

**REPORT ON EXAMINATION**

**OF**

**HARTFORD INSURANCE COMPANY OF**

**THE SOUTHEAST**

**LAKE MARY, FLORIDA**

**AS OF**

**DECEMBER 31, 2002**

**BY THE**

**OFFICE OF INSURANCE REGULATION**

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Tallahassee, Florida  
January 26, 2004

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Dear Madam and Sirs:

Pursuant to your instructions, in compliance with Section 624.316, 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, 2002, of the financial condition and corporate affairs of:

**HARTFORD INSURANCE COMPANY OF THE SOUTHEAST  
200 COLONIAL CENTER PARKWAY, SUITE 500  
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 of January 1, 1998 through December 31, 2002. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 1997. This examination commenced with planning at the Office, on October 31, 2003 to November 12, 2003. The fieldwork commenced on November 17, 2003, and was concluded as of January 16, 2004. 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 an association zone 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 and 69O-138.001, 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 A.M. Best 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/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2002. Transactions subsequent to year-end 2002 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.

The Company's independent CPA performed a consolidated statutory basis audit on Hartford Fire Insurance Company and its Combined Affiliates. Since the Company is a small part of the consolidated group, much of the work was not considered useful to this examination.

### **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, 1997, along with resulting action taken by the Company in connection therewith.

#### **Cash**

The Company was directed to maintain its assets in the State of Florida, pursuant to Section 628.271(2), FS, or obtain the necessary written approval for an exemption, pursuant to Section 628.281(1)(c)(1), FS, from the Office.

**Resolution:** The Company established Money Market Funds for which the investments were processed through a daily sweep account that was established at the JP Morgan/Chase Bank located in New York, New York. JP Morgan/Chase Bank was the custodian bank of the Company.

After each sweep was completed, the Company anticipated having a zero cash balance in its account. However, this procedure was not totally effective in preventing cash balances located in an out of state bank. J P Morgan/Chase Bank now has a new improved passive end of day sweep for the Company which will automatically remove all cash from the account at the end of each day.

#### **Short Term Investments/Loan Agreement**

The Company was in violation of Section 625.332(1), FS, which prohibits loans to stockholders.

**Resolution:** The Company has discontinued this practice of loans to stockholders and obtained repayment of the loans.

#### **Short Term Investments - "Investment Pooling Agreement"**

On the December 31, 1998 annual statement, short term investments were comprised of the Company's funds maintained in an "Investment Pool". The Company did not own any of the specific securities. This investment in the Short Term Investment Pool had not been valued by the NAIC Securities Valuation Office. The Short Term Investment Pool was located in the State of Connecticut.

**Resolution:** The Company no longer participates in the "Investment Pool" and its securities are now held in the Company's name.

## **HISTORY**

### **General**

The Company was incorporated in Florida on December 28, 1979 and commenced business on January 1, 1980 as Hartford Insurance Company of the Southeast.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2002:

Fire	Allied Lines
Farmowners Multi Peril	Homeowners Multi Peril
Commercial Multi Peril	Ocean Marine
Inland Marine	Earthquake
Workers' Compensation	Other Liability
Medical Malpractice	Burglary and Theft
PPA Physical Damage	Mobile Home Multi Peril
Mobile Home Physical Damage	Commercial Auto Physical Damage
Private Passenger Auto Liability	Livestock
Commercial Automobile Liability	Glass
Surety	Fidelity
Industrial Fire	Boiler and Machinery
Industrial Extended Coverage	

The Company has not written insurance coverage in the last five years in the lines of business of Mobile Home Multi Peril, Mobile Home Physical Damage and Livestock.

The articles of incorporation and the bylaws were amended during the period covered by this examination. The articles of incorporation and the bylaws were not in agreement regarding the number of directors of the Company.

### **Capital Stock**

As of December 31, 2002, the Company's capitalization was as follows:

Number of authorized common capital shares	50,000
Number of shares issued and outstanding	23,500
Total common capital stock	\$2,350,000
Par value per share	\$100.00

The control of the Company was maintained by its parent, Hartford Fire Insurance Company, who owned 100 percent of the stock issued by the Company until December 2002 when The

Hartford Financial Services Group, Inc., purchased the Company as of November 30, 2002 from the Hartford Fire Insurance Company.

### **Profitability of Company**

For the years 1998, 1999, 2000, 2001 and 2002, the company's underwriting profit (loss) was (\$1,133,225), (\$1,509,977), (\$1,048,829), (\$4,727,758) and (\$442,294) respectively, while the overall profit (loss) was \$1,566,114, \$3,502,851, \$6,704,708, \$1,823,487 and \$4,796,776. The Company was a member of a pooling agreement, hence its profitability was tied to the profitability of the pool. In the first quarter of 2003 the Company increased its loss and loss adjustment reserves by \$15 million as a result of the Hartford Fire Insurance Company's comprehensive review of its asbestos exposures. The Company expects that this is a one time adjustment, and stated that plans for rate increases and a stronger marketing effort on its more profitable commercial lines of business will result in continued profitability.

### **Dividends to Stockholders**

In accordance with Section 628.371, FS, the Company declared and paid dividends to its stockholder in 1998, 1999 and 2000 in the amounts of \$4,899,985, \$1,999,850 and \$3,500,000, respectively.

### **Management**

There was no record of an annual shareholder meeting for the election of directors, pursuant to Sections 607.1601 and 628.231, FS.

The directors serving as of December 31, 2002, were:

### **Directors**

<b>Name and Location</b>	<b>Principal Occupation</b>
Thomas M. Marra Simsbury, Connecticut	Director, Hartford Insurance Company of the Southeast
Ramani Ayer West Simsbury, Connecticut	Director, Hartford Insurance Company of the Southeast
David K. Zwiener Hartford, Connecticut	Director, Hartford Insurance Company of the Southeast
Neal S. Wolin West Hartford, Connecticut	Director, Hartford Insurance Company of the Southeast
David M. Znamierowski Glastonbury, Connecticut	Director, Hartford Insurance Company of the Southeast
John N. Giamalis Farmington, Connecticut	Director, Hartford Insurance Company of the Southeast
Michael H. Wallace Sanford, Florida	Director, Hartford Insurance Company of the Southeast

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

### **Senior Officers**

<b>Name</b>	<b>Title</b>
Ramani Ayer	Chairman and Chief Executive Officer
David K. Zwiener	President and Chief Operating Officer
Neal S. Wolin	Executive VP and General Counsel
David M. Znamierowski	Group Senior VP and Chief Investment Officer

John N. Giamalis

Senior VP and Treasurer

Michael H. Wallace

Senior VP

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. Following are the principal internal board committees and their members as of December 31, 2002:

**Executive Committee**

Ramani Ayer<sup>1</sup>  
David M. Znamierowski  
David K. Zwiener

**Investment Committee**

Ramani Ayer<sup>1</sup>  
David M. Znamierowski  
David K. Zwiener

<sup>1</sup>Chairman

The Company did not maintain an audit committee as required by Section 624.424(8), FS.

**Conflict of Interest Procedure**

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

Documentation did not exist to indicate the Company's directors reviewed the previous examination report.

Documentation did not exist in the minutes reviewed that the Company's directors appointed the CPA for its annual audit.

There was no documentation in the minutes reviewed that the Company's directors met four times or more in 1998, 2000 and 2002, as specified in the Company's bylaws.

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

In December 2002, in a corporate reorganization, the outstanding shares of the Company's stock were purchased from Hartford Fire Insurance Company by The Hartford Financial Services Group, Inc.

#### **Surplus Debentures**

The Company had no surplus debentures.

## **AFFILIATED COMPANIES**

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3) FAC. The latest holding company registration statement was filed with the State of Florida on May 1, 2003 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:

### **Tax Allocation Agreement**

The Company's federal income tax return was consolidated with The Hartford Financial Services Group, Inc. and its includable subsidiaries. The method of allocation among affiliates of the Company was subject to a written agreement approved by the Board of Directors and was based upon separate return calculations with credit for net losses to the extent the losses provided a benefit in the consolidated tax return.

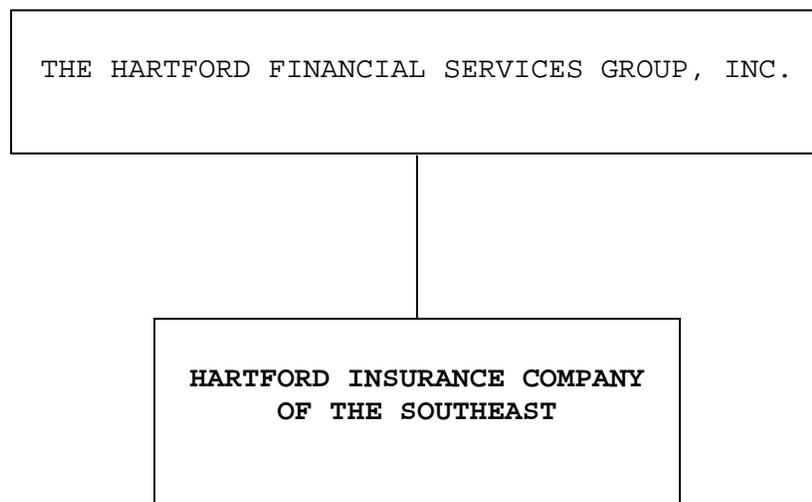
### **Reinsurance and Pooling Agreement**

Effective January 31, 1989, the Company entered into an intercompany reinsurance and pooling agreement to share premiums, losses and underwriting expenses on a proportional basis. Hartford Fire Insurance Company was the lead company, and it reinsured business with non-affiliated reinsurers prior to pooling with its affiliated pool members. Hartford Fire Insurance Company also assumed all direct business (except for accident & health business) written by pool members. Hartford Fire Insurance Company then ceded a percentage of the total pool to each participant based on its proportional share of the pool.

A simplified organizational chart as of December 31, 2002, reflecting the holding company system is shown below. Schedule Y of the Company's 2002 annual statement provided a list of all related companies of the holding company group.

**HARTFORD INSURANCE COMPANY OF THE SOUTHEAST  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2002**



## **FIDELITY BOND AND OTHER INSURANCE**

The Company was included in a fidelity bond along with other members of The Hartford Financial Services Group, Inc. The fidelity bond coverage included an aggregate liability of \$190,000,000, a single limit of \$95,000,000 and single loss deductible of \$5,000,000, which adequately covered the suggested minimum amount of coverage for the group as recommended by the NAIC.

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

The Company did not have any employees, nor any pension plans, stock ownership plans or insurance plans. All employees providing services for the Company were employees of Hartford Fire Insurance Company. The Company incurred pension costs and employee insurance costs on a proportionate basis per the pooling agreement.

## **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	FL BD OF EDUC, 5.625%, 06/01/08	<u>\$ 320,000</u>	<u>\$ 354,202</u>
	TOTAL FLORIDA DEPOSITS	<u>\$ 320,000</u>	<u>\$ 354,202</u>
GA	LA GEN OBLIGATION, 5.7%, 05/15/08	\$ 200,000	\$ 223,548
LA	LA GEN OBLIGATION, 5.7%, 05/15/08	100,000	111,774
MI	FL BD OF EDUC, 5.625%, 06/01/08	<u>75,000</u>	<u>83,016</u>
	Total Other Deposits	<u>\$ 375,000</u>	<u>\$ 418,338</u>
	Total Special Deposits	<u>\$ 695,000</u>	<u>\$ 772,540</u>

## INSURANCE PRODUCTS AND RELATED PRACTICES

### Territory and Plan of Operation

The Company was authorized to transact insurance in the following states, in accordance with Section 624.401(2), FS:

Florida	Louisiana	Pennsylvania
Georgia	Connecticut	

### 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**

Effective January 1, 1989, the Company entered into a reinsurance and pooling agreement in which Hartford Fire Insurance Company was the lead company in an affiliated group of insurance companies. The reinsurance agreements reviewed were found to comply with NAIC standards with respect to the standard insolvency clause, transfer of risk, arbitration clause, reporting and settlement information deadlines. The Company did not provide an evaluation to determine whether a reinsurer may realize a significant loss on its various reinsurance treaties.

### **Assumed**

The Company assumed risk on an excess of loss basis from the Hartford Fire Insurance Company.

### **Ceded**

The Company ceded risk on a quota share and excess of loss basis to the Hartford Fire Insurance 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 1998, 1999, 2000, 2001 and 2002, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002.

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

The Company maintained its principal operational offices in Hartford, Connecticut, where this examination was conducted.

The Company and non-affiliates had the following agreements:

### **Custodial Agreement**

The Company had a Custody Agreement with JP Morgan/Chase Bank. The Company had Vista Prime Money Market Funds maintained by a transfer agent that was not a national bank, state bank or trust company, as required by Rule 69O-143.041(1), FAC.

### **Independent Auditor Agreement**

The Company had an agreement with Deloitte & Touche LLP for an independent CPA audit.

## **Risk-Based Capital**

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

## **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2002, 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."

**HARTFORD INSURANCE COMPANY OF THE SOUTHEAST  
Assets**

**DECEMBER 31, 2002**

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$106,430,729		\$106,430,729
Cash:			
On deposit	(19,595)		(19,595)
Short-term investments	3,822,671		3,822,671
Accrued retrospective premiums	872,325		872,325
FIT recoverable	3,485,000		3,485,000
Guaranty funds receivable	91,141		91,141
Interest and dividend income due & accrued	1,951,517		1,951,517
Receivable from PSA	12,378		12,378
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Totals	\$116,646,166	\$0	\$116,646,166
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**HARTFORD INSURANCE COMPANY OF THE SOUTHEAST**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2002**

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$44,788,106		\$44,788,106
Loss adjustment expenses	6,798,278		6,798,278
Commissions payable	506,701		506,701
Other expenses	732,716		732,716
Taxes, licenses and fees	966,917		966,917
FIT	170,356		170,356
Unearned premium	17,771,979		17,771,979
Dividends declared and unpaid, policyholders	127,795		127,795
Payable to parent, subsidiaries and affiliates	34,354		34,354
 Total Liabilities	 \$71,897,202		 \$71,897,202
 Common capital stock	 2,350,000		 2,350,000
Gross paid in and contributed surplus	7,267,854		7,267,854
Unassigned funds (surplus)	35,131,110		35,131,110
Surplus as regards policyholders	\$44,748,963		\$44,748,964
Total liabilities, capital and surplus	\$116,646,166	\$0	\$116,646,166

**HARTFORD INSURANCE COMPANY OF THE SOUTHEAST**  
**Statement of Income**

**DECEMBER 31, 2002**

**Underwriting Income**

Premiums earned	\$38,391,917
DEDUCTIONS:	
Losses incurred	22,991,166
Loss expenses incurred	4,312,347
Other underwriting expenses incurred	11,510,699
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$38,814,212</u>
Net underwriting gain or (loss)	(\$422,295)

**Investment Income**

Net investment income earned	\$5,789,344
Net realized capital gains or (losses)	283,400
Net investment gain or (loss)	<u>\$6,072,744</u>

**Other Income**

Net gain or (loss) from agents' or premium balances charged off	\$0
Finance and service charges not included in premiums	1,020,233
Aggregate write-ins for miscellaneous income	0
Total other income	<u>\$1,020,233</u>

Net income before dividends to policyholders and before federal & foreign income taxes	\$6,670,683
Dividends to policyholders	160,518
Net Income, after dividends to policyholders, but before federal & foreign income taxes	<u>\$6,510,165</u>
Federal & foreign income taxes	<u>1,713,389</u>
Net Income	\$4,796,776

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year	\$35,117,979
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**Gains and (Losses) in Surplus**

Net Income	\$4,796,776
Net unrealized capital gains or losses	(2,123)
Change in net deferred income tax	597,000
Change in non-admitted assets	767,723
Surplus adjustments: Paid in	3,471,608
Change in surplus as regards policyholders for the year	<u>\$9,630,984</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$44,748,963</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Losses and Loss Adjustment Expense

\$51,586,384

The Company's actuary rendered an opinion that the amounts carried in the balance sheet as of December 31, 2002, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office relied upon the Milliman USA report on the Analysis of the Hartford Fire Insurance Pool Loss and Loss Expense Reserves as of December 31, 2002, which was prepared for the State of Connecticut examination and authorized for use in this examination.

**HARTFORD INSURANCE COMPANY OF THE SOUTHEAST**  
**Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2002**

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, 2002, Annual Statement	\$44,748,963
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
No adjustments			
LIABILITIES:			
No adjustments			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2002, Per Examination			\$44,748,963

## SUMMARY OF FINDINGS

### **Compliance with previous directives**

The Company has taken the necessary actions to comply with the comments made in the 1997 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 Company regarding findings in the examination as of December 31, 2002.

#### **General**

The Company had not written insurance coverage in certain lines of business for a period of five years. **The Company is directed to comply with Section 624.430, FS, and request that these lines of insurance be removed from its certificate of authority. The Company is to provide documentation of compliance to the Office within 90 days after the report is issued.**

#### **Corporate Records**

The Company's bylaws and articles of incorporation were not in agreement regarding the number of directors of the Company.

**The Company is directed to provide documentation to the Office within 90 days after the report is issued that the bylaws and articles of incorporation are in agreement regarding the number of directors.**

### **Annual Meeting of Shareholders**

There was no record of an annual meeting of stockholders to elect directors during the period under examination. The Company's bylaws specify that an annual meeting of the stockholders be held "for the election of Directors and such other business as may properly come before said meeting".

**The Company is directed to provide documentation to the Office within 90 days after the report is issued that there has been a stockholders meeting to elect directors as required in the Company bylaws.**

### **Appointment of a CPA**

There was no record that the board of directors appointed the CPA that prepared the required annual audit. Section 624.424(8)(c), FS requires that the board of directors appoint the CPA for the annual audit.

**The Company is directed to provide and maintain documentation to the Office that the board of directors has appointed a CPA for the 2003 annual audit within 90 days after this report is issued.**

## **Audit Committee**

There was no record that the Company's board of directors established an audit committee as required by Section 624.424(8)(c), FS.

**The Company is directed to provide documentation to the Office within 90 days after the report is issued that an audit committee has been established.**

## **Review of Examination Reports**

There was no record that the Company's board of directors reviewed the last examination report issued by the Office.

**It is recommended that the board of directors review the examination report issued by the Office and document the review in the meeting minutes.**

## **Meetings of the Board of Directors**

The Company's bylaws specify that the board of directors meet no less than four times a year.

**The Company is directed to hold at least four meetings of the board of directors in 2004, and each year thereafter.**

## **Securities**

The Company had Vista Prime Money Market Funds maintained by a transfer agent that was not a national bank, state bank or trust company, as required by Rule 690-143.041(1), FAC.

**The Company is directed to provide documentation to the Office by December 31, 2004 that funds held in the Vista Prime Money Market Funds have been redeposited into an account held by a national bank, state bank or trust company.**

## **Reinsurance**

The Company did not provide an evaluation to determine whether a reinsurer may realize a significant loss on its various reinsurance treaties. This evaluation is required by SSAP No. 62, Paragraph 14.

**The Company is directed to provide to the Office within 90 days after the report is issued, an evaluation to determine whether or not it is reasonably possible for a reinsurer to realize a significant loss on its various reinsurance treaties.**

## **SUBSEQUENT EVENTS**

As a result of the recent conclusion of a comprehensive review of the asbestos exposures for the Hartford Group of insurers, the Company increased its reserves for loss and loss adjustment expense by \$15 million on a pre -tax basis in the first quarter of 2003.

In the second quarter of 2003, the Company's parent made an additional contribution to gross paid in and contributed capital of \$9,000,000.

## CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Hartford Insurance Company of the Southeast** as of December 31, 2002, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$44,748,963, which was in compliance with Section 624.408, FS.

Respectfully submitted,

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Roger Kelley  
Financial Examiner/Analyst II  
Florida Office of Insurance Regulation

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Mary James, CFE  
Financial Examiner/Analyst II Supervisor  
Florida Office of Insurance Regulation