

**REPORT ON EXAMINATION**  
**OF**  
**HOMEOWNERS CHOICE PROPERTY**  
**AND CASUALTY INSURANCE**  
**COMPANY, INC.**  
**CLEARWATER, FLORIDA**

**AS OF**  
**DECEMBER 31, 2008**

**BY THE**  
**OFFICE OF INSURANCE REGULATION**

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Tallahassee, Florida

June 4, 2009

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:

**HOMEOWNERS CHOICE PROPERTY AND CASUALTY INSURANCE COMPANY, INC.  
2340 DREW STREET #200  
CLEARWATER, FLORIDA 33765**

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

## **SCOPE OF EXAMINATION**

This examination covered the period of May 10, 2007, through December 31, 2008. This was the first examination of the Company by representatives of the Florida Office of Insurance Regulation (Office). This examination commenced, with planning at the Office, on March 29, 2009, to April 1, 2009. The fieldwork commenced on April 6, 2009, and was concluded as of June 4, 2009.

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 Demotech, Inc. report, 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**

This was the first year examination of the Company.

## **HISTORY**

### **General**

The Company was incorporated in Florida on May 10, 2007 and commenced business on May 10, 2007 as Homeowners Choice Property and Casualty Insurance Company, Inc.

The Company was party to the following Consent Orders as of the examination date:

- Consent Order 89783-07-CO, filed March 30, 2007
- Amended Consent Order 90127-07-CO, filed May 10, 2007
- Consent Order 90450-07-CO, filed June 1, 2007
- Amended Consent Order 93346-07-CO, filed December 19, 2007
- Amended Consent Order 97441-08-CO, filed August 29, 2008

The Company was in compliance with the above Consent Orders as of the examination date.

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

Homeowners Multi Peril

Fire

The Company was authorized to assume 95,000 policies from Citizens Property Insurance Corporation (Citizens). The "opt out" rate on the policies assumed from Citizens was approximately 25%. Of the insured's that chose not to "opt out", approximately 80% renewed their

policies with the Company. The Company has not taken steps to generate new business, but has concentrated on renewing the business assumed from Citizens.

The Articles of Incorporation and 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	10,000
Number of shares issued and outstanding	1,000
Total common capital stock	\$1,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, Homeowners Choice, Inc., who owned 100% of the stock issued by the Company.

### Profitability of Company

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

	<b>2008</b>	<b>2007</b>
Premiums Earned	46,658,903	7,034,125
Net Underwriting Gain/(Loss)	9,040,769	(2,329,354)
Net Income	3,357,912	(2,682,285)
Total Assets	116,967,851	36,327,522
Total Liabilities	92,203,289	25,894,368
Surplus As Regards Policyholders	24,764,562	10,433,155

## **Dividends to Stockholders**

The Company did not declare or pay dividends to its stockholder during the period covered by this examination.

## **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**

<b>Name and Location</b>	<b>Principal Occupation</b>
Francis Xavier McCahill III Indialantic, Florida	President, Homeowners Choice, Inc.
Pareshbai Suryakant Patel Clearwater, Florida	Chairman, Homeowners Choice, Inc.
Gregory Politits Safety Harbor, Florida	President, Xenia Property Management
Martin Albert Traber Tampa, Florida	Principal, Foley and Lardner, LLP
Sanjay Madhu Tampa, Florida	Investor Relations, Homeowners Choice, Inc.
Anthony Saravanos Tampa, Florida	Principal, The Boardwalk Company

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

### **Senior Officers**

<b>Name</b>	<b>Title</b>
Francis Xavier McCahill III	President
Richard Ralph Allen	Chief Financial Officer

Andrew Lloyd Graham

Corporate Secretary

As of December 31, 2008, the Company's Board failed to establish an audit committee, which was in violation of Section 624.424 (8)(c), Florida Statutes.

**Subsequent Event:** The Company's Board officially established an audit committee, as reflected in the April 2009 Board minutes.

### **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, 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 Purchase or Sales through Reinsurance**

There were no acquisitions, mergers, disposals or dissolutions during the examination period. The company assumed 74,565 policies from Citizens Insurance Company during the calendar year 2008.

## **Surplus Debentures**

The Company did not have any surplus debentures at December 31, 2008.

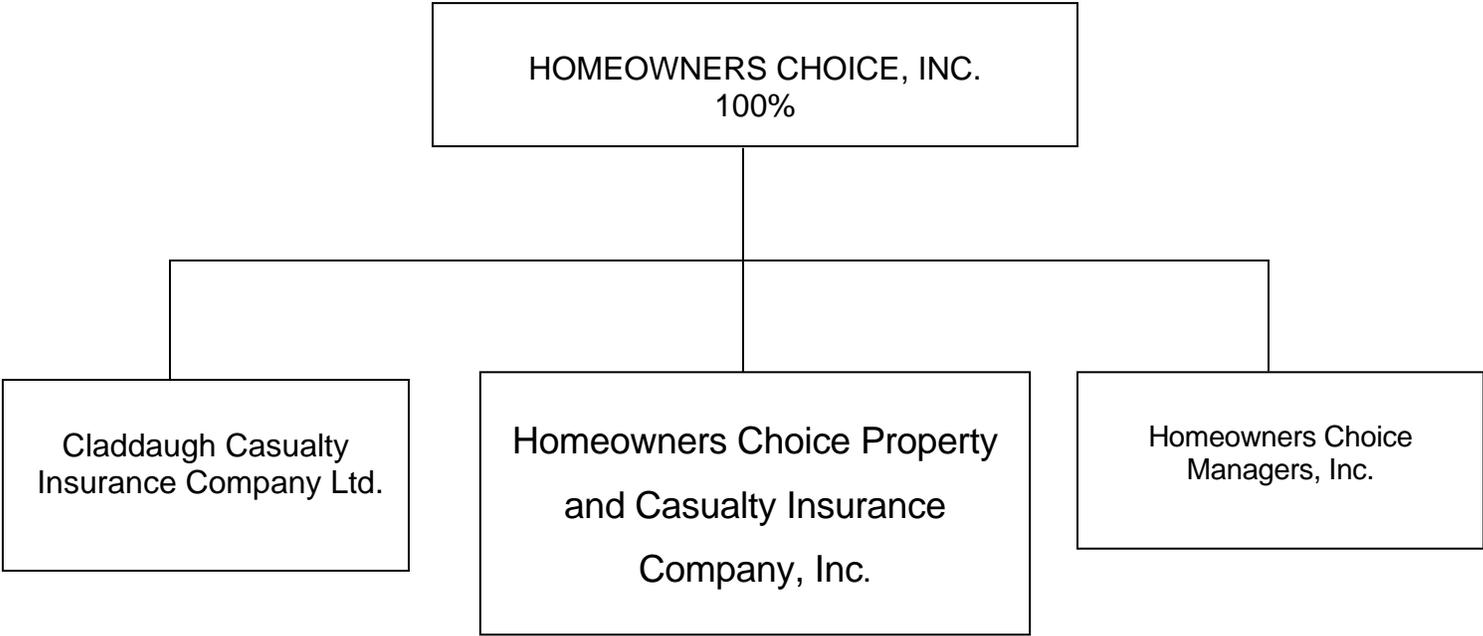
## **AFFILIATED COMPANIES**

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 June 5, 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.

**HOMEOWNERS CHOICE PROPERTY AND CASUALTY INSURANCE COMPANY, INC.  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2008**



The following agreements were in effect between the Company and its affiliates:

### **Tax Allocation Agreement**

The Company, along with its parent and other affiliates, filed a consolidated federal income tax return. On December 31, 2008, the method of allocation between the Company's parent and its subsidiaries was based on after tax income of each entity. Each of the subsidiaries computed a separate tax return and paid any tax liability to the parent company. If a subsidiary incurred a tax loss, or generated a tax credit that could not be utilized to offset a tax liability, only the subsidiary shall be entitled to the tax benefit.

### **Managing General Agent Agreement**

The Company had a Managing General Agency Agreement with its affiliate, Homeowners Choice Managers, Inc. For consideration, Homeowners Choice Managers, Inc. produced, administered and managed the Company's insurance policies and provided other services for managing and administering the affairs of the Company. Services included, but were not limited to, marketing, claims analysis, general ledger accounting, information services, product and underwriting development and management, and catastrophe risk management.

The Company did not record the \$25 per policy MGA fee as premium as required by Section 627.403, Florida Statutes.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained fidelity bond coverage up to \$250,000 with a deductible of \$50,000, which did not adequately cover the suggested minimum amount of coverage for the Company as recommended by the NAIC. The Company also maintained a Directors and Officers (D&O) liability

insurance policy that covered limits of \$5,000,000 with retention of \$100,000 and an Employment Practices liability insurance policy that covered limits of \$5,000,000 with self-insured retention of \$50,000 applicable to each claim.

**Subsequent Event:** The Company obtained fidelity bond coverage up to \$1,000,000, effective May 19, 2009, which exceeded the suggested minimum amount of coverage for the Company as recommended by the NAIC.

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

The Company's employees were provided coverage under a group health plan.

### **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	Cash	<u>\$ 300,000</u>	<u>\$ 300,000</u>
Total Florida Deposits		<u>\$ 300,000</u>	<u>\$ 300,000</u>

### **INSURANCE PRODUCTS**

#### **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 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 insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

### **Assumed**

The Company assumed risk from Citizens in various take out amounts totaling 95,000 policies pursuant to three filed Consent Orders from the Office. All of the Company's assumed reinsurance was through the Citizens takeout process.

### **Ceded**

The Company ceded risk through four excess of loss treaties to authorized and unauthorized reinsurers. Benfield Inc. was recognized as the intermediary who negotiated two excess of loss "per risk" treaties and one excess of loss "catastrophe" treaty. A Bermuda affiliate, Claddaugh Casualty Insurance Company Ltd., was the reinsurer on an excess property catastrophe treaty.

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 Clearwater, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the years 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 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 incorrectly reported \$2,302,794 of the \$4,881,829 reported for "Uncollected Premiums" in the 2008 Annual Statement. The Company should have reported \$2,579,035 for "Uncollected Premiums" on Page 2, Line 13.1, and \$2,302,794 for "Deferred Premiums" on Page 2, Line 13.2, in the 2008 Annual Statement.

**Subsequent Event:** As reflected in the quarterly statement as of March 31, 2009, the Company properly reported uncollected and deferred premiums on Page 2, lines 13.1 and 13.2, respectively.

## **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."

**HOMEOWNERS CHOICE PROPERTY AND CASUALTY INSURANCE COMPANY, INC.**  
**Assets**

**DECEMBER 31, 2008**

	Per Company	Examination Adjustments	Per Examination
Cash and short-term investments	\$101,725,285		\$101,725,285
Investment income due and accrued	56,658		56,658
Agents' Balances:			
Uncollected premiums	4,881,829	(2,302,794)	2,579,035
Deferred premiums		2,302,794	2,302,794
Other amounts receivable under reinsurance contracts	7,122,108		7,122,108
Net deferred tax asset	2,995,558		2,995,558
FHCF and Citizens Assessments Recoverable	186,413		186,413
Totals	\$116,967,851	\$0	\$116,967,851

**HOMEOWNERS CHOICE PROPERTY AND CASUALTY INSURANCE COMPANY, INC.**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2008**

	Per Company	Examination Adjustments	Per Examination
Losses	\$14,162,908		\$14,162,908
Loss adjustment expenses	600,818		600,818
Other expenses	381,966		381,966
Taxes, licenses and fees	1,083,302		1,083,302
Current federal and foreign income taxes	2,905,411		2,905,411
Unearned premiums	66,790,459		66,790,459
Amounts withheld or retained by company for account of others	40,276		40,276
Assumed Reinsurance Balances Payable (Citizens Insurance Corp)	6,238,149		6,238,149
Total Liabilities	<u>\$92,203,289</u>		<u>\$92,203,289</u>
Common capital stock	\$1,000		\$1,000
Gross paid in and contributed surplus	21,999,000		21,999,000
Unassigned funds (surplus)	<u>2,764,562</u>		<u>2,764,562</u>
Surplus as regards policyholders	<u>\$24,764,562</u>		<u>\$24,764,562</u>
Total liabilities, surplus and other funds	<u><u>\$116,967,851</u></u>		<u><u>\$116,967,851</u></u>

**HOMEOWNERS CHOICE PROPERTY AND CASUALTY INSURANCE COMPANY, INC.**  
**Statement of Income**

**DECEMBER 31, 2008**

**Underwriting Income**

Premiums earned		\$46,658,903
	<b>Deductions:</b>	
Losses incurred		19,667,396
Loss expenses incurred		4,697,509
Other underwriting expenses incurred		13,253,229
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		<u>\$37,618,134</u>
Net underwriting gain or (loss)		\$9,040,769

**Investment Income**

Net investment income earned		\$1,503,126
Net realized capital gains or (losses)		0
Net investment gain or (loss)		<u>\$1,503,126</u>

**Other Income**

Aggregate write-ins for miscellaneous income		\$0
Total other income		<u>\$0</u>
Net Income, after dividends to policyholders, but before federal and foreign income taxes		\$10,543,895
Federal and foreign income taxes incurred		<u>7,185,983</u>
Net Income		\$3,357,912

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year		\$10,433,155
Net Income		\$3,357,912
Change in net deferred income tax		3,542,163
Change in non-admitted assets		(2,540,667)
Surplus Adjustments:		
Paid in		10,000,000
Aggregate write-ins for gains and losses in surplus		(28,001)
Change in surplus as regards policyholders for the year		<u>\$14,331,407</u>
Surplus as regards policyholders, December 31 current year		<u>\$24,764,562</u>

## COMMENTS ON FINANCIAL STATEMENTS

### Assets

**Uncollected premiums** \$2,579,035

Uncollected premiums reported as \$4,881,829 were reduced by \$2,302,794 for the amount of deferred premiums receivable not yet due as of December 31, 2008, which had been improperly included in this line item.

**Deferred premiums** \$2,302,794

Deferred premiums reported as \$0 were increased by \$2,302,794 for the amount of deferred premiums receivable not yet due as of December 31, 2008, which were improperly shown in uncollected premiums.

**HOMEOWNERS CHOICE PROPERTY AND CASUALTY INSURANCE COMPANY, INC.  
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	\$24,764,562
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	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS
<b>ASSETS:</b>			
Uncollected premiums	\$4,881,829	\$2,579,035	\$0
Deferred premiums	\$0	\$2,302,794	\$0
<b>LIABILITIES:</b>			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2008, Per Examination			\$24,764,562

## SUMMARY OF FINDINGS

### Compliance with previous directives

This was the first examination of the Company 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, 2008.

### General

The Company did not record the \$25 per policy MGA fee as premium as required by Section 627.403, Florida Statutes. **We recommend that the Company comply with Section 627.403, Florida Statutes and record the \$25 per policy MGA fee as premium.**

## SUBSEQUENT EVENTS

In January, 2009, the Company's parent, Homeowners Choice, Inc., retained the services of the consulting firm, Securance, for the purpose of meeting Sarbanes-Oxley (SOX) requirements applicable to publicly traded companies.

The Company currently maintains a FSR of "A" with Demotech, Inc., as of June 16, 2009.

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Homeowners Choice Property and Casualty Insurance Company, Inc.** 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 \$24,016,562, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Patricia Casey Davis, CFE, CPA, INSRIS Examiner Supervisor; Matt Perkins, CFE, INSRIS Examiner-in-Charge; Robert McGee, CFE, INSRIS Examiner; Vetreca Smith, OIR Financial Specialist and Jerry Golden, OIR Examination Manager, participated in the examination. We also recognize Michael Morro, ACAS, MAAA and James R. Neidermyer, FCAS, MAAA of INS Consultants, Inc. and INS Services, Inc.'s participation in the examination.

Respectfully submitted,

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Mary James, CFE, CPM  
Chief Examiner  
Florida Office of Insurance Regulation