

REPORT ON EXAMINATION
OF
HILLCREST INSURANCE COMPANY
GAINESVILLE, FLORIDA

AS OF
DECEMBER 31, 2008

BY THE
OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION.....	1
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION	3
HISTORY	3
GENERAL	3
CAPITAL STOCK.....	4
PROFITABILITY OF COMPANY	5
DIVIDENDS TO STOCKHOLDERS	5
MANAGEMENT	5
CONFLICT OF INTEREST PROCEDURE.....	7
CORPORATE RECORDS	7
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASES OR SALES THROUGH REINSURANCE.....	7
SURPLUS DEBENTURES	7
AFFILIATED COMPANIES	8
ORGANIZATIONAL CHART	8
MANAGEMENT AGREEMENT	9
FIDELITY BOND AND OTHER INSURANCE.....	9
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS	9
STATUTORY DEPOSITS.....	10
TERRITORY	10
TREATMENT OF POLICYHOLDERS.....	10
REINSURANCE	10
ASSUMED.....	11
CEDED	11
ACCOUNTS AND RECORDS.....	11
CUSTODIAL AGREEMENT	12
GENERAL AGENCY AGREEMENT.....	12
INDEPENDENT AUDITOR AGREEMENT.....	12
CLAIMS SERVICE AGREEMENT.....	12
BANKING PROFESSIONAL SERVICES AGREEMENT.....	12
INFORMATION TECHNOLOGY REPORT.....	13
FINANCIAL STATEMENTS PER EXAMINATION.....	13
ASSETS	14
LIABILITIES, SURPLUS AND OTHER FUNDS	15
STATEMENT OF INCOME.....	16

COMMENTS ON FINANCIAL STATEMENTS..... 17
 LIABILITIES 17
 CAPITAL AND SURPLUS..... 17
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS..... 18
SUMMARY OF FINDINGS 19
CONCLUSION 20

Tallahassee, Florida

March 22, 2010

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, 2008, of the financial condition and corporate affairs of:

**HILLCREST INSURANCE COMPANY
7201 NW 11TH PLACE
GAINESVILLE, FLORIDA 32605**

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, 2008, through December 31, 2008. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2007. This examination commenced with planning at the Office on November 16, 2009, to November 20, 2009. The fieldwork commenced on November 23, 2009, and concluded as of March 22, 2010.

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.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

Risk-focused examinations consist of a seven-phase process that can be used to identify and assess risk, assess the adequacy and effectiveness of strategies/controls used to mitigate risk and assist in determining the extent and nature of procedures and testing to be utilized in order to

complete the review of that activity. The process should generally include a determination of the quality and reliability of the corporate governance structure and risk management programs. In addition, it can be used for verification of specific portions of the financial statements or other limited-scope reviews, increased focus on, and can result in increased substantive testing of, accounts identified as being at high risk of misstatement. Conversely, the risk assessment process should result in decreased focus on, and fewer substantive tests on the accounts identified as being at low risk of misstatement. The risk-focused surveillance process can be used to assist examiners in targeting areas of high-risk.

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 Company as of December 31, 2008. Transactions subsequent to year-end 2008 were reviewed where relevant and deemed significant to the Company's financial condition.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

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 reports, the Company's independent audit reports and certain work papers prepared by the Company'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 was confined to financial statements and comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

Status of Adverse Findings from Prior Examination

There were no exceptions or findings in the examination as of December 31, 2007.

HISTORY

General

The Company was incorporated in Florida on June 23, 2005 and commenced business on August 25, 2005.

The Company was party to Consent Order 81816-05-CO, filed June 5, 2005, and Consent Order 82883-05-CO, filed August 25, 2005, with the Office regarding the application for the issuance of a Certificate of Authority and related matters. The Company complied with all provisions of these consent orders.

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2008:

Allied Lines
Fire
Homeowner's multi peril
Inland marine

On July 25, 2008, in compliance with Section 624.430(1), Florida Statutes, the Company agreed to remove the lines Other Liability, Mobile Home Multi Peril, and Mobile Home Physical Damage from its Certificate of Authority due to there being no inforce policies or outstanding liabilities in connection with these lines of business.

The Articles of Incorporation were amended and filed on September 2, 2008, with the Florida Secretary of State, advising of the change of address to 7201 Northwest 11th Place, Gainesville, FL 32605.

The Bylaws were not amended during the period covered by this examination

Capital Stock

As of December 31, 2008, the Company's capitalization was as follows:

Number of authorized common capital shares	100,000
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 company, Hillcrest Holdings, LLC, which owned 100 percent of the stock issued by the Company. Hillcrest Holdings, LLC in turn was ninety seven (97%) percent owned by the Vernon Smith Family, LLC, a Florida corporation, and three (3%) percent by Ernest and Kathy Petrone.

Profitability of Company

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

	2008	2007	2006
Premiums Earned	15,162,378	13,939,075	3,914,421
Net Underwriting Gain/(Loss)	1,297,633	341,190	(2,849,708)
Net Income	1,202,460	1,080,150	(2,298,810)
Total Assets	22,484,821	19,641,418	14,138,784
Total Liabilities	13,535,611	11,352,027	8,912,084
Surplus As Regards Policyholders	8,949,210	8,289,391	5,226,700

Dividends to Stockholders

The Company did not declare nor pay a dividend to its stockholder in 2008.

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, 2008, were:

Directors

Name and Location

Principal Occupation

Vernon Dudley Smith
Ft. Pierce, Florida

Chief Executive Officer
Riverside Bank of Central Florida

Ernest Anthony Petrone
Winter Park, Florida

President and Chief Executive Officer
Hillcrest Insurance Company

Kathy Smith Petrone
Winter Park, Florida

Chairwoman and Treasurer
Hillcrest Insurance Company

Karen Smith Espling
Melbourne, Florida

Secretary
Carlton Jewelers

Christopher Douglas Smith
Vero Beach, Florida

President
Horizon Tree Farms

William John Thompson

Chief Financial Officer, Chief Operating
Officer and Secretary
Hillcrest Insurance Company

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

Senior Officers

Name	Title
Ernest Anthony Petrone	President and Chief Executive Officer
Kathy Smith Petrone	Chairwoman and Treasurer
William John Thompson	Chief Financial Officer, Chief Operating Officer and Secretary

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, 2008:

Compensation Committee	Audit Committee	Investment Committee
Vernon Smith ¹ Kathy Petrone	Vernon Smith ¹ Christopher Smith Karen Espling	Vernon Smith ¹ Ernest Petrone Kathy Petrone Bill Thompson

¹ Chairman

Subsequent Event: The Company failed to provide the Office with notice of its intent to purchase the shares of common stock, in the amount of \$600,000, from its Director, Mr. Vernon D. Smith, which was a violation of Rule 69O-143.047(4)(e), Florida Administrative Code, which requires prior notification of the transaction.

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook.

Corporate Records

The recorded minutes of the shareholder, Board of Directors (Board), and certain internal committees were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

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

There were no acquisitions, mergers, disposals, dissolutions or purchases or sales through reinsurance during 2008.

Surplus Debentures

The Company issued a surplus debenture in the amount of \$2,000,000 on February 2, 2007 to its parent, Hillcrest Holdings, LLC. The debenture bears interest at a rate of prime plus 3 percent (8.75 percent at date of issue), with interest to be paid quarterly. During 2008, the Company paid quarterly interest and principal reduction resulting in a surplus debenture in the amount of \$1,400,000 as of December 31, 2008. The payments of interest and the repayment of principal were approved by the Office.

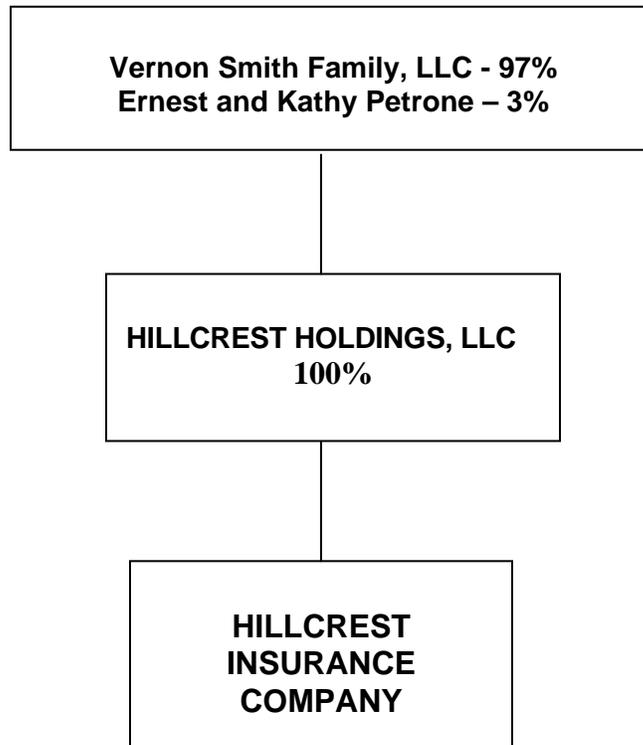
AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on April 13, 2009, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2008, reflecting the holding company system, is shown below. Schedule Y of the Company's 2008 annual statement provided a list of all related companies of the holding company group.

HILLCREST INSURANCE COMPANY ORGANIZATIONAL CHART

DECEMBER 31, 2008



The following agreement was in effect between the Company and its affiliate:

Management Agreement

The Company entered into a management agreement with the Company's parent, Hillcrest Holdings, LLC, effective as of June 23, 2005. The agreement provided for legal, accounting, reinsurance, auditing, administrative, information technology and other such services as required. The Company made payments to Hillcrest Holdings, LLC under this agreement in the amount of two (2%) percent of written premiums on new and renewal business, monthly.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$500,000 with a deductible of \$10,000, which reached the suggested minimum amount as recommended by the NAIC. The Company also maintained a Business Owners Policy for general liability coverage with an aggregate limit of \$2,000,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company did not have pension plans, stock ownership or insurance plans. All services were provided by the Company's parent, Hillcrest Holdings, LLC.

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	Freddie Mac, 6.25%, 08/18/21	<u>\$325,000</u>	<u>\$331,984</u>
TOTAL FLORIDA DEPOSITS		\$325,000	\$331,984
TOTAL SPECIAL DEPOSITS		<u>\$325,000</u>	<u>\$331,984</u>

Territory

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

Treatment of Policyholders

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

The Company maintained a claims 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 insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

Assumed

The Company did not assume any reinsurance risks during 2008.

Ceded

The Company ceded risks on an excess of loss basis to various authorized and unauthorized non-affiliated reinsurers and ceded a substantial volume of business to the Florida Hurricane Catastrophe Fund. The Company did not cede any risks on a quota share basis during the examination period.

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

ACCOUNTS AND RECORDS

The Company maintained its principal operational offices in Gainesville, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2006, 2007 and 2008, 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's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company had a custodial agreement with U.S. Bank NA. The agreement complied with Rule 69O-143.042, Florida Administrative Code.

General Agency Agreement

The Company had a general agency agreement with Tower Hill Insurance Group, Inc. The agreement provided for the management and direct oversight of the production of business for the underwriting and policy administrative functions. Additionally, the general agent was to facilitate the payment of premiums and provide various other accounting, reporting and administrative functions.

Independent Auditor Agreement

The Company had an agreement with Thomas Howell Ferguson, P.A. to perform a statutory annual audit of the Company's financial statements for the 2008 year.

Claims Service Agreement

The Company had a claims service agreement with Tower Hill Claims Services, Inc. The agreement provided for the management, adjustment, payment request and other various claims administrative duties, as required.

Banking Professional Services Agreement

The Company entered into a banking professional services agreement with Riverside National Bank, dated January 1, 2008. Pursuant to the agreement, Riverside provided bond investment

management services. The agreement provided for quarterly payments made by the Company of \$1,500 for the services. The term of the agreement was one year.

Information Technology Report

INS Services, Inc., Philadelphia, PA, performed a desk review of the Evaluation of Controls in Information Systems Questionnaire prepared by the Company. The desk review documented an understanding of the IT control environment and provided an assessment of the Company's overall risk mitigation strategies/controls related to the Company's information systems for those policies and procedures represented to be in place as of December 31, 2008, and subsequently. Results of the evaluation were noted in the Information Technology Report provided to the Company.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2008, 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."

HILLCREST INSURANCE COMPANY
Assets

DECEMBER 31, 2008

	Per Company	Examination Adjustments	Per Examination
Bonds	\$14,981,021		\$14,981,021
Cash	4,723,227		4,723,227
Investment income due and accrued	140,285		140,285
Agents' balances:			
Uncollected premium	1,902,862		1,902,862
Net deferred tax asset	506,431		506,431
Aggregate write-ins for other than invested assets	230,995		230,995
	<hr/>		
Totals	\$22,484,821	\$0	\$22,484,821

HILLCREST INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2008

	Per Company	Examination Adjustments	Per Examination
Losses	\$2,692,296		\$2,692,296
Loss adjustment expenses	511,015		511,015
Other expenses	170,603		170,603
Taxes, licenses and fees	152,564		152,564
Current federal and foreign income taxes	68,567		68,567
Unearned premium	6,736,690		6,736,690
Ceded reinsurance premiums payable	3,107,060		3,107,060
Provision for reinsurance	3,000		3,000
Payable to parent, subsidiaries and affiliates	23,113		23,113
Aggregate write-ins for liabilities	70,703		70,703
Total Liabilities	\$13,535,611	\$0	\$13,535,611
Common capital stock	\$100,000		\$100,000
Surplus notes	1,400,000		1,400,000
Gross paid in and contributed surplus	6,900,000		6,900,000
Unassigned funds (surplus)	549,210		549,210
Surplus as regards policyholders	\$8,949,210		\$8,949,210
Total liabilities, surplus and other funds	\$22,484,821	\$0	\$22,484,821

HILLCREST INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2008

Underwriting Income

Premiums earned		\$15,162,378
	Deductions:	
Losses incurred		5,704,420
Loss expenses incurred		643,472
Other underwriting expenses incurred		7,516,853
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$13,864,745
Net underwriting gain or (loss)		\$1,297,633

Investment Income

Net investment income earned		\$559,796
Net realized capital gains or (losses)		391
Net investment gain or (loss)		\$560,187

Other Income

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

Net income before dividends to policyholders and before federal & foreign income taxes		\$1,857,820
Dividends to policyholders		0
Net income, after dividends to policyholders, but before federal & foreign income taxes		\$1,857,820
Federal and foreign income taxes		655,360
Net income		\$1,202,460

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$8,289,391
Net income		\$1,202,460
Change in net deferred tax asset		43,432
Change in non-admitted assets		(9,073)
Change in provision for reinsurance		23,000
Change in surplus notes		(600,000)
Change in surplus as regards policyholders for the year		\$659,819
Surplus as regards policyholders, December 31 current year		\$8,949,210

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$3,203,311

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2008, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The consulting actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

Capital and Surplus

The amount reported by the Company of \$8,949,210, exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

**HILLCREST INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2008

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 December 31, 2008, per Annual Statement	\$8,949,210
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustments			
LIABILITIES:			
No adjustments			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2008, Per Examination			\$8,949,210

SUMMARY OF FINDINGS

Compliance with previous directives

There were no exceptions or findings in the examination as of December 31, 2007.

Current examination comments and corrective action

The following is a brief summary of the item of interest and corrective action to be taken by the Company regarding exceptions or findings in the examination as of December 31, 2008.

Management

The Company failed to provide the Office with notice of its intent to purchase the shares of common stock in Riverside Banking Company, in the amount of \$600,000 on February 20, 2009 from its Director Mr. Vernon D. Smith, in violation of Rule 69O-143.047(4)(e), Florida Administrative Code, which required prior notification of the transaction to the Office. **We recommend that the Company comply with Rule 69O-143.047 (4)(e), Florida Administrative Code and Consent Order 109600-10 dated March 24, 2010.**

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Hillcrest Insurance Company** as of December 31, 2008, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$8,949,210, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Jean Alton, CFE, Ins Regulatory Insurance Services, Inc. (InsRis); Patricia Casey Davis, CPA, CFE, Supervisor, InsRis; John V. Normile, CFE, InsRis; Giles W. Larkin, CFE, InsRis; Robert McGee, CFE, InsRis; Joseph Funkhouser, InsRis; Vetrecia Smith, Florida Office of Insurance Regulation Financial Analyst/Examiner; Oswaldo Herrera, Florida Office of Insurance Regulation Financial Analyst/Examiner; and Brian Dunn, CFE, INS Consultants, Inc., participated in portions of the examination. Eugene G. Thompson, ACAS, MAAA, INS Consultants, Inc. and James R. Neidermyer, FCAS, MAAA, INS Consultants, Inc. completed the actuarial portion of this examination. We also recognize Claude Granese, CPA, INS Services, Inc. participation in the examination.

Respectfully submitted,

Kethessa Carpenter, CPA
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation