

REPORT ON EXAMINATION
OF
ROYAL PALM INSURANCE COMPANY
ORMOND BEACH, FLORIDA

AS OF
DECEMBER 31, 2007

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

June 6, 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, 2007, of the financial condition and corporate affairs 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 covered the period of March 31, 2006 through December 31, 2007. This is the initial examination of the Company. This examination commenced with planning at the Florida Office of Insurance Regulation (Office), on March 17, 2008, to March 20, 2008. The fieldwork commenced on March 31, 2008, and was concluded as of June 6, 2008.

We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook (NAIC Handbook), Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The NAIC Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles.

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, 2007. Transactions subsequent to year-end 2007 were reviewed where relevant and deemed significant to the Company's financial condition.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio reports, the 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:

- Bonds
- Cash and cash equivalents
- Short-term investments
- Ceded reinsurance premiums payable

HISTORY

General

The Company is a domestic, stock company licensed only in Florida. The Company was incorporated under Florida law on March 31, 2006. The Company was a member of a holding company and the ultimate parent was Ritchie Capital Management, LLC (Ritchie Capital).

The initial capital for the Company was \$65 million in capital and surplus. The parent company, Ritchie Risk-Linked LLC, (Risk-Linked), provided \$30 million in capital, while its only non-voting member, Ritchie Risk-Linked Strategies Trading, Ltd. (Strategies Trading), a Bermuda corporation, provided \$35 million in the form of a surplus debenture. A subsequent cash contribution of \$25 million in the form of a surplus debenture was received in December 2006 from the State Board of Administration in order for the Company to participate in the Capital Build-up Incentive Program. On February 29, 2008, the Company paid \$10 million to Strategies Trading which was applied to the principal balance. The payment was approved by the Office, which also approved the accounting for this payment on the Company's 2007 Annual Statement.

The Company was party to Consent Order No. 85654-06-CO filed March 31, 2006 with the Office regarding the application for the issuance of a Certificate of Authority. The Company failed to comply with the provisions of the consent order which required the Company to maintain sufficient and adequate internal controls and supervision of any external contractor(s) providing services in connection with insurance transactions. The following control deficiencies were noted:

- There was no written long term mission statement or strategic plan or written corporate governance framework.
- The Company did not have an internal audit department or internal audit function.
- The Company had an audit committee; however, the Company did not maintain minutes of the meetings or provide information on the functions of the committee or when meetings were held. In addition, the Company did not provide evidence of minutes for any of its appointed committees. Subsequent event: The Company provided a copy of the Audit

Committee Charter, which was adopted during the Board of Directors meeting, August 6, 2007 and approved by the Company or president July 10, 2008.

- There were no executed conflict of interest statements.
- There were no formal written policies and procedures manuals.
- Processes were in place to review and approve reporting, however there was no documentation or evidence of review or approval signoffs.
- There was no policy for mandatory vacations.

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

Fire

Homeowners multi peril

Capital Stock

As of December 31, 2007, the Company's capitalization was as follows:

Number of authorized common capital shares	100,000
Number of shares issued and outstanding	55,000
Total common capital stock	\$5,500,000
Par value per share	\$100.00

The Company was owned 100% by Risk-Linked, an insurance holding company incorporated in the state of Delaware. Risk-Linked was owned by Strategies Trading. Strategies Trading was a wholly-owned subsidiary of Ritchie Capital, a worldwide alternative investment firm whose ultimate controlling person was Thane Ritchie. Brian Murphy and Duncan Goldie-Morrison co-managed Risk-Linked, and on March 31, 2006, a disclaimer of control was submitted by Ritchie Capital stating that no other individuals or entities other than Brian Murphy or Duncan Goldie-Morrison would exercise any control over the affairs of the Company. On March 27, 2008, the

Office approved the amended disclaimer of control affidavit certifying Thomas Moss, John Kermath and Gerry Komlofske as the only individuals who were authorized to exercise control over the activities of the Company.

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.

	2007	2006
Premiums earned	87,861,860	34,341,069
Net Underwriting gain (loss)	(32,726,723)	(21,712,477)
Net Income	(23,591,409)	(19,918,075)
Total Assets	243,117,765	182,313,476
Total Liabilities	181,803,582	88,034,997
Surplus as Regards Policyholders	61,314,183	94,278,478

Dividends to Stockholders

There were no dividends declared or paid to its stockholders during the examination year.

MANAGEMENT AND CONTROL

The Company was in compliance with Section 628.231(2), Florida Statutes, which requires the election of directors at the annual meeting of the stockholders.

Directors serving as of December 31, 2007, as reported on the 2007 annual statement were:

Directors

Name and Location	Principal Occupation
Wallace Lockwood Burt Ormond Beach, FL	President, Ormond Re Group, Inc.
Roseann McLaren Bradley Palm Coast, FL	Vice President, Ormond Re Group, Inc.
Donald Gene Brocksmith Daytona Beach, FL	Assistant Vice President, Ormond Re Group, Inc.
John D. Kermath Houston, TX	President, Ritchie Capital Management
Thomas A. F. Moss Santa Fe, NM	Senior Managing Director, Finance, Ritchie Capital Management
Paul Nibbio (a) Glen Ellyn, IL	Director, Human Capital Management, Ritchie Capital Management

(a) Paul Nibbio resigned effective January 29, 2008.

Subsequent Event

The April 17, 2008 meeting of the shareholders reduced the number of the Board of Directors from six to five members. In addition, Roseann Bradley was removed from the Board of Directors.

The senior officers serving as of December 31, 2007 were:

Senior Officers

Name	Title
Wallace Lockwood Burt	President
Donald Gene Brocksmith	Treasurer
Roseann McLaren Bradley	Secretary

Anthony Liberato DiPardo

Vice President

Walter Theodore Zehnder

Assistant Vice President

Subsequent Event:

The April 29, 2008 meeting of the Board of Directors appointed Gerry Komlofske as Chief Executive Officer.

The Company's Board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following are the principal internal board committees and their members as of December 31, 2007:

Executive Committee

Thomas A. F. Moss¹
W. Lockwood Burt
John D. Kermath

Audit Committee

Thomas A. F. Moss¹
John D. Kermath
Gerry Komlofske

Investment Committee

John D. Kermath¹
Donald G. Brocksmith
Thomas A. F. Moss

¹ Chairman

Conflict of Interest Procedure

The Company adopted a statement of policy regarding conflict of interest requiring disclosure of affiliation with entities or transactions representing current or anticipated conflict circumstances.

Surplus Debentures

On March 26, 2006, the Company executed a Subordinated surplus debenture with Strategies Trading in order to increase the Surplus as regards policyholders of the Company. The contribution to surplus in the amount of \$35 million in the form of cash was approved by the Office, in compliance with Section 628.401, Florida Statutes. Pursuant to the agreement, accrued interest

was payable quarterly commencing July 1, 2006 after initial approval by the Office. The maturity date of the agreement was March 31, 2026.

As previously mentioned, on December 20, 2006, the Company executed a Surplus note with the State Board of Administration of Florida in the amount of \$25 million in new capital in order to participate in the Capital Build-up Incentive Program. The term of the agreement was 20 years.

Corporate Records

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 with the exception of approval of investments. Section 625.304, Florida Statutes, requires that the approval of investments are submitted for approval to the Board of Directors, and recorded in the minutes.

Subsequent event: the Company documented approval of investments during the Board of Directors meeting, February 5, 2008.

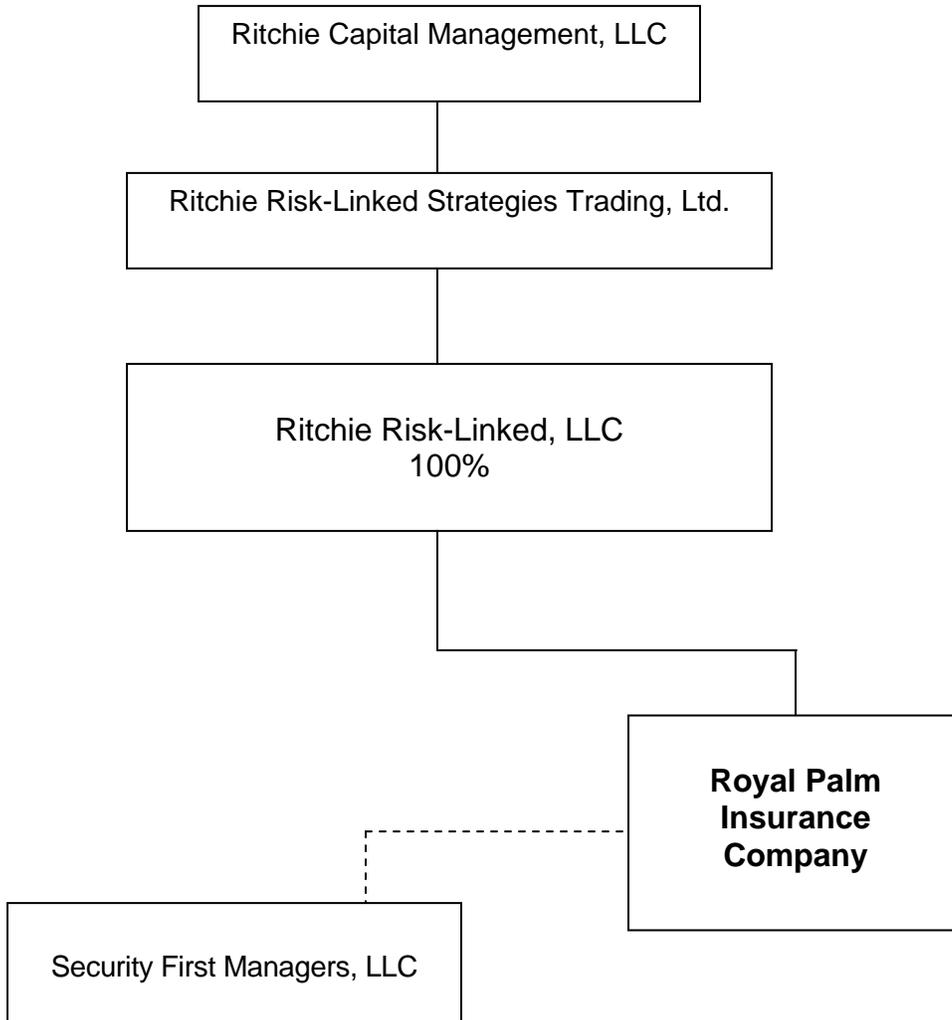
Affiliated Companies

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on March 18, 2008, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

An organizational chart as of December 31, 2007, reflecting the holding company system is shown below.

**ROYAL PALM INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2007



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

Managing General Agent (MGA) Agreement

On April 1, 2006, the Company entered into a managing general agency agreement with its affiliate Security First Managers, LLC (Security First). Pursuant to the agreement, Security First produced, administered and managed the Company's policies. The MGA had authority for the binding of coverage, the issuing and endorsing of policies, and the canceling and non-renewal of contracts. In addition, the MGA had authority to adjust claims and provide other services including marketing, claims analysis, general ledger accounting, information services, product and underwriting development and management, and catastrophe risk management on behalf of the Company. The MGA issued policies pursuant to underwriting guidelines provided in writing to the MGA from the Company. The term of the agreement was five years, with optional renewal in one year increments.

The MGA, in a fiduciary capacity on behalf of the Company accepted all premiums, policies, fees, interest, and service charges collected and other funds relating to business written under the agreement. Settlement occurred monthly.

The MGA retained 26.25% of the Company's total gross written annual premium as commission for its services, excluding claims services. In addition, the MGA was entitled to retain a \$25.00 per policy fee. The Company paid the MGA 4.75% of the Company's total earned annual premium for claims services. On a monthly basis, the Company paid the MGA 20% of all salvage and subrogation recovered by the MGA.

On February 29, 2008, the Office approved the retroactive reduction in the calendar year 2007 for MGA fees paid by the Company from 26.25% to 16.5%. The Office approved the Company

to use SSAP No. 72 treatment of the transactions to allow entry in the December 31, 2007 financial statements of the Company.

Security First utilized non-affiliated subcontractors for the Company's operational duties. The non-affiliated third party administrators contracted with the MGA and not with the Company.

FIDELITY BOND AND OTHER INSURANCE

The Company was not in compliance with Rule 69O-142.011(11)(b)16, Florida Administrative Code requiring fidelity bond coverage for employees. The Company had one employee, Locke Burt, President. Subsequent event: The Company provided a copy of Fidelity Bond coverage for the period of July 31, 2008 to July 31, 2009, in the amount of \$1,250,000, with a deductible of \$50,000.

PLAN OF OPERATION

The Company was licensed in Florida only. The Company had no plans to expand lines of business or write in other states. The Company initially began operations by assuming approximately 120,000 policies from Allstate Floridian Insurance Company and Allstate Floridian Indemnity Company. The Company purchased renewal rights for the previously assumed block of business and began writing the business on a direct basis. Business was produced by the agency force of the two Allstate companies mentioned previously. Currently, there were about 1,500 agents appointed by the Company. The Company began assuming premium from Vanguard Insurance Company in the second quarter of 2007.

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

Effective April 1, 2006, the Company entered into a quota share reinsurance agreement with Allstate Floridian Insurance Company and Allstate Floridian Indemnity Company; whereby, the Company assumed 100% of the losses associated with a book of homeowners policies in Florida. The Company assumed written premium totaling \$150,861,494 for the year 2006 and \$8,740,925 for the year 2007.

Ceded

The Company ceded risk on a quota share and excess of loss basis to various unrelated reinsurers.

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 Ormond Beach, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2006 and 2007, 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 various computerized systems. The Company's balance sheet accounts, with the exception of two 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 maintained a custodial agreement with Morgan Stanley Trust, N. A. The Company was not in compliance with Rule 69O-143.042, Florida Administrative Code, which stipulates the requirements of a custodial agreement. The agreement with Morgan Stanley was not signed by both parties, which violated Rule 69O-143.042(2)(h), Florida Administrative Code, which states that the custodian should maintain records sufficient to determine and verify information relating to custodied securities.

Subsequent Event: The Company provided the agreement dated February 14, 2009 signed by both parties, March 5, 2009.

Investment Management Agreement

On December 31, 2007, the Company entered into an investment management agreement with Morgan Stanley & Company Incorporated (Morgan Stanley) to serve as investment advisor and was responsible for implementing investment management decisions. Morgan Stanley provided

management services in accordance with investment policies and guidelines provided by the Company.

Investment Manager Agreement

On March 22, 2006, the Company entered into the investment manager agreement with Sage Advisory Services, Ltd. Co. (Sage). Sage acted as investment manager and advisor with respect to certain of the Company's assets held by Morgan Stanley, pursuant to a separate custodial agreement. Sage supervised and directed investments on behalf of the Company subject to the terms of the written investment policies and guidelines established by the Company.

Information Technology Report

INS Services, Inc. performed an evaluation of controls in information systems on the Company. Results of the evaluation were disclosed in the Information Technology (IT) report provided to the Company.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes:

<u>State</u>	<u>Description</u>	<u>Par Value</u>	<u>Market Value</u>
FL	CASH	<u>\$2,000,000</u>	<u>\$2,000,000</u>
TOTAL FLORIDA DEPOSITS		<u>\$2,000,000</u>	<u>\$2,000,000</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2007, 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."

**ROYAL PALM INSURANCE COMPANY, INC.
DECEMBER 31, 2007**

Assets

	Per Company	Examination Adjustments	Per Examination
Bonds	\$98,572,568	\$0	\$98,572,568
Cash and short-term investments	93,838,056		93,838,056
Investment income due and accrued	1,914,871		1,914,871
Agents' Balances:			
Uncollected premium	10,008,341		10,008,341
Deferred premium	19,465,915		19,465,915
Other amounts receivable under reinsurance contracts	2,724,851		2,724,851
Receivable from parents, subsidiaries and affiliates	16,593,163		16,593,163
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Totals	\$243,117,765	\$0	\$243,117,765
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**ROYAL PALM INSURANCE COMPANY, INC.
DECEMBER 31, 2007**

Liabilities, Surplus and Other Funds

	Per Company	Examination Adjustments	Per Examination
Losses	\$20,460,997		\$20,460,997
Reinsurance payable on paid losses	2,026,438		2,026,438
Loss adjustment expenses	4,548,347		4,548,347
Other expenses	1,388,618		1,388,618
Taxes, licenses and fees	1,079,466		1,079,466
Unearned premiums	76,708,645		76,708,645
Advance premium	4,878,717		4,878,717
Ceded reinsurance premiums payable	60,712,354		60,712,354
Payable to parent, subsidiaries and affiliates	10,000,000		10,000,000
Total Liabilities	\$181,803,582	\$0	\$181,803,582
Common capital stock	\$5,500,000		\$5,500,000
Surplus notes	50,000,000		50,000,000
Gross paid in and contributed surplus	49,500,000		49,500,000
Unassigned funds (surplus)	<u>(43,685,817)</u>		<u>(43,685,817)</u>
Surplus as regards policyholders	<u>\$61,314,183</u>		<u>\$61,314,183</u>
Total liabilities, surplus and other funds	<u>\$243,117,765</u>	\$0	<u>\$243,117,765</u>

**ROYAL PALM INSURANCE COMPANY, INC.
DECEMBER 31, 2007**

Statement of Income

Underwriting Income

Premiums earned		\$87,861,860
	Deductions:	
Losses incurred		45,199,904
Loss expenses incurred		12,047,134
Other underwriting expenses incurred		63,341,545
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$120,588,583
Net underwriting gain or (loss)		(\$32,726,723)

Investment Income

Net investment income earned		\$7,306,904
Net realized capital gains or (losses)		891,323
Net investment gain or (loss)		\$8,198,227

Other Income

Net gain or (loss) from agents' or premium balances charged off		(\$22,718)
Finance and service charges not included in premiums		963,662
Aggregate write-ins for miscellaneous income		(3,857)
Total other income		\$937,087
Net income before dividends to policyholders and before federal & foreign income taxes		(\$23,591,409)
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		(\$23,591,409)
Federal & foreign income taxes		0
Net Income		(\$23,591,409)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$94,278,477
Net Income		(\$23,591,409)
Change in net unrealized capital gains or losses		(27,238)
Change in net deferred income taxes		8,450,620
Change in non-admitted assets		(8,505,267)
Change in provision for reinsurance		709,000
Change in surplus notes		(10,000,000)
Examination Adjustment		0
Change in surplus as regards policyholders for the year		(\$32,964,294)
Surplus as regards policyholders, December 31 current year		\$61,314,183

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses	<u>\$25,009,344</u>
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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, 2007, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

INS Consultants, Inc. was retained by the Office to conduct an independent review of the Company's loss and loss adjustment expense reserves as of December 31, 2007. The overall analysis was made on a net and gross of reinsurance basis. INS Consultants, Inc. reviewed the Statement of Actuarial Opinion prepared by the Company's appointed actuary and the Company's work papers that balanced the data utilized in their actuarial report to Schedule P.

A specific audit to verify the accuracy or completeness of the data provided to INS was performed during the process of examination. It was ascertained that the data was accurate and complete.

The INS Consultants, Inc. actuarial estimates of both net and gross reserves compared with the Company's booked reserves were \$3 million lower than the Company's loss and loss adjustment expense reserves of \$25 million. The amount did not meet the materiality threshold established for this examination, and no financial adjustment was made to the financial statement of this report.

Capital and Surplus

The amount reported by the Company of \$61,314,183, exceeds the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

**ROYAL PALM INSURANCE COMPANY, INC.
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2007

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, 2007, per Annual Statement	\$61,314,183
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment.			0
LIABILITIES:			
No adjustment.			0
Net Change in Surplus:			0
Surplus as regards policyholders December 31, 2007, Per Examination			\$61,314,183

SUMMARY OF SIGNIFICANT FINDINGS

Current examination comments and corrective action

There are no exceptions or findings in the examination as of December 31, 2007.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Royal Palm Insurance Company** as of December 31, 2007, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$61,314,183, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Jean Alton, CFE, INS Regulatory Insurance Services (INSRIS), Barry Armstrong, CFE, Supervisor, INSRIS, Giles W. Larkin, CFE, INSRIS, Brian Dunn, CFE, INSRIS, and Maurice Fuller, Financial Examiner/Analyst II, participated in portions of the examination. Mike Morro, ACAS, MAAA, INS Consulting, Inc. completed the actuarial portion of this examination. We also recognize the participation of Paul Berkebile, CFSA, INS Services, Inc. with the IT evaluation.

Respectfully submitted,

Mary M. James, Financial Administrator, CFE, CPM
Florida Office of Insurance Regulation