REPORT ON EXAMINATION

OF

OCEAN HARBOR CASUALTY INSURANCE COMPANY

TALLAHASSEE, FLORIDA

AS OF

DECEMBER 31, 2003

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida
July 23, 2004

Honorable Sally McCarty
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Commissioner
Indiana Department of Insurance
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Indianapolis, Indiana 46204-2787

Honorable John Morrison
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Commissioner
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840 Helena Avenue
Helena, Montana 59601

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
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Tallahassee, Florida 32399-0326

Dear Madam and Sirs:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (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, 2003, of the financial condition and corporate affairs of:

OCEAN HARBOR CASUALTY INSURANCE COMPANY
1545 RAYMOND DIEHL ROAD
TALLAHASSEE, FLORIDA 32308

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, 2002 through December 31, 2003. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2001. This examination commenced, with planning at the Office, on April 5, 2004, to April 9, 2004. The fieldwork commenced on April 12, 2004, and was concluded as of July 23, 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 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(4) and 69O-138.001, Florida Administrative Code (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, 2003. Transactions subsequent to year-end 2003 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.

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:

Contingent commissions
Net deferred tax assets
Current federal and foreign income taxes

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, 2001, along with resulting action taken by the Company in connection therewith.

Corporate Records

The Company did not give notice to the Office that they were not writing Commercial Auto business as approved on their Certificate of Authority (COA). **Resolution:** The Company notified the Office that they did not intend to write commercial auto business and requested that those lines of business be removed from their COA.

The Company did not document in the board of director's minutes, a review of the prior examination report. **Resolution:** The minutes of the board of director's meeting held on November 23, 2003 discussed the 2001 financial examination report findings.

The Company failed to maintain an audit committee. **Resolution:** The minutes of the board of director's meetings held in 2002 and 2003 indicates that the Company elected and maintained an audit committee.

The Company did not report their tax allocation agreement maintained with their parent on their Holding Company Registration Statement. **Resolution:** The Holding Company Registration Statement filed by the Company in September 2003 disclosed the existence of the tax allocation agreement between the Company and it's parent.

The Company failed to report all transactions with its parent, RM Ocean Harbor Holding, Inc, on Schedule Y, Part 2 of the annual statement. **Resolution:** The Company did not maintain any management, service contract, or reinsurance agreements with its parent, RM Ocean Harbor Holding, Inc. The Company did, however, maintain a cost sharing arrangement with its parent, which was reported in Schedule Y, Part 2.

The Company did not maintain all of their original records in the State of Florida. The Company maintained accounting and administrative records in New Jersey and New York. **Resolution:** The Company contracted with Gulf Atlantic Insurance Services Inc., to act as their custodian of records. Copies of corporate and financial records were maintained in the Gulf Atlantic offices located in Tallahassee, Florida.

Management - Agreements

The Company's tax allocation agreement did not list all parties on their Federal income tax return. **Resolution:** The tax allocation agreement was between the Company and its parent, RM Ocean Harbor Holding, Inc., as was the consolidated federal income tax return.

The Company did not maintain a custodial agreement. **Resolution:** None. The Company had not entered into a custodial agreement with their broker prior to the conclusion of fieldwork.

Expenses were not allocated between the Company and the parent, RM Ocean Harbor Holding, Inc., according to the terms of the service agreement. Invoices were paid in total by the Company, with the exception of one individual's total salary for the year. **Resolution:** The Company replaced the service agreement with a cost allocation agreement.

Bonds and Common Stock

The Company maintained their investments with an investment broker, TD Waterhouse Investor Services. **Resolution:** The prior examination report gave the Company until December 31, 2004 to comply and this examination report gives the Company until December 31, 2005 to comply. The Company continued to maintain investments with TD Waterhouse.

The Company reported an investment in affiliated common stock of Ocean Harbor Premium Finance Company totaling $42,088. The Company overvalued the stock. **Resolution:** Ocean Harbor Premium Finance Company was dissolved in 2002.

Cash and Short Term Investments

The Company did not include checks outstanding from their claims accounts for the period from 1995 to 2001, totaling $11,152,576. The Company did not report a cash account balance of $5,891 and did not account for a difference on the bank reconciliation in the amount of $23,808. **Resolution:** The Company included outstanding checks from 2002 and 2003 in the bank reconciliation.

The Company did not maintain an Escheat payable account on their chart of accounts and had not filed a report of abandoned property with the Department of Financial Services. **Resolution:** The Company subsequently filed an abandoned property report for year-end 2002 and reported outstanding claims checks issued prior to 1998. However, the Company did not maintain an escheat payable account or file an abandoned property report for the year ended 2003.

Reinsurance Recoverable

The reported balance for reinsurance recoverables contained errors and was not aged properly on Schedule F. **Resolution:** The Company did not report any reinsurance recoverable in the 2003 annual statement.

Other Expenses

The Company failed to accrue all liabilities for Other expenses at December 31, 2001. **Resolution:** The Company accrued for the material items and only a few immaterial miscellaneous expenses and fees were not accrued for at December 31, 2003.

The Company incorrectly reported guaranty fees on the line item for Other expenses. This should have been reported on the line item for Taxes, licenses and fees. **Resolution:** There were no guaranty fees outstanding at year-end 2003.

Taxes, Licenses and Fees

The Company failed to accrue all liabilities for Taxes, licenses and fees, at December 31, 2001, including an under-accrual for Premium taxes and no accrual for Florida state corporate income taxes since 1994. **Resolution:** None. The Company subsequently failed to accrue for miscellaneous occupational licenses and taxes at December 31, 2003.

Ceded Reinsurance Premiums Payable

The Company incorrectly reported the balance for Ceded reinsurance premiums payable. **Resolution:** None. The Company continued to erroneously report Ceded reinsurance premiums payable net of reinsurance recoverable at December 31, 2003.

Funds Held by Company Under Reinsurance Agreements

The Company incorrectly reported the balance for Funds held by company under reinsurance agreement. **Resolution:** The Company reported no funds held by the Company under reinsurance agreements in the 2003 annual statement.

HISTORY

General

The Company was incorporated on June 17, 1986, under the laws of the State of Oklahoma and was subsequently re-domesticated to the State of Florida effective March 17, 1994. The Company commenced business on June 26, 1986 and began writing premium, in Florida in 1994.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2003:

Private Passenger Auto Liability	PPA Physical Damage
Commercial Automobile Liability	Commercial Auto Physical Damage

The Company has never written insurance coverage in the commercial auto liability or commercial auto physical damage lines of business and failed to have these lines removed from their certificate of authority in violation of Section 624.430(1) FS.

Subsequent Event: In response to the finding in the prior examination report, the Company notified the Office on June 15, 2004 that they did not intend to write any commercial auto business and requested that those lines of business be removed from their COA.

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	1,000,000
Total common capital stock	$3,000,000
Par value per share	$3.00

Control of the Company was maintained by its parent, RM Ocean Harbor Holding, Inc., a Delaware corporation, who owned 100 percent of the stock issued by the Company. 100% of the common stock of RM Ocean Harbor Holding, Inc., was wholly owned by Lucille Milo, in trust for Philip Milo and Jennifer Milo. Ralph Milo owned 100% of the preferred stock of RM Ocean Harbor Holding, Inc.

Profitability of Company

With earned premiums of $52,878,345 and $48,960,388 for 2003 and 2002 respectively, the Company reported a net underwriting gain of $3,102,211 and after tax income of $3,370,344 in 2003. In 2002, the Company reported a net underwriting loss of ($454,103) and after tax income of $625,093. The Company dramatically increased gross premiums in Florida by 86.7% in 2003 and began writing in California for an overall increase in gross premiums of 94%.

Dividends to Stockholders

No dividends were declared or paid to the stockholder during the two-year period covered by this examination.

Management

The annual shareholder's meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. Directors serving as of December 31, 2003, were:

Directors

Name and Location	Principal Occupation
Donna M. Erickson New York, New York	Director; Ocean Harbor Casualty Insurance Company
Robert D. Ferguson Port St. Lucie, Florida	Retired Insurance Executive
Carl J. Hildner Chicago, Illinois	Retired Insurance Executive
David J. Maundrell III New York, New York	Realtor
Philip J. Milo New York, New York	VP; Ocean Harbor Casualty Insurance Company
Ralph Milo New York, New York	President; Ocean Harbor Casualty Insurance Company
William E. Roche New York, New York	Insurance Executive Clarendon Insurance Company

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

Senior Officers

Name	Title
Ralph Milo	President & Treasurer
Philip Milo	Vice President
Donna M. Erickson	Secretary & Assistant 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, 2003:

Audit Committee	Investment Committee	Nominating Committee
Ralph Milo[1]	Philip J. Milo[1]	Ralph Milo[1]
Robert D. Ferguson	Ralph Milo	Philip J. Milo
David J. Maundrell III	Donna M. Erickson	Donna M. Erickson
William E. Roche		
Donna M. Erickson		
Philip J. Milo		
Carl J. Hildner		

[1] Chairman

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 shareholder, Board of Directors, Audit, Investment and Nominating 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.

The Company failed to comply with its bylaws with regard to the annual meeting date and the number of regular meetings.

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

Ocean Harbor Premium Finance Company was dissolved on January 23, 2002.

Surplus Debentures

As of December 31, 2003, there were no outstanding surplus debentures of the Company.

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 February 28, 2004, 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

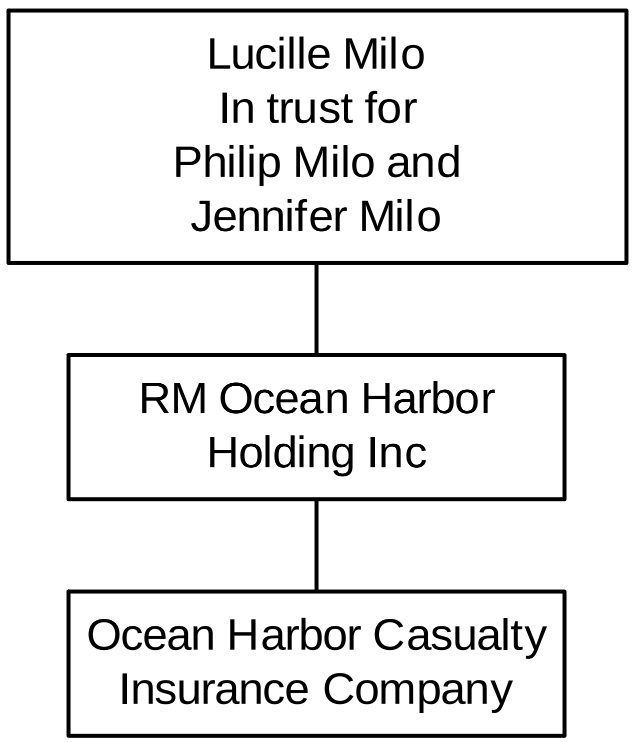
The Company, along with its parent, filed a consolidated federal income tax return for the taxable year ending May 31, 2003. The agreement provided that the Company should compute and remit its taxes as if they filed a separate return.

Cost Allocation Agreement

The Company entered into a cost allocation agreement with its parent on November 24, 2003, which provides that the parent shall apportion any expenses paid on behalf of the Company. Expenses shall be settled no later than 30 days following each calendar quarter.

A simplified organizational chart as of December 31, 2003, reflecting the holding company system, is shown below. Schedule Y of the Company's 2003 annual statement provided a list of all related companies of the holding company group.

OCEAN HARBOR CASUALTY INSURANCE COMPANY
ORGANIZATIONAL CHART
DECEMBER 31, 2003



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to $2,500,000 with a deductible of $100,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company had no employees. The staff of RM Ocean Harbor Holding, Inc., the parent, provided services to the Company and allocated a portion of their salaries to the Company. The employees were are covered by a 401(k) defined contribution and profit sharing plan, and a portion of the matching contributions were allocated to the Company. The cost to the Company for matching contributions in 2003 was $20,066.

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	USTNTS,	7.575%,	11/15/04	$ 500,000	$ 528,595
FL	USTNTS,	7.25%,	08/15/03	1,500,000	1,556,715
Total Special Deposits				$2,000,000	$2,085,310

INSURANCE PRODUCTS AND RELATED PRACTICES

Reliance was placed on the latest market conduct examination, filed November 14, 2003, by the Office to determine the accuracy of premium computation, policy construction, claims handling procedures and use of filed rates and forms. The exceptions noted in the issued report did not affect the solvency of the Company.

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	Oklahoma	California

The Company did not write any insurance business in the state of Oklahoma during the period covered by this examination.

Treatment of Policyholders

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

REINSURANCE

The reinsurance agreements reviewed were found to comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, and reporting and settlement information deadlines.

An independent review of the Company's reinsurance agreements was conducted by Buttner, Hammock and Company, under the direction of the Office. This review revealed that the quota share reinsurance agreement covering the Florida business did not transfer significant insurance risk and therefore must be recorded using deposit accounting in accordance with NAIC Statements of Statutory Accounting Principles (SSAP), 62. The net effect of unwinding this reinsurance agreement was a reduction in surplus of $4,249,008.

Subsequent event: Effective April 1, 2004, the Company terminated the quota share reinsurance agreement covering the Florida business on a cut off basis and replaced it with a prospective treaty determined to have an adequate transfer of risk in accordance with SSAP 62. The new quota share reinsurance treaty applies to inforce, new and renewal business effective April 1, 2004.

Assumed

The Company did not assume any insurance business during the period covered by this examination.

Ceded

The Company ceded risk on a quota share basis to: Ace Property and Casualty Insurance and Partner Reinsurance Company, both authorized reinsurers.

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 2002 and 2003, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, FAC.

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, with the exception of adjustments to line items as noted within this report.

The accounts and records maintained by the Company did not accurately disclose direct written premium. The Company failed to include SR22 fees collected from policyholders as premiums in accordance with Section 627.403, FS, which provides that any policy or similar fee charged for an insurance contract is deemed part of the premium.

The Company inadvertently classified payments for loss adjustment expenses as loss payments in violation of SSAP 55 (5), which indicates that expenses incurred in the adjusting, recording and paying of claims should be reported as loss adjustment expenses.

The Company failed to report, pay, or deliver to the Department of Financial Services all funds in their possession that were unclaimed for more than 5 years in accordance with Sections 717.102 and 717.117, FS.

The Company maintained its statutory home office in Tallahassee, Florida, where this examination was conducted.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company utilized the services of TD Waterhouse Investor Services, Inc., and failed to obtain a written custodial safekeeping agreement in violation of Rule 69O-143.042, FAC.

MGA Agreement

The Company maintained an agency agreement with JAJ Holding Company, Inc. (JAJ), effective September 1, 1994 for the administration of the private passenger automobile physical damage and property damage liability program. The agreement provided that JAJ had the authority to receive and accept proposals for insurance, to collect and receive premiums on insurance, to make customary endorsements changes, assignments, transfers, and modifications of existing policies and to deliver and countersign insurance policies.

The Company's MGA failed to maintain errors and omissions insurance coverage and fidelity bond coverage as required by Article VIII of the agency agreement as well as the requirements of Section 626.7453, FS.

Subsequent Event: The Company received a copy of the binder for errors and omissions coverage for the MGA prior to the conclusion of fieldwork.

The Company failed to obtain from the MGA an independent financial examination in a form acceptable to the Office for 2002 as required by Section 626.7454, FS. Furthermore, Section IX of the agreement indicates that within 150 days after the end of the year, the agent shall furnish the Company true copies of its audited financial statements. The MGA's 2003 financial statements were not available until July 16, 2004, which exceeded 150 days after the end of the year.

Claims Service Agreement

The Company maintained a claims service agreement with JAJ, effective September 1, 1994, whereby JAJ shall perform claims services for policies issued under the agency agreement and administer and adjust all claims arising under the policies issued by JAJ.

General Agency Agreement

The Company maintained a general agency agreement effective April 1, 2003 with Express General Insurance Agency LLC Company, Inc. (EG), a limited liability corporation organized under the laws of the State of California. The Company appointed EG as its agent and granted them authority to solicit, receive and accept applications for insurance coverage in California and to perform other acts and duties under policies of insurance issued by the Company as otherwise would be performed by the Company.

Claims Service Agreement

The Company maintained a claims service agreement with Newport Claim Services LLC, effective July 1, 2003. The agreement provides Newport Claim Services shall administer and adjust claims arising from policies issued by EG.

Program Administrator Agreement

The Company entered into a program administrator agreement on July 1, 2003 appointing EG as the Company's program administrator to solicit, receive and accept applications for insurance, to collect and receive premiums, and to underwrite quote, bind, rate, issue, and service policies written in California.

Records Custodian Agreement

The Company entered into an agreement with Gulf Atlantic Insurance Services, Inc. (Gulf Atlantic) effective November 24, 2003 whereby Gulf Atlantic would act as the custodian for the Company's corporate and accounting records and to provide various administrative services.

Independent Auditor Agreement

The Company engaged Law, Redd, Crona & Munroe, P.A. for the purpose of annually auditing and reporting on the statutory basis financial statements at year-end.

Risk-Based Capital

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

INFORMATION TECHNOLOGY REQUIREMENTS

Computer Aid Inc., under the direction of the Office, conducted an evaluation of the Company's information systems requirements to determine if the Company was in compliance with information technology (IT) standards. The Company's primary information systems and support were provided by JAJ, who maintained, operated, controlled and updated programs and software. JAJ had an inhouse technology department that developed and supported all systems applications. The following is a summary of principal findings and recommendations:

Management Controls

Management controls were good overall. However, JAJ did not have a formal IT steering committee. Furthermore, standing meetings were not scheduled to address and document IT issues. Finally, there was no internal IT audit function. We recommend that better documentation be maintained for IT plans, project status, and actions taken.

Organizational Controls

Job descriptions were not fully documented. Few written control procedures existed. We recommend formal job descriptions be documented for each person. We further recommended that policies, procedures and job duties also be documented and kept current.

Application Change Control

Controls in this area were acceptable. However, insufficient documentation existed regarding the changes made to production source code, modification and testing. We recommend that changes made to production source codes be documented. We also recommend implementing software to control and limit access to production versions of the source code.

System and Program Development

These controls were acceptable overall; however, the documentation regarding the Systems Development Life Cycle (SDLC) for the ITS application had not been fully implemented. We recommend all provisions of the SDLC not currently in place be implemented.

Operations

Overall, the operations controls were good; however, an alternate power supply does not exist. A Standard Operating Manual does not exist. We recommend that standard operating procedures be documented and maintained in a single location for immediate access.

Documentation

Documentation controls were generally acceptable. Documentation standards were established but not implemented. We recommended that the Company maintain complete and current documentation.

Logical and Physical Security

The Company had no written security policy. Application passwords were assigned to users by the IT staff. Users could not change the assigned passwords. We recommend passwords be set to expire, by the user. Informal security policies, standards, and practices were not documented. Further, specific policies for password controls, remote access, authorization and systems administration should be fully documented.

Contingency Planning

The contingency plan had not been fully tested. We recommend that the Company conduct a “walk through” test to insure people understand their roles, contact numbers are accurate, backup tapes are readily available and an alternate site facility can respond appropriately. Additionally, a Business Continuity Plan (BCP) should be developed to compliment the IT Disaster Recovery Plan.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2003, 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."

OCEAN HARBOR CASUALTY INSURANCE COMPANY
Assets

DECEMBER 31, 2003

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	$25,408,789	$0	$25,408,789
Stocks:			
Preferred	1,705,340	0	1,705,340
Cash:			
On deposit	22,073,617	0	22,073,617
Short-term investments	9,003,685	0	9,003,685
Investment income due and accrued	471,973	0	471,973
Premiums and considerations:			
Uncollected premium	10,187,240	1,454,617	11,641,857
Reinsurance recoverable	0	174,626	174,626
Net deferred tax asset	2,115,648	(111,658)	2,003,990
Reinsurance deposit	0	22,663,871	22,663,871
Aggregate write-in for other than invested assets	6,142	(6,142)	0
Totals	$70,972,434	$24,175,314	$95,147,748

OCEAN HARBOR CASUALTY INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2003

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	$22,520,907	$8,724,044	$31,244,951
Loss adjustment expenses	1,211,000	900,000	2,111,000
Other expenses	37,328	0	37,328
Taxes, licenses and fees	1,086,266	0	1,086,266
Current federal and foreign income taxes	554,096	0	554,096
Unearned premium	20,812,822	20,534,959	41,347,781
Ceded reinsurance premiums payable	2,346,124	(723,023)	1,623,101
Aggregate write-ins for liabilities	1,981,586	(900,000)	1,081,586
Total Liabilities	$50,550,129	28,535,980	$79,086,109
Common capital stock	3,000,000		3,000,000
Gross paid in and contributed surplus	3,359,723		3,359,723
Unassigned funds (surplus)	14,062,582	(4,360,666)	9,701,916
Surplus as regards policyholders	20,422,305	(4,360,666)	16,061,639
Total liabilities, capital and surplus	$70,972,434	24,175,314	$95,147,748

OCEAN HARBOR CASUALTY INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2003

Underwriting Income	
Premiums earned	$52,878,345
DEDUCTIONS:	
Losses incurred	35,791,110
Loss expenses incurred	2,061,813
Other underwriting expenses incurred	11,923,211
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	$49,776,134
Net underwriting gain or (loss)	$3,102,211
Investment Income	
Net investment income earned	$1,771,559
Net realized capital gains or (losses)	(258,750)
Net investment gain or (loss)	$1,512,809
Other Income	
Total other income	$0
Net income before dividends to policyholders and before federal & foreign income taxes	$4,615,020
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	$4,615,020
Federal & foreign income taxes	1,244,676
Net Income	$3,370,344
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	$16,811,932
Gains and (Losses) in Surplus	
Net Income	$3,370,344
Net unrealized capital gains or losses	539,304
Change in net deferred income tax	(125,178)
Change in non-admitted assets	(174,097)
Aggregate write-ins for gains and losses in surplus	0
Examination Adjustment	(4,360,666)
Change in surplus as regards policyholders for the year	($750,293)
Surplus as regards policyholders, December 31 current year	$16,061,639

COMMENTS ON FINANCIAL STATEMENTS

Assets

Investment Income Due and Accrued $471,973

The above amount is the same as that reported by the Company. However, the Company inadvertently miscalculated accrued interest on select bonds using erroneous payment dates. Since the accrued interest amount was considered immaterial, no examination adjustment required.

Agent's Balances $11,641,857

Agent's balances reported as $10,187,240 was comprised primarily by $10,043,595, which represented premiums due from the MGA, who was a controlled or controlling person. JAJ did not maintain a trust account, irrevocable letter of credit, financial guaranty bond payable to the insurer, or a financial evaluation indicating the ability to pay as required by Section 625.012(5)(a), FS, to admit the receivable. The account used by JAJ was in the name of JAJ for the benefit of the Company and all premium was deposited into this account by JAJ.

Subsequent event:

On October 28, 2004, the Company replaced the aforementioned account with a new account in the name of the Company; and provided a copy of the Citibank account statement where premiums from the policyholders were deposited directly by the MGA, rather than being held by the MGA.

The account was increased by $1,448,475, which represented funds held by EG and not yet payable to the Company under the terms of the agency agreement.

Finally, $6,142, which represented a receivable for policy fees due from EG, was reclassified from annual statement line A-23 “Aggregate write in for other than invested assets”.

Reinsurance Recoverable $174,626

The above amount is $174,626 greater than that reported by the Company. The account was increased by $4,487,645 for reinsurance recoverable on paid loss and loss adjustment expenses which was inadvertently used to offset ceded reinsurance payable in violation of SSAP 62, which provided that reinsurance recoverable shall be recorded as an asset with no available offset.

The account was then reduced by $4,313,018, which represented transactions related to the reinsurance agreement that did not transfer significant risk in accordance with SSAP 75.

Deferred Tax Assets $2,003,990

The deferred tax asset reported at $2,115,648 was reduced by $111,658, which represented the portion that exceeded 10% of the surplus reported on the most recently filed financial statement prior to year-end 2003, as required by SSAP 10.

Aggregate write in for other than invested assets $-0-

The Company misclassified policy fees receivable from EG. Section 627.403, FS defines premium as the consideration for insurance, by whatever name called. Any assessment, or any membership, policy, survey, inspection, service or similar fee or charge in consideration for an insurance contract is deemed part of the premium. Therefore, this amount should be included as agent’s balances.

Reinsurance Deposit $22,633,871

Because the reinsurance treaty covering the Florida business did not transfer significant insurance risk, an asset was created to record the amount paid for this reinsurance treaty during 2003. SSAP 62 provides that deposit accounting be used for reinsurance treaties that do not transfer significant insurance risk.

Liabilities

Losses and Loss Adjustment Expenses $33,355,951

The above amount is $9,624,044 greater than the $23,731,907 reported by the Company. The account was increased by $900,000, which was misclassified and recorded on annual statement line L-23, Aggregate Write-in for Liabilities. The remaining $8,724,044 was the result of unwinding reinsurance due to a lack of transfer of significant insurance risk.

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, 2003, 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 engaged Veris Consulting LLC (Veris) to perform a reserve analysis to determine the adequacy of the Company's reserves. The reserve analysis brought forth several issues:

There was concern with the extraordinary direct and assumed premium growth in 2003. While a small portion (a 7.3% rate change, effective 3/1/03, yielding a 6.1% effect on 2003 written premium) of the premium increase for 2003 can be explained by a rate change, most of the 78% premium increase is due to an increase in exposures.

Additionally, loss adjustment expenses were not being reported on a consistent basis. For example, for accident year 2002, total loss adjustment expenses (LAE) paid for private passenger automobile liability (PPAL) as of year-end 2002 was reported as $2,852,000 in Schedule P. The loss adjustment expenses for 2002 at year-end 2003 were reported as $1,744,000, a decrease of about 40%. It is highly unusual for paid accident year amounts for loss adjustment expenses to decrease from one reporting period to the next. Similarly, automobile physical damage (APD) paid LAE for accident year 2002 decreased from year-end 2002 to year-end 2003, by about 35%.

The workpapers from the Company's actuary, contained no paid or reserve amounts for LAE, other than the actuary's calculations, based off of loss reserves. There was no Schedule P reconciliation included in the actuary's workpapers. While Veris relied on historical Schedule P LAE data for purposes of calculating reserve requirements, the Schedule P LAE data may not be accurate, absent some basis for comparison.

The Company maintains no ALAE reserves. Based on the Schedule P calculations, a small reserve would be appropriate.

Finally, Veris encountered several problems when attempting to reconcile the Company's data to the claims files and to the actuarial workpapers. Further, they were not provided with any material to reconcile loss adjustment expenses.

The results of this analysis determined that, the held direct and assumed reserve amounts were slightly less than those selected in their study, but they fell well within the calculated reserve range.

Other Expenses <u>$37,328</u>

The Company failed to accrue for a few immaterial expenses at December 31, 2003 as required by Section 625.041(4) FS. No adjustment was made during this examination, as the amount was immaterial.

Unearned Premium <u>$41,347,781</u>

The amount reported by the Company of $20,812,822 was increased by $20,534,959 due to the reinsurance failing to transfer significant insurance risk.

Ceded Reinsurance Premiums Payable <u>$1,623,101</u>

The above amount is $723,023 less than $2,346,124 reported by the Company. The account was increased by $5,936,119, which represents funds due to reinsurers held by the agent as well as ceded balances payable erroneously offset by reinsurance recoverable on paid loss and loss adjustment expenses in violation of SSAP 62 which provides that reinsurance recoverable shall be recorded as an asset with no available offset.

Finally, the account was reduced by $6,659,142, which represents the amount reported as reinsurance premiums on the treaty that did not transfer significant insurance risk.

Aggregate write-in for Liabilities <u>$1,081,586</u>

The amount reported by the Company of $1,981586 was reduced by $900,000, which represents unpaid loss adjustment expenses that were reclassified to annual statement line L-3 Loss Adjustment Expense.

The Company used contingent commissions receivable of $1,164,300, a non-admitted asset, to offset $2,245,886 payable to JAJ under the Claims and MGA agreements, to record a net liability of $1,081,586.

OCEAN HARBOR CASUALTY INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2003

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, 2003, Annual Statement				$20,422,305
	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
ASSETS:				
Agents Balances	$10,187,240	11,641,857	1,454,617	
Reinsurance Recover	$0	$174,626	$174,626	
Deferred Tax Asset	$2,115,648	2,003,990	(111,658)	
Agg w/in for OTIA	$6,142	$0	($6,142)	
Reinsurance Deposit	$0	$22,663,871	$22,663,871	
LIABILITIES:				
Losses	$22,520,907	$31,244,951	($8,724,044)	
LAE	$1,211,000	2,111,000	(900,000)	
Unearned Premiums	$20,812,822	$41,347,781	($20,534,959)	
Ceded Reins Payable	$2,346,124	1,623,101	723,023	
Agg w/in for Liab	$1,981,586	$1,081,586	$900,000	
Net Change in Surplus:				(4,360,666)
Surplus as Regards Policyholders December 31, 2003, Per Examination				16,061,639

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2001 examination report issued by the Office except for the following:

Custodial Agreement

The Company did not maintain a custodial agreement with its custodian. Additionally, the Company maintained their investments with an investment broker for which the Company was to correct by December 31, 2004 and is now recommended to correct by December 31, 2005.

Bonds and Common Stock

The Company maintained its investments with an investment broker, TD Waterhouse Investor Services, instead of a bank or trust company.

Cash and Short-term Investments

The Company did not maintain an Escheat Payable on their Chart of Accounts and had not filed a report of abandoned property with the Department of Financial Services for year-end 2003.

Taxes, Licenses and Fees

The Company failed to accrue all liabilities for Taxes, Licenses and Fees, at December 31, 2003.

Ceded Reinsurance Premiums Payable

The Company incorrectly reported the balance for Ceded Reinsurance Premiums Payable.

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, 2003.

Corporate Records

The Company failed to comply with its Bylaws with regard to the annual meeting date and the number of regular meetings. **The Company is directed to amend or comply with its Bylaws. The Company is to provide documentation of compliance to the Office within 90 days after the report is issued.**

Reinsurance

The reinsurance treaty covering the Florida business did not transfer significant insurance risk and therefore must be recorded using deposit accounting in accordance with NAIC Statements of Statutory Accounting Principles (SSAP) 62. This treaty was terminated effective April 1, 2004. **The Company is directed to comply with SSAP 62 and record all reinsurance treaties that do not transfer significant insurance risk using deposit accounting.**

Accounts and Records

The Company failed to include SR22 fees as written premiums in violation of Section 627.403, Florida Statutes. **The Company is directed to comply with Section 627.403, FS and correctly report written premiums on all future annual and quarterly statement filings.**

The Company inadvertently classified payments for loss adjustment expenses as loss payments in violation of SSAP 55 (5). **The Company is directed to comply with SSAP 55 and correctly report loss and loss adjustment expenses paid on all future annual and quarterly statement filings.**

The Company failed to report, pay, or deliver to the Department of Financial Services, all funds in their possession and unclaimed for more than 5 years, in accordance with Sections 717.102 and 717.117 FS. **The Company is directed to comply with Section 717.117, FS, file timely abandoned property reports and provide a copy of such report to the Office within 90 days after this report is issued.**

Information Technology Requirement

The information technology section of this report, on pages 19 through 21, identify eight deficiencies and recommendations. User passwords did not adhere to the generally accepted practice of being assigned by the user and expiring periodically. **It is recommended that the Company implement these recommendations within 180 days after this report is issued.**

Custodial Agreement

The Company failed to obtain a written custodial safekeeping agreement in violation of Rule 69O-143.042, FAC. The Company is directed to comply with Rule 69O-143-042 FAC and obtain a written custodial safekeeping agreement. The Company is to provide documentation of compliance to the Office no later than 90 days after the report is issued.

MGA Agreement

The Company's MGA failed to maintain errors and omissions insurance coverage and fidelity bond coverage as required by Article VIII of the agency agreement as well as Section 626.7453 FS. **The Company is directed to comply with Section 626.7453 and ensure the MGA maintain errors and omissions coverage. The Company is to provide documentation of compliance to the Office no later than 90 days after the report is issued.**

Investment Income Due and Accrued

The Company inadvertently calculated accrued interest on a few bonds using erroneous payment dates. **The Company is directed to correctly report accrued interest on all future annual and quarterly statement filings.**

Agent's Balances

The Company incorrectly reported balance for premiums receivable. **The Company is directed to correctly report agent's balances on all future annual and quarterly statement filings.**

Deferred Tax Asset

The Company failed to limit the deferred tax asset to 10% of the surplus reported on the most recent filed financial statement, in violation of SSAP 10. **The Company is directed to comply with SSAP 10 and correctly report deferred tax assets on all future annual and quarterly statement filings.**

Aggregate write-in for Other than Invested Assets

The Company failed to classify policy fees receivable from EG as premiums receivable. **The Company is directed to correctly report premiums receivable on all future annual and quarterly statement filings.**

Loss and Loss Adjustment Expense

The Company misclassified unpaid loss adjustment expenses. **The Company is directed to correctly report unpaid loss adjustment expenses on all future annual and quarterly statement filings.**

Other Expenses and Taxes, Licenses and Fees

The Company failed to accrue for a few immaterial expenses at December 31, 2003 as required by Section 625.041(4) FS. **The Company is directed to correctly accrue and report unpaid expenses on all future annual and quarterly statement filings.**

Ceded Reinsurance Premiums Payable

The Company erroneously offset reinsurance recoverable on paid loss and loss adjustment expenses with ceded reinsurance premiums payable in violation of SSAP 62. **The Company is directed to comply with SSAP 62 and correctly report ceded reinsurance premiums payable on all future annual and quarterly statement filings.**

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Ocean Harbor Casualty Insurance Company** as of December 31, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was $16,061,639, which was in compliance with of Section 624.408, FS.

In addition to the undersigned, Kimberly A. Ferrell, FLMI, Financial Examiner/Analyst II, Computer Aid Inc., Veris Consulting LLC, and Buttner, Hammock and Company participated in the examination.

Respectfully submitted,

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Mary M. James, CFE, CPM
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation

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Kethessa Carpenter, CPA
Financial Specialist
Florida Office of Insurance Regulation