gains and losses in surplus		332,251
Examination Adjustment		0
Change in surplus as regards policyholders for the year		(\$525,680)
Surplus as regards policyholders, December 31 current year		\$3,109,728

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

**Losses and Loss Adjustment Expenses** \$7,616,871

An outside actuarial firm appointed by the Board of Trustees, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2006, 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 contracted an independent actuary, L.J. Halliwell, LLC who reviewed work papers provided by the Company and concluded that the loss and loss expense reserves were reasonable.

A comparative analysis of changes in surplus is shown below.

**FLORIDA RURAL ELECTRIC SELF INSURER'S FUND  
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

**DECEMBER 31, 2006**

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 December 31, 2006, per Annual Statement	\$3,109,728
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
<b>ASSETS:</b>			
No adjustment.			
<b>LIABILITIES:</b>			
No adjustment.			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2006, per Examination			\$3,109,728

## SUMMARY OF FINDINGS

### **Compliance with previous directives**

The Fund has taken the necessary actions to comply with the comments made in the 2003 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, 2006.

### **Conflict of Interest Statements**

The Fund did not provide signed conflict of interest statements for the year 2006. **We recommend the Fund comply with the provisions of NAIC 2006 Financial Condition Examiners Handbook procedures, Part 1, IV, A., 4., e. as adopted by Rule 69O-138.001, Florida Administrative Code, which requires the Fund to provide conflict-of-interest statements completed by management and directors.**

### **Investment Approval**

The investments of the Fund were not approved by the Board of Trustees. **We recommend the Fund comply with Section 625.304, Florida Statutes, which requires the Board of Trustees to authorize investments by approval recorded in the minutes.**

### **Fidelity Bond**

The fidelity coverage in the Commercial crime policy does not name as insured the trustees of the Fund. **We recommend the Fund comply with Rule 69O-187.005(5), Florida Administrative**

**Code, which requires the Fund to obtain and maintain a fidelity bond covering each individual trustee.**

#### **Reinsurance – Insolvency Clause**

The Federated Rural Electric Insurance Exchange Excess Indemnity policy did not contain an acceptable insolvency clause. **We recommend the Fund comply with SSAP No. 62, Paragraph 8(a), which requires that the agreement contain an acceptable insolvency clause.**

## CONCLUSION

The 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, 2006, consistent with the insurance laws of the State of Florida.

Per examination findings, the Fund amount of \$3,109,728, was compliance with Section 624.4621 (10), Florida Statutes.

In addition to the undersigned, Mike Hampton, CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor, Exam Manager, participated in the examination. We also recognize the participation of Leigh J. Halliwell, FCAS, MAAA of L.J. Halliwell, LLC in the examination.

Respectfully submitted,

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Mike Young, Examiner in Charge  
Financial Examiner/Analyst II  
Florida Office of Insurance Regulation