

**REPORT ON LIMITED SCOPE EXAMINATION
OF
ROYAL PALM INSURANCE
COMPANY**

ORMOND BEACH, FLORIDA

**AS OF
SEPTEMBER 30, 2008**

**BY THE
OFFICE OF INSURANCE REGULATION**

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Tallahassee, Florida

April 9, 2009

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted a limited scope examination of the premium collection and deposit process as of September 30, 2008 of:

**ROYAL PALM INSURANCE COMPANY
140 SOUTH ATLANTIC AVENUE, SUITE 400
ORMOND BEACH, FLORIDA 32176**

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

SCOPE OF EXAMINATION

This examination was a limited scope examination that covered the premium collection and deposit process as of September 30, 2008, and subsequent events as directed by the Florida Office of Insurance Regulation (the Office). The field work commenced on November 11, 2008, and concluded on April 9, 2009.

This target statutory financial examination was 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.

HISTORY

The Company commenced operations and began writing property and casualty insurance in Florida on April 1, 2006. The Company began operations through an assumption reinsurance agreement with two unrelated primary insurance companies. Subsequently, the Company purchased renewal rights for the previously assumed block of business and began writing the business on a direct basis. The Company was wholly-owned by Ritchie Risk-Linked, LLC, a Delaware Corporation.

The Company predominantly wrote homeowners multiple peril (93% of total written premium for the period January 1, 2008, to September 30, 2008) exclusively in the state of Florida.

The Company had 100,000 shares of capital stock authorized, with 55,000 shares issued and outstanding; each carried a par value of \$100.

EXAMINATION REVIEW

Narratives of the premium collection and deposit process, as well as the financial reporting process for premium-related accounts were provided and updated as necessary during the course of the examination. No findings were noted with respect to the premium collection and deposit process as documented in the narratives.

A sample of premium cash receipts received during 2008 (utilizing the written premium transaction detail as the population) was selected in order to corroborate the cash receipts process described in the narratives of the premium collection and deposit process. No findings were noted with respect to the process documented in the narratives provided. The same sample of premium cash receipts was also utilized to corroborate certain aspects of the managing general agency and claims administration agreement (the MGA agreement) filed with the Office and to verify that cash receipts were deposited into accounts owned by the Company. Certain exceptions which are further discussed on page 4, were identified with respect to the calculation of amounts paid to the MGA as well as handling of funds by the MGA. As respects the amounts paid to the MGA, these exceptions are not considered significant. These exceptions were not resolved as of the date of this report.

The totals of the written premium transaction report, aging of premium receivables report, and schedule of unearned premium by policy transaction, were reconciled to the corresponding lines on the Company's September 30, 2008, Quarterly Statement. The nonadmitted portion of past due premiums receivable as of September 30, 2008, was recalculated using the aging of premium receivables report. Exceptions were identified with respect to the calculation of nonadmitted balances due from policyholders as well as reporting of nonadmitted balances as reported in the September 30, 2008, Quarterly Statement. Additionally, unearned premium at September 30, 2008, was recalculated utilizing the schedule of unearned premium by policy transaction.

MGA AGREEMENT

Effective April 1, 2006, the Company entered into an MGA agreement with Security First Managers, LLC (the MGA). This agreement required the MGA to be responsible for the underwriting, processing of policies issued by the Company and processing and payment of claims incurred on the Company's policies. As compensation, the MGA was entitled to retain 26.25% of the Company's total gross written annual premium as commission in addition to a \$25 per policy fee. As compensation for processing and payment of claims incurred on the Company's policies, the Company paid the MGA 4.75% of its total earned annual premium. In addition, the MGA was entitled to share in the profit of the Company calculated at 15% of the Company's pre-tax statutory earnings. "On June 26, 2008 the Company gave notice to terminate the agreement and the MGA continued by agreement to underwrite and process policies and process the payment of claims and continued to receive compensation for these services, although the basis and amount of that compensation are in dispute." On November 11, 2008, the Company instructed the MGA to discontinue all MGA services effective November

14, 2008, including performing any runoff services. This was documented in the review of service agreements filed with the Office.

WRITTEN PREMIUM AND EARNED PREMIUM USED TO CALCULATE CASH SETTLEMENTS TO THE MGA

Cash settlements to the MGA were calculated on a daily basis utilizing daily written premium and earned premium. The following differences in daily written premiums were noted:

Date	WP used in calculation	WP used by examiner*	Difference
9/11/2008	\$381,581.00	\$379,358.00	\$2,223.00
9/16/2008	329,403.00	324,586.00	4,817.00
9/19/2008	458,625.00	453,363.00	5,262.00
9/23/2008	311,180.00	311,160.00	20.00
9/24/2008	424,104.00	424,039.00	65.00
9/26/2008	562,508.00	519,068.00	43,440.00
9/30/2008	996,799.00	859,966.00	136,833.00
Total difference:			\$192,660.00
Sept Adj:	(180,231.00)		

*The sum of all daily written premium (for the period 1/1/2008 to 9/30/2008) used by the examiner agreed with written premium as reported on the September 30, 2008, Quarterly Statement.

Management of the MGA indicated the cause of the differences to be the timing of when daily written premium reports were generated. As a result, an adjustment of \$180,231 (indicated above) has been recorded to adjust the underlying written premium used in the calculation of MGA commissions and claim service fees. After the effect of the two adjustments, MGA

commissions and claims service fees were found to be overstated by \$3,263 ($\$12,429 \times 26.25\%$) and \$590 ($\$12,429 \times 4.75\%$), respectively.

The unearned premium used in the calculation of earned premium for the September 30, 2008 cash settlement was \$112,264,234 which differed from the direct unearned premium reported in the September 30, 2008 Quarterly Statement by \$134,293. Unearned premium reported in the September 30, 2008 Quarterly Statement consisted of direct unearned premium of \$112,129,941, assumed unearned premium of \$120,959, and ceded unearned premium of \$55,594,009. This difference created an understatement of claims service fees of \$6,379.

The differences in written premium and unearned premium used in the calculation of MGA commissions and claims service fees resulted in a net underpayment to the MGA of \$2,526 ($\$6,379 - \$3,853$).

HANDLING OF FUNDS RECEIVED BY THE MGA

Cash receipts received by the MGA were deposited into an account entitled "Security First Managers LLC FBO Royal Palm Insurance Company" and were then transferred into an analyzed business checking account in the MGA's name. Checks were prepared from the analyzed business checking account and remitted to a premium trust account in the Company's name. The above actions were in violation of section 3.2 of Article III, *Handling of Funds*, of the MGA agreement and Section 625.012 (5) (a)1, Florida Statutes, which provides that funds shall be held as trust funds and may not be commingled. It should be noted that prior to August 27,

2008, all funds were deposited directly into the premium trust account in the Company's name from the P.O. Box where premium payments were mailed.

The MGA instructed MacNeill to change the Company's deposit procedures without the Company's knowledge or consent. Shortly after discovering the August 27, 2008, change in deposit procedures, the Company sent a letter dated September 4, 2008, instructing MacNeill to disregard the MGA's instructions and to resume depositing the Company's premiums into the Company's premium trust account. The Company then sent additional letters on September 5 and 9, 2008, instructing MacNeill to resume depositing Company premiums in the Company premium trust account. However, MacNeill did not comply with the Company's instructions, but rather continued to follow the MGA's instructions to deposit the Company's premiums into the MGA's account.

PREMIUM COLLECTION

Effective April 1, 2006, the Company and the MGA entered into a program management agreement (PM agreement) with MacNeill Group, Inc. (MacNeill); however, the MGA was solely responsible to compensate MacNeill for the services performed. On July 17, 2008, the Company gave notice to MacNeill that it had noticed the termination of the MGA agreement on June 26, 2008, and MacNeill continued by agreement to provide policy management services. For those renewal notices sent on or prior to November 14, 2008, the Company instructed MacNeill to continue to underwrite and issue policies for new business until December 31, 2008. In addition to providing various policy management services specified in the PM agreement, MacNeill was responsible for the collection, processing and deposit of premium cash receipts received from the Company's policyholders. From the inception date of this agreement to

August 27, 2008, MacNeill deposited premium cash receipts into a premium trust account in the Company's name. From August 27, 2008, to September 30, 2008, (and thereafter), MacNeill deposited premium cash receipts into an account in the MGA's name for benefit of the Company. This was documented in the review of service agreements filed with the Office.

CALCULATION OF NONADMITTED UNCOLLECTED PREMIUM BALANCES

In testing the Company's aging of balances greater than ninety days past due, the Company neglected to nonadmit all receivables from policies where one installment was past due as provided by paragraph 9.a. of Statement of Statutory Accounting Principles No. 6, *Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers*, (SSAP No. 6) which states "if an installment premium is over ninety days due, the amount over ninety days due plus all future installments that have been recorded on that policy shall be nonadmitted". Accordingly, uncollected premium balances for which any portion was in excess of 90 days past due should be nonadmitted in its entirety. Therefore, nonadmitted premiums receivable were understated by \$57,242 and net admitted premiums receivable were overstated for this error. The total amount of admitted balances that should be nonadmitted in accordance with SSAP No. 6 is \$57,242.

PREMIUM RECEIVABLE SUBSIDIARY LEDGER

In testing the Company's premium receivable subsidiary ledger and reconciling it to the September 30, 2008 Quarterly Statement, it was determined that the uncollected premiums in line 13.1, column (1) of the September 30, 2008 Quarterly Statement was reported net of the calculated nonadmitted balance reported on line 13.1, column (2) (\$473,806). Therefore, the

net uncollected premiums receivable reported on line 13.1, column (3) was understated by \$473,806.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of September 30, 2008, and the results of its operations 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."

Royal Palm Insurance Company
Assets

September 30, 2008

	Per Company	Examination Adjustments	Per Examination
Bonds	\$114,413,430		\$114,413,430
Stocks:			
Common	16,076,190		16,076,190
Mortgage loans on real estate:			
Real Estate:			
Properties occupied by Company			
Cash	62,960,279		62,960,279
Other invested assets			
Investment income due and accrued:	1,074,779		1,074,779
Agents' Balances:			
Uncollected premium	1,524,307	416,564	1,940,871
Deferred premium	13,956,767		13,956,767
Reinsurance recoverable	1,000,000		1,000,000
Current federal taxes recoverable			
Net deferred tax asset	214,559		214,559
EDP Equipment			
Receivable from parents, subsidiaries and affiliates	689,266		689,266
Aggregate write-ins for other than invested assets			
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Totals	<u>\$211,909,577</u>	<u>416,564.00</u>	<u>\$212,326,141</u>

Royal Palm Insurance Company
Liabilities, Surplus and Other Funds

September 30, 2008

	Per Company	Examination	Per Examination
		Adjustments	
Losses	\$26,155,842		\$26,155,842
Reinsurance payable on paid losses and loss expenses	517,304		517,304
Loss adjustment expenses	5,382,907		5,382,907
Other expenses	1,014,978	2,526	1,017,504
Taxes, licenses and fees	1,521,847		1,521,847
Unearned premiums	56,656,891		56,656,891
Advance premium	6,653,894		6,653,894
Ceded reinsurance premiums payable	66,087,895		66,087,895
Funds held under reinsurance treaties			
Amounts withheld or retained by company			
Provision for reinsurance			
Aggregate write-ins for liabilities			
	<hr/>		<hr/>
Total Liabilities	163,991,558		163,994,084
Aggregate write-ins for special surplus funds			
Surplus notes	50,000,000		50,000,000
Common capital stock			
Gross paid in and contributed surplus	49,500,000		49,500,000
Unassigned funds (surplus)	(51,581,981)	414,038	(51,167,943)
	<hr/>		<hr/>
Surplus as regards policyholders	47,918,019	414,038	48,332,057
	<hr/>		<hr/>
Total liabilities, surplus and other funds	\$211,909,577	414,038	\$212,326,141

Royal Palm Insurance Company
Comparative Analysis of Changes in Surplus

September 30, 2008

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

Surplus as Regards Policyholders September 30, 2008, per Quarterly Statement	\$47,918,019
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
Agents' Balances	\$15,481,074	\$15,897,638	\$416,564
LIABILITIES:			
Other expenses	\$1,014,978	\$1,017,504	(\$2,526)
Net Change in Surplus:			\$414,038
Surplus as Regards Policyholders September 30, 2008, Per Examination			\$48,332,057

SUMMARY OF FINDINGS

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 September 30, 2008.

Written premium and earned premium used to calculate cash settlements to the MGA

Written premium and earned premium used in the calculation of MGA fees and claims service fees did not agree to written premium and earned premium as reported in the September 30, 2008 Quarterly Statement. **We recommend that the Company ensure that written premium and earned premium used in the calculation of MGA fees and claims service fees is correct and as reported in financial information provided to the Office.**

Handling of funds received by the MGA

Premium cash receipts received after August 27, 2008, were comingled with operating funds of the MGA in violation of the MGA Agreement and Section 625.012 (5) (a)1 Florida Statutes. **We recommend that the Company adequately monitor the cash collection process and ensure compliance with all aspects of the MGA agreement and Section 625.012 (5) (a)1, Florida Statutes.**

Calculation of nonadmitted uncollected premium balances

The Company's subsidiary ledger of uncollected premium balances included admitted balances for which there was also nonadmitted balances. **We recommend that the Company report uncollected premium balances in accordance with paragraph 9.a. of Statement of Statutory Accounting Principles No. 6, *Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers.***

Premium Receivable Subsidiary Ledger

The Company's uncollected premiums as reported in line 13.1, column (1) of the September 30, 2008 Quarterly Statement was reported net of the calculated nonadmitted balance reported on line 13.1, column (2) (\$473,806). Therefore, the net uncollected premiums receivable reported on line 13.1, column (3) is understated by \$473,806. **We recommend that the Company verify that financial information provided to the Office reconciles with corresponding subsidiary ledgers.**

CONCLUSION

The customary insurance examination practices and procedures have been followed in examining the September 30, 2008 premium collection and deposit process of **Royal Palm Insurance Company**.

In addition to the undersigned, William A. Ferguson, CPA, Andrew J. Woodward, CPA, and Erik D. Luoma, CPA, of Thomas Howell Ferguson P.A., participated in the examination.

Respectfully submitted,

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