

REPORT ON EXAMINATION
OF
NATIONAL GROUP INSURANCE
COMPANY

CORAL GABLES, FLORIDA

AS OF
DECEMBER 31, 2006

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

March 14, 2008

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

**NATIONAL GROUP INSURANCE COMPANY
238 PALERMO AVENUE
CORAL GABLES, FLORIDA 33134**

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

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2006 through December 31, 2006. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2005. This examination commenced, with planning at the Office, on December 26, 2007, to December 28, 2007. The fieldwork commenced on January 14, 2008, and was concluded as of March 14, 2008.

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 Company as of December 31, 2006. Transactions subsequent to year-end 2006 were reviewed where relevant and deemed significant to the Company's financial condition.

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 A.M. Best 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 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 Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPAs, after verifying the statutory requirements, for the following accounts:

Taxes, licenses and fees
Federal income taxes

Status of Adverse Findings from Prior Examination

There were no significant adverse findings in the Office's prior examination report as of December 31, 2005.

HISTORY

General

The Company was incorporated in Florida on June 9, 2004 and commenced business on August 4, 2004 as National Group Insurance Company.

The Company was party to Consent Order No. 76503-04-CO filed June 3, 2004 with the Office regarding the application for the issuance of a certificate of authority. The Company failed to comply with a provision of the consent order which required them to obtain prior written approval for a material deviation from its plan of operation regarding written premium.

The original plan called for \$13 M, \$15 M and \$18 M of written premium in 2003, 2004 and 2005 respectively. They did not write any premiums until 2006.

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2006:

Fire	Glass
Commercial multi peril	Burglary and theft
Other liability	Commercial automobile liability
Fidelity	Commercial auto physical damage
Allied lines	Inland marine
Miscellaneous casualty	

The Company had not written insurance coverage in the last two years in the line of business of Fidelity, Fire and Inland Marine. The Company was not in compliance with Section 624.430, Florida Statutes which requires that an insurer not writing premiums in a kind or line of insurance within a calendar year to have that kind or line of insurance removed from its certificate of authority.

The articles of incorporation and the bylaws were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2003, the Company's capitalization was as follows:

Number of authorized common capital shares	1,000,000
Number of shares issued and outstanding	250,000
Total common capital stock	\$250,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, National Insurance Company, which owned 100% of the stock issued by the Company. National Insurance Company was an insurance company domiciled and incorporated in Puerto Rico.

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.

	2006	2005	2004
Premiums Earned	0	0	0
Net Underwriting Gain/(Loss)	(207,102)	0	0
Net Income	414,350	200,102	100,995
Total Assets	7,073,566	5,301,097	5,176,603
Total Liabilities	1,358,120	0	75,608
Surplus As Regards Policyholders	5,715,446	5,301,097	5,100,995

Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2006.

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, 2006, were:

Directors

Name and Location	Principal Occupation
Carlos M. Benitez, Jr. San Juan, Puerto Rico	President and Chairman
Maria Julia Garcia Bayamon, Puerto Rico	Treasurer and Vice President
Lina Delgado Miami, Florida	Executive Vice President and Secretary
Jorge Benitez Miami, Florida	Vice President
Ramon L. Cruz Colon Guaynabo, Puerto Rico	Director
Edgardo Van Rhyn San Juan, Puerto Rico	Director

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

Senior Officers

Name	Title
Carlos M. Benitez	President & CEO
Lina Delgado	Executive Vice President & Secretary
Maria Julia Garcia	Vice President & Treasurer

The Company's Board appointed several internal committees in accordance with Section 607.0825, Florida Statutes.

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

Executive Committee	Audit Committee	Investment Committee
Ramon L. Cruz Colon ¹	Maria Julia C. de Garcia ¹	Maria Julia C. de Garcia ¹
Lina M. Delgado	Oscar J. Rivera	Lina M. Delgado
Edgardo Van Rhyn	Luis F. Rivera Flores	Ramon L. Cruz Colon

¹ President

Conflict of Interest Procedure

The Company had not adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook.

Subsequent Event

In April of 2007, 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

The Company had no acquisitions, mergers, disposals, dissolutions, and purchases or sales through reinsurance.

Surplus Debentures

The Company did not have any surplus debentures at December 31, 2006.

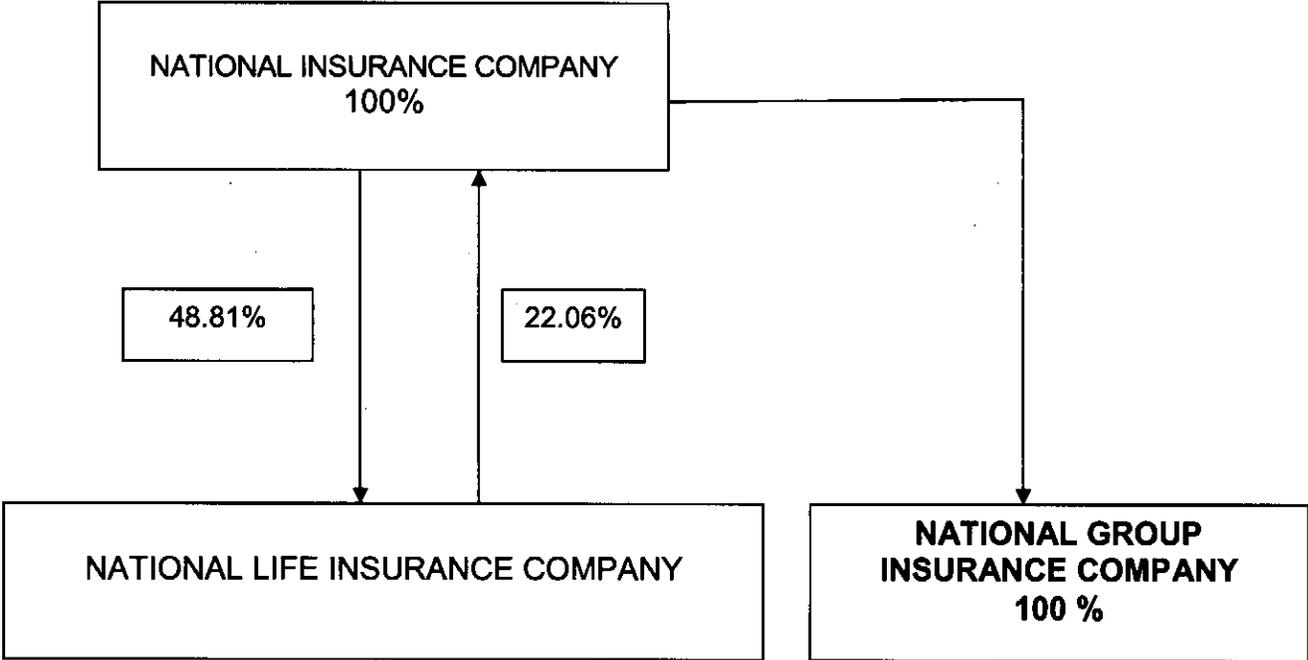
AFFILIATED COMPANIES

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 October 5, 2007, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code. The Company did not file an updated holding company registration statement to report subsequent changes in affiliates, as required by Rule 69O-143.046 (4), Florida Administrative Code.

A simplified organizational chart as of December 31, 2006, reflecting the holding company system, is shown below. Schedule Y of the Company's 2006 annual statement did not provide a list of all related companies of the holding company group.

**NATIONAL GROUP INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2006



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

Managing General Agent Agreement

The managing general agent (MGA) audit report was obtained and no significant findings were noted. The Company had a MGA agreement, in which the MGA, Phoenix Insurance Underwriting LLC, performed the Company's underwriting by engaging 260 agents.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$500,000 with a deductible of \$10,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC Financial Condition Examiners Handbook.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no pension, stock ownership or insurance plans, or any employees 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 Bonds, 4.375%, 06/15/07	<u>\$ 325,000</u>	<u>\$ 327,047</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 325,000</u>	<u>\$ 327,047</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 325,000</u>	<u>\$ 327,047</u>

INSURANCE PRODUCTS

Territory

The Company was authorized to transact insurance in the following states:

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 no risk.

Ceded

The Company ceded 100% of its business to its parent, National 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

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

An independent CPA audited the Company's statutory basis financial statements annually for the year 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 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 and non-affiliates had the following agreements:

Custodial Agreement

The Company had a custodial agreement with Citibank, NA of San Juan, PR. The agreement met the requirements of Rule 69O-143.042(2), Florida Administrative Code.

Independent Auditor Agreement

The Company had an independent audit agreement with PriceWaterhouseCoopers LLP, Hato Rey, PR.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company'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."

NATIONAL GROUP INSURANCE COMPANY
Assets

DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Bonds	\$5,137,957		\$5,137,957
Cash:	631,338	\$227,736	403,602
Agents' Balances:			
Uncollected premium	1,079,569	132,847	946,722
Interest and dividend income due & accrued	31,949		31,949
Receivable from parents, subsidiaries and affiliates	192,753		192,753
	<hr/>		
Totals	\$7,073,566	\$360,583	\$6,712,983

NATIONAL GROUPE INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Ceded reinsurance premiums payable	\$1,224,654		\$1,224,654
Current Federal income taxes		\$147,569	147,569
Taxes, licenses and fees		25,369	25,369
Aggregate write-ins for liabilities	133,466		133,466
Total Liabilities	\$1,358,120	\$172,938	\$1,531,058
Common capital stock	\$250,000		\$250,000
Gross paid in and contributed surplus	4,750,000		4,750,000
Unassigned funds (surplus)	715,446		181,925
Surplus as regards policyholders	\$5,715,446	\$533,521	\$5,181,926
Total liabilities, surplus and other funds	\$7,073,566	\$360,583	\$6,712,983

NATIONAL GROUP INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2006

Underwriting Income		
Premiums earned		\$0
Deductions:		
Other underwriting expenses incurred		(207,102)
Total underwriting deductions		<u>(207,102)</u>
Net underwriting gain or (loss)		(\$207,102)
Investment Income		
Net investment income earned		\$207,248
Net investment gain or (loss)		<u>\$207,248</u>
Other Income		
Net income before dividends to policyholders and before federal & foreign income taxes		\$414,350
Net Income, after dividends to policyholders, but before federal & foreign income taxes		<u>\$414,350</u>
Net Income		<u>\$414,350</u>
Capital and Surplus Account		
Surplus as regards policyholders, December 31 prior year		\$5,301,097
Net Income		\$414,350
Examination Adjustment		(533,521)
Change in surplus as regards policyholders for the year		<u>(\$119,171)</u>
Surplus as regards policyholders, December 31 current year		<u><u>\$5,181,926</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Cash \$403,602

Bonds reported as \$631,338 were reduced by \$227,736, which represented cash held out of the state of Florida. The Company was in violation of Section 628.27(2), Florida Statutes, which requires that the Company maintain its assets in the state of Florida.

Agents balances in the course of collection \$946,722

Agents balances in the course of collection reported as \$1,079,569 were reduced by \$132,847 which represented premiums receivable over 90 days old. The Company was in violation of Section 625.012, Florida Statutes, which only permits premiums receivable less than 90 days old as admitted assets.

Liabilities

Losses and Loss adjustment expenses \$0

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, 2006, 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 contracted actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

Taxes, licenses and fees

\$25,369

Taxes, licenses and fees reported as \$0 were increased by \$25,369 for the amount of tax due as of December 31, 2006.

Federal income tax due and accrued

\$147,569

Federal income tax due and accrued reported as \$0 was increased by \$147,569 for the amount of federal income tax due as of December 31, 2006.

A comparative analysis of changes in surplus is shown below.

**NATIONAL GROUP INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2006

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, 2006, per Annual Statement	\$5,715,447
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
Cash	\$631,338	\$403,602	(\$227,736)
Agent's Balances	1,079,569	946,722	(132,847)
LIABILITIES:			
Taxes, Licenses & Fees	0	25,369	(25,369)
Federal Income Tax Due and accrued	0	147,569	(147,569)
 Net Change in Surplus:			(533,521)
 Surplus as Regards Policyholders December 31, 2006, Per Examination			\$5,181,926

SUMMARY OF FINDINGS

Compliance with previous directives

There were no significant adverse finding in the prior examination report.

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2006.

General

The Company had not written insurance coverage in certain lines of business for a period of two years: Fire, Inland Marine and Fidelity. **We recommend that the Company comply with Section 624.430, Florida Statutes, and request that the Office remove these lines of insurance from its certificate of authority.**

Cash

The Company reported cash of \$631,338, in the annual statement, which incorrectly included \$227,736 of Cash held by Citibank in Puerto Rico, out of the state of Florida. **We recommend that the Company maintain assets in Florida as required by Section 628.271(2), Florida Statutes and correctly report account balances on all future annual and quarterly statement filings.**

Consent Order

The Company failed to comply with a provision in Consent Order No. 76503-04-CO filed June 3, 2004, which requires prior written approval for a material deviation from their plan of operation. **We**

recommend that the Company comply with all provisions of Consent Order No. 76503-04-CO and make a formal request to the Office regarding any deviation in their plan of operation.

Agents' balances

The Company incorrectly reported \$1,079,569, which included \$132,846 of premiums receivable that were over 90 days past due. **We recommend that the Company non-admit premiums over 90 days old as required by Section 625.012, Florida Statutes and correctly report account balances on all future annual and quarterly statement filings in accordance with the NAIC Financial Condition Examiners Handbook.**

Taxes, licenses and fees

The Company incorrectly reported \$0 in the annual statement. An accrued liability of 25,369 should have been reported. **We recommend that the Company properly accrue liabilities and correctly report account balances on all future annual and quarterly statement filings as required by the NAIC Financial Condition Examiners Handbook.**

Federal income taxes

The Company incorrectly reported \$0 in the annual statement. An accrued liability of \$147,569 should have been reported for this account. **We recommend that the Company properly accrue liabilities and correctly report account balances on all future annual and quarterly statement filings.**

Holding company registration statement

The Company did not file an updated holding company registration statement to report subsequent changes in affiliates. **We recommend that the Company file an updated holding company registration statement, as required by Rule 690-143.046 (4), Florida Administrative Code.**

SUBSEQUENT EVENTS

Mr. Edgardo Van Rhyn was elected President of National Insurance Company (PR) on August 14, 2007 and of National Group Insurance Company on May 2, 2008 replacing Mr. Carlos M. Benitez in both companies.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **National Group Insurance Company** as of December 31, 2006, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$5,181,926, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, John Berry, Financial Examiner/Analyst Supervisor, Stephen Feliu, Financial Examiner/Analyst II and Richard Shaffer, Financial Specialist, participated in the examination. We also recognize Bonnie Maxie, FCAS, MAAA and Andrew Chandler, FCAS, MAAA, of Oliver Wyman Actuarial Consulting participation in the examination.

Respectfully submitted,

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