

REPORT ON EXAMINATION

OF THE

QUALSURE INSURANCE CORPORATION

SARASOTA, FLORIDA

AS OF

DECEMBER 31, 2002

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida
October 3, 2003

Kevin M. McCarty
Director
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0300

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, an examination has been made as of December 31, 2002, of the financial condition and corporate affairs of the:

**QUALSURE INSURANCE CORPORATION
506 SARASOTA QUAY
SARASOTA, FLORIDA 34236**

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

SCOPE OF EXAMINATION

This examination covered the intervening period from January 1, 2002, to the close of business on December 31, 2002. The Company was last examined by representatives of the Office of Insurance Regulation (Office) as of December 31, 2001. This examination commenced on May 27, 2003, and the fieldwork was concluded as of October 3, 2003. 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 represents a statutory financial examination conducted in accordance with the Financial Examiners Handbook, Accounting Practices and Procedures Manual and Annual Statement Instructions, promulgated by the National Association of Insurance Commissioners (NAIC) as adopted by Rules 4-137.001(4) and 4-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws, rules and regulations of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination or estimation of liabilities, as affects 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 and related records prepared by the Company's independent certified public accountants were reviewed and utilized where applicable within the scope of this examination.

The Company's assets were valued and/or verified and the liabilities were determined or estimated as of December 31, 2002. Transactions subsequent to year-end 2002 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

The following is a summary of significant regulatory information disclosed and the adverse findings from the previous examination as of December 31, 2001, by the Office, with the action taken by the Company in connection therewith:

Fidelity Bond and Other Insurance

As of December 31, 2001, the Company had not obtained fidelity bond coverage as recommended by the NAIC.

Resolution: As of October 9, 2002, the Company was covered pursuant to Rider No. 1 of the financial institution bond to U.S. RE Companies, Inc.

Cash & Short-term Investments

As of December 31, 2001, the Company incorrectly reported certain items on Schedule DA, Part 1, of its 2001 Annual Statement.

Resolution: As December 31, 2002, the Company correctly completed Schedule DA, Part 1, of its 2002 Annual Statement.

Premiums Receivable

The Company erroneously included certain amounts of agents' balances and installments booked but deferred and not yet due on line 10.1 of its 2001 Annual Statement. These amounts should have been reported on line 10.2.

Resolution: As of December 31, 2002, the Company's premiums receivable in the amount of \$2,783,215 was reported on line 10.1 of its 2002 Annual

Statement. This amount included \$1,516,788 of installments booked but deferred and not yet due, which should have been reported on line 10.2. The Company subsequently corrected this error and reported lines 10.1 and 10.2 correctly on its Quarterly Statement ended March 31, 2003.

Custodial Agreement

As of December 31, 2001, the Company's custodial agreement with South Trust Bank regarding indemnification of assets, was not in accordance with Rule 4-143.042, Florida Administrative Code. The agreement also did not reflect the Company's correct name as Qualsure Insurance Corporation. The Company was to amend the agreement in accordance with the above rule including its proper name as Qualsure Insurance Corporation and provide a copy of the agreement to the Office by September 30, 2003.

Resolution: On September 30, 2003, the Company submitted a revised copy of its custodial agreement to the Office for approval. The examiner's review of the revised agreement noted compliance with the above Rule and that the proper name of Qualsure Insurance Corporation was stated in the revised agreement.

HISTORY

General

The Company was incorporated January 13, 2000, under the laws of the state of Florida, as a stock property and casualty insurer and commenced business on January 31, 2000, with name of Magna Florida Insurance Corporation. On February 3, 2000, the Office approved the name change to Qualsure Insurance Corporation.

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

Fire	Inland Marine
Allied Lines	Other Liability
Homeowners Multi Peril	Mobile Home Multi Peril
Commercial Multi Peril	Mobile Home Physical Damage

The Company assumed policies from Citizens Property Insurance Company (Citizens), formerly Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) and the Florida Windstorm Underwriting Association (FWUA). To generate new business, the Company

hired a marketing representative, began to appoint agents and wrote new business through a managing general agency relationship.

The Articles of Incorporation and the Bylaws were not amended during the period covered by this examination.

Capital Stock

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

Number of authorized common capital shares	100,000
Number of shares issued and outstanding	20,000
Total common capital stock	\$20,000
Par value per share	\$1

Control of the Company was maintained by its parent, Qualsure Holding Corporation, (QHC) who owned 100 percent of the stock issued by the Company. QHC was owned 64% by Fenelon Ventures, II, LLC, and 36% by NEM West Indies Insurance Limited (NEM).

The Company's parent, QHC, a Florida Corporation, received \$3,500,000 from NEM, a Trinidad and Tobago corporation, per a convertible subordinated promissory note dated January 21, 2000, that is due January 21, 2008. The note was provided pursuant to the terms of the Securities Purchase Agreement dated January 20, 2000 by the holding company, Qualsure Underwriting Agencies, Inc., Qualsure Insurance Corporation, Fenelon Ventures II, LLC (a Delaware limited liability company) and NEM.

Profitability of Company

As of December 31, 2002, the Company reported an underwriting and overall loss of \$7,341,750 and \$4,160,441, respectively.

Company management stated they experienced increased reinsurance costs and other expenses. The Company requested and received a rate increase in 2002 from the Office. The Company hopes to increase its spread of risk, while simultaneously managing its probable maximum loss (PML). The Company has currently met the terms of the takeout assumption agreement as of January 31, 2003 and stated that it will likely examine the rates for the wind-only policies. In late 2002, the Company renegotiated its claims administration agreement, to reduce adjusting expenses in 2003 and beyond. The Company's agency agreement with Braishfield Associates, Inc. (BAI) has been cancelled. Management stated this cancellation will give the Company better control over its PML and reinsurance costs. The Company was in the process of finalizing a 2004 Profitability Plan that will be submitted to its Board of Directors in the fourth quarter 2003. Key elements of the plan will include rate rationalization, reduction of vendor fees, and efforts to achieve better spread of risk and renegotiation of its quota share reinsurance treaties.

Dividends to Stockholders

There were no dividends declared or paid to the Company's stockholder in 2002.

Management

The annual shareholder meeting or the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. The Directors serving as of December 31, 2002, were:

Directors

Name and Location	Principal Occupation
John N. Lombardo Bonita Springs, Florida	Chairman of the Board; current Director of American Re
Gerrard Lee-Inniss Trinidad, West Indies	President, CEO, and Director of NEM West Indies Ltd.
Tal P. Piccione Upper Saddle River, New Jersey	President and CEO of US Re and subsidiaries, including Fenelon II
Jack Norton Lexington, South Carolina	Vice President of CSC
Mike Joye Jacksonville, Florida	General Counsel of US RE

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

Senior Officers

Name	Title
*Robert T. Savage, Jr.	President & CEO
Elizabeth R. Monts	CFO, Treasurer & Assistant Secretary

*On May 13, 2003, Robert T. Savage, Jr. was replaced by James P. Brown as President and CEO by unanimous consent by the Company's board of directors.

The Company used several internal committees in accordance with Section 607.0825, Florida Statutes. The following is a list of the principal internal committees and their members as of December 31, 2002:

Investment Committee

Tal P. Piccione, Chairman
Jack Norton

Compensation Committee

John N. Lombardo, Chairman
Tal P. Piccione

Audit Committee

Gerrard Lee-Inniss, Chairman
Jack Norton
Tal P. Piccione

Conflict of Interest Procedure

The Company had adopted a policy statement that required annual disclosure on conflicts of interest, in accordance with Section 607.0832, Florida Statutes. No exceptions were noted during this examination period.

Corporate Records

The recorded minutes of the meetings by the Shareholder, Board of Directors, Investment and Executive Committees were reviewed for the period under examination. The minutes were documented and adequately approved Company transactions, in accordance with Section 607.1601, Florida Statutes, including the authorization of investments in accordance with Section 625.304, Florida Statutes.

The minutes reviewed did not document whether the Company directors reviewed the previous examination report.

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

There were no acquisitions, mergers, disposals, dissolutions or purchase or sales through reinsurance.

Surplus Debentures

The Company reported no surplus debentures.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 4-143.045(3), Florida Administrative Code. The latest holding company registration filing with the State of Florida, as required by Section 628.801, Florida Statutes, and Rule 4-143.046, Florida Administrative Code, was made in July, 2002.

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

Tax Allocation Agreement

The Company, along with its parent and Qualsure Underwriting Agencies, Inc., filed a consolidated federal income tax return. On December 31, 2002, the method of allocation between the parties was the separate return method described in Treasury Regulation 1.1552-1 (a) (2). This method allocates a percentage of the total tax to each member as if each member had filed a separate return.

MGA Agreement

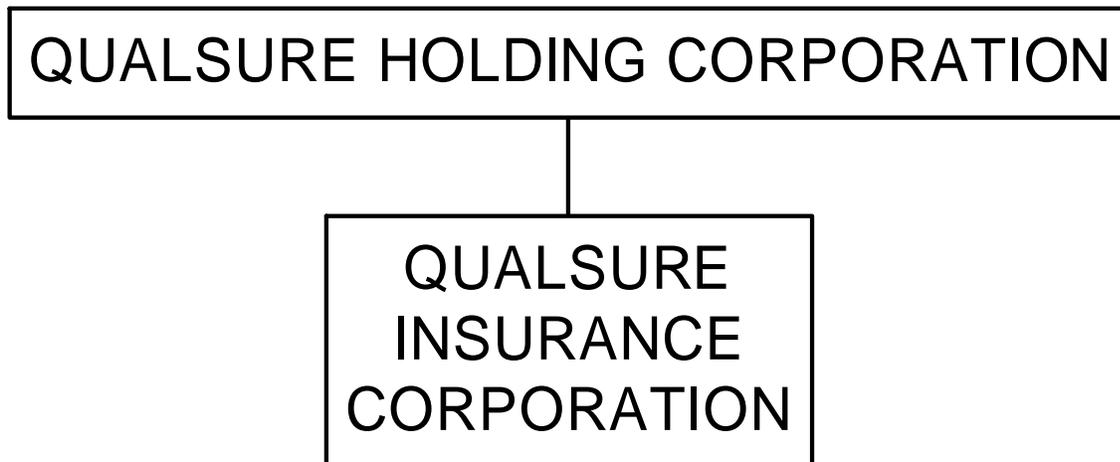
The Company had a Managing General Agency (MGA) Agreement with Qualsure Underwriting Agencies, Inc., (QUA), a company that is affiliated indirectly through common shareholders and common business interests. QUA is responsible for underwriting and marketing functions. In 2002, expenses incurred under this agreement totaled \$8,117,734. Additionally, QUA received a \$25 per policy fee for each policy issued totaling \$2,207,200 for 2002. The Company failed to include the MGA policy fees as premiums on the 2002 Annual Statement.

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

QUALSURE INSURANCE CORPORATION

ORGANIZATIONAL CHART

DECEMBER 31, 2002



FIDELITY BOND AND OTHER INSURANCE

As of December 31, 2002, the Company had fidelity bond coverage as recommended by the NAIC pursuant to Rider No. 1 of the financial institution bond of U.S. RE Companies, Inc.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company adopted a 401(k) defined contribution plan that covered substantially all employees. The plan provided for a company match of 50% of the first 6% of employee contributions and allowed for the discretionary profit sharing contributions. No profit sharing contributions were made during the examination period.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes, and with various state officials as required or permitted by law:

State	Description	Par Value	Market Value
FL	USTBLS, 5.75%, 04/30/03	<u>\$2,100,000</u>	<u>\$2,130,849</u>
Total Special Deposits		<u>\$2,100,000</u>	<u>\$2,130,849</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Company was authorized to transact insurance only in the state of Florida, in accordance with Section 624.401(2), Florida Statutes.

As of January 1, 2002, the Company had two major components in its marketing strategy. The first component was a network of agents appointed directly by the Company to write homeowners business on its behalf. The other component was to utilize a program manager, BAI, to generate business from other sources. Subsequently, on March 28, 2003 the Company terminated its relationship with BAI.

Treatment of Policyholders

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

REINSURANCE

The reinsurance agreements reviewed were found to meet NAIC regulations with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

Assumed

The Company assumed risk from the FRPCJUA on a "Takeout Basis". The FRPCJUA was created by the Legislature of the state of Florida pursuant to Section 627.351, Florida Statutes. The Company also assumed risk from the FWUA.

Ceded

The Company ceded risk on a quota share and catastrophic excess of loss basis. The Company ceded 68.25% on the gross account quota share. The catastrophe excess of loss contracts include six layers with various reinsurers. The Company's current reinsurance was reviewed by a reinsurance specialist and it was determined that the Company's catastrophe reinsurance program is structured to adequately protect the Company in the event of hurricane catastrophe losses up to the 100 year level; and the Company would experience only a very minor reduction in capital and surplus in the event of either a 20, 50 or 100 year storm.

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 was audited annually by an independent Certified Public Accountant (CPA) for the years 2000, 2001 and 2002, in accordance with Section 624.424(8), Florida Statutes. Audited Statutory Financial Statements and supporting work papers were prepared by the CPA as required by Rule 4-137.002, Florida Administrative Code.

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

This examination was conducted at the Company's principal operational offices in Sarasota, Florida.

The following agreements were in force between the Company and non-affiliates:

Custodial Agreement

The Company had a custodial agreement with South Trust Bank for the safekeeping of its securities. The agreement was not in accordance with Rule 4-143.042, Florida Administrative Code, regarding indemnification of assets. The custodial agreement also did not properly state the Company's name as Qualsure Insurance Corporation.

Claims Administration Services Agreement

The Company had a claims administration services agreement with Insurance Network Services, Inc., (INS). This agreement was renegotiated during 2002 in order to reduce the Company's claims administration costs. INS is responsible for all claims adjusting services. In 2002 expenses incurred under this agreement totaled \$4,748,334.

Risk-Based Capital

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

FINANCIAL STATEMENTS PER EXAMINATION

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

QUALSURE INSURANCE CORPORATION
Analysis of Assets

DECEMBER 31, 2002

Classification	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$33,370,320	\$0	\$33,370,320
Cash:			
On deposit	1,995,847		1,995,847
Short-term Investments	2,494,644		2,494,644
Receivable for securities	977,885		977,885
Premiums:			
Uncollected premium	2,767,238	1,590,773	1,176,465
Deferred premium	0	(1,516,788)	1,516,788
Reinsurance recoverable	2,783,215		2,783,215
Federal income tax recoverable	2,929,390		2,929,390
EDP equipment	22,192		22,192
Interest and dividend			
income due & accrued	321,265		321,265
Receivable from PSA	430,072		430,072
Other assets nonadmitted	37,972	37,972	0
Aggregate write-in for			
other than invested assets	870,413	501,735	368,678
	<hr/>	<hr/>	<hr/>
Totals	49,000,453	613,692	\$48,386,761
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QUALSURE INSURANCE CORPORATION
Liabilities, Surplus and Other Funds

DECEMBER 31, 2002

Liabilities		
Losses		\$2,575,878
Loss adjustment expenses		642,821
Other expenses		948,880
Taxes, licenses and fees		462,239
Unearned premium		13,749,514
Advance premiums		868,047
Ceded reinsurance premiums payable		5,708,086
Provision for reinsurance		4,655
Payable to parent, subsidiaries and affiliates		1,379,061
Payable for securities		1,042,267
Aggregate write-ins for liabilities		<u>1,792,340</u>
Total Liabilities		\$29,173,788
Common capital stock	\$20,000	
Gross paid in and contributed surplus	24,980,000	
Unassigned funds (surplus)	<u>(5,787,027)</u>	
Surplus as regards policyholders		<u>19,212,973</u>
Total liabilities, capital and surplus		<u><u>\$48,386,761</u></u>

QUALSURE INSURANCE CORPORATION

Statement of Income

DECEMBER 31, 2002

Underwriting Income

Premiums earned	\$6,836,426
DEDUCTIONS:	
Losses incurred	5,160,715
Loss expenses incurred	2,210,232
Other underwriting expenses incurred	6,807,229
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$14,178,176</u>
Net underwriting gain or (loss)	(\$7,341,750)

Investment Income

Net investment income earned	\$990,207
Net realized capital gains or (losses)	446,932
Net investment gain or (loss)	<u>\$1,437,139</u>

Other Income

Total other income	\$0
Net income before dividends to policyholders and before federal & foreign income taxes	(\$5,904,611)
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$5,904,611)
Federal & foreign income taxes	<u>(1,744,170)</u>
Net Income	(\$4,160,441)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$23,581,927
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Gains and (Losses) in Surplus

Net Income	(\$4,160,441)
Net unrealized capital gains or losses	0
Change in nete deferred income tax	192,151
Change in non-admitted assets	(396,009)
Change in provision for reinsurance	(4,655)
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>(\$4,368,954)</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$19,212,973</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Premiums Receivable \$2,693,253

The Company erroneously included \$1,516,788 of installments booked but deferred and not yet due on line 10.1 of the 2002 annual statement. These amounts should have been reported on line 10.2.

Liabilities

Losses and Loss Adjustment Expenses \$3,218,699

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, 2002, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

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

QUALSURE INSURANCE CORPORATION
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2002

The following is a reconciliation of surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders per December 31, 2002 Annual Statement	\$19,212,973
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	INCREASE (DECREASE) <u>IN SURPLUS</u>
ASSETS:			
Premiums:			
Premiums Uncollected	\$2,693,253	\$1,176,465	(\$1,516,788)
Deferred and not yet due	\$0	\$1,516,788	\$1,516,788

LIABILITIES:

Net Change in Surplus:	0
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Surplus as Regards Policyholders December 31, 2002, Per Examination	\$19,212,973
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FINDINGS, COMMENTS AND CORRECTIVE ACTION

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.

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2002.

Premiums Receivable

The Company included \$1,516,788 of installments booked but deferred and not yet due as uncollected amounts on line 10.1 of its 2002 Annual Statement. These amounts should have been reported on line 10.2.

The Company subsequently corrected this error and reported lines 10.1 and 10.2 correctly on its Quarterly Statement ended March 31, 2003.

Accounts and Records

The Company failed to include the \$25 per policy MGA fee as premiums on its 2002 Annual Statement. **The Company is directed to comply with Section 627.403, Florida Statutes, which provides that any policy or similar fee charged for an insurance contract is deemed part of the premium. The Company is directed to correctly report such as premium in all future annual and quarterly statement filings.**

Subsequent Events

As of May 13, 2003, Robert Thomas Savage, Jr. was replaced by James P. Brown as President and CEO of the Company, by unanimous consent by the Company's board of directors.

CONCLUSION

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

Per examination findings, the Company's Surplus as regards policyholders was \$19,212,973, which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Mary James, CFE, Financial Examiner/Analyst Supervisor and Doug Haseltine, Actuary, participated in the examination.

Respectfully submitted,

Vince Dyal, CFE
Financial Specialist
Florida Department of Financial Services