

**REPORT ON EXAMINATION
OF
SOUTHERN EAGLE INSURANCE COMPANY**

BRADENTON, FLORIDA

AS OF

DECEMBER 31, 2006

**BY THE
OFFICE OF INSURANCE REGULATION**

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Tallahassee, Florida

March 18, 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 of December 31, 2006, of the financial condition and corporate affairs of:

SOUTHERN EAGLE INSURANCE COMPANY
410 43rd STREET WEST, SUITE N
BRADENTON, FL 34209

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

SCOPE OF EXAMINATION

This examination covered the period from June 1, 2005 through December 31, 2006. This is the first examination by the representatives of the Florida Office of Insurance Regulation (Office). This examination commenced, with planning at the Office, on November 8 and November 9, 2007. The fieldwork commenced on January 2, 2008, and was concluded as of March 11, 2008.

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

In this examination, emphasis was directed to the quality, value and integrity of the statement of assets and the determination of liabilities, as those balances affect the financial solvency of the Company as of December 31, 2006. Transactions subsequent to year-end 2006 were reviewed where relevant and deemed significant to the Company's financial condition.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio reports, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) and other reports as considered necessary were reviewed and utilized where applicable within the scope of this examination.

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

Based on the review of the Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPA, after verifying the statutory requirements, for the following accounts:

Deferred tax asset
Commitments and contingencies

HISTORY

General

The Company was incorporated in Florida on May 4, 2005 and commenced business on June 1, 2005 as Southern Eagle Insurance Company.

The Company was party to Consent Order 81294-05-CO filed April 28, 2005 and Consent Order 81629-05-CO filed May 19, 2005 with the Office regarding the application for the issuance of a certificate of authority. The Company was in compliance with both consent orders.

The Company was authorized to transact Workers' compensation and Employers' liability insurance coverage in Florida on December 31, 2006.

Capital Stock

As of December 31, 2006, the Company's capitalization was as follows:

Number of authorized common capital shares	10,000
Number of shares issued and outstanding	10,000
Total common capital stock	\$500,000
Par value per share	\$50.00

Control of the Company was maintained by its parent, Peel-Bushong Holding Company which owned 100% of the stock issued by the Company, and which in turn was 100% owned by Mrs. Sarah M. Peel, the Chief Executive Officer 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.

	2006	2005
Premiums Earned	16,635,046	12,211,304
Net Underwriting Gain/(Loss)	3,272,723	1,236,634
Net Income	2,458,722	616,113
Total Assets	21,035,715	15,450,010
Total Liabilities	11,059,972	9,408,430
Surplus As Regards Policyholders	9,975,743	6,041,580

Dividends to Stockholders

No dividends were declared or paid during 2005 or 2006.

Management

The annual shareholder meeting for the election of directors was not held in accordance with Sections 607.1601 and 628.231, Florida Statutes. The bylaws of the Company also required the annual shareholder meeting for the election of directors. Directors serving as of December 31, 2006, were:

Directors

Name and Location	Principal Occupation
Dan M. Robertson Bradenton, Florida	Chairman and Chief Operating Officer, Southern Eagle Insurance Company
Robert F. Kennedy San Francisco, California	President, ReSource Intermediates, Inc.
James R. Zuhlke N. Barrington, Illinois	Insurance Executive
Marshall T. Bower Fort Myers, Florida	Attorney
Craig E. Johnson Bookelia, Florida	Insurance Consultant
Sarah M. Peel Bradenton, Florida	Chief Executive Officer, Southern Eagle Insurance Company
Kelly S. Hudson Bradenton, Florida	Director of Workers Compensation, Southern Eagle Insurance Company
Henry J. Abbott, Jr. Bradenton, Florida	Executive Vice President, Southern Eagle Insurance Company
Janice H. Legters (a) Bradenton, Florida	Secretary/Treasurer Southern Eagle Insurance Company

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

Senior Officers

Name	Title
Sarah M. Peel	Chief Executive Officer
Dan M. Robertson	Chairman and COO
Henry J. Abbott, Jr. (a)	Executive Vice President
Kelly S. Hudson	Director of Workers Compensation
Howard S. Cosner, III	Controller
Janice H. Legters (a)	Secretary/Treasurer

(a) Ms. Legters resigned on February 27, 2007 and was replaced by Mr. Henry J. Abbott, Jr. as Secretary/Treasurer

During 2005 and 2006 the Company did not maintain an audit committee, in violation of Section 624.424(8), Florida Statutes.

Subsequent Event:

The minutes of the Board of Directors meeting on June 27, 2007 documented the appointment of an audit committee that was in compliance with 624.424(8), Florida Statutes.

The Company did not maintain an investment committee during 2005 and 2006.

Subsequent Event:

The Company appointed an investment committee in 2007.

Conflict of Interest Procedure

The Company did not adopt a policy statement requiring annual disclosure of conflicts of interest as recommended by the NAIC Financial Condition Examiners Handbook. We note that Mr. Robert F. Kennedy, a director of the Company, was also President of ReSource Intermediaries, Inc., a reinsurance intermediary which represented the Company in that capacity during the period of the examination.

Corporate Records

The recorded minutes of the Board of Directors were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events in accordance with Section 607.1601, Florida Statutes. The minutes did not document the authorization of investments as required by Section 625.304, Florida Statutes. Section 625.304, Florida Statutes, requires that all investment transactions are approved by either the Board of Directors, or by its appointed investment committee.

There was no documentation in the minutes reviewed that the Company's directors approved the appointment of the Company's CPA, as required by Section 624.424(8), Florida Statutes.

The Company did not annually appoint its consulting actuaries, Milliman, Inc., in its Board of Directors minutes, as required by the NAIC Annual Statement Instructions and Rule 69O-138.042, Florida Administrative Code.

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

There were no acquisitions, mergers, disposals, etc. during the period of the examination

Surplus Debentures

There were no surplus debentures issued during the period of the examination.

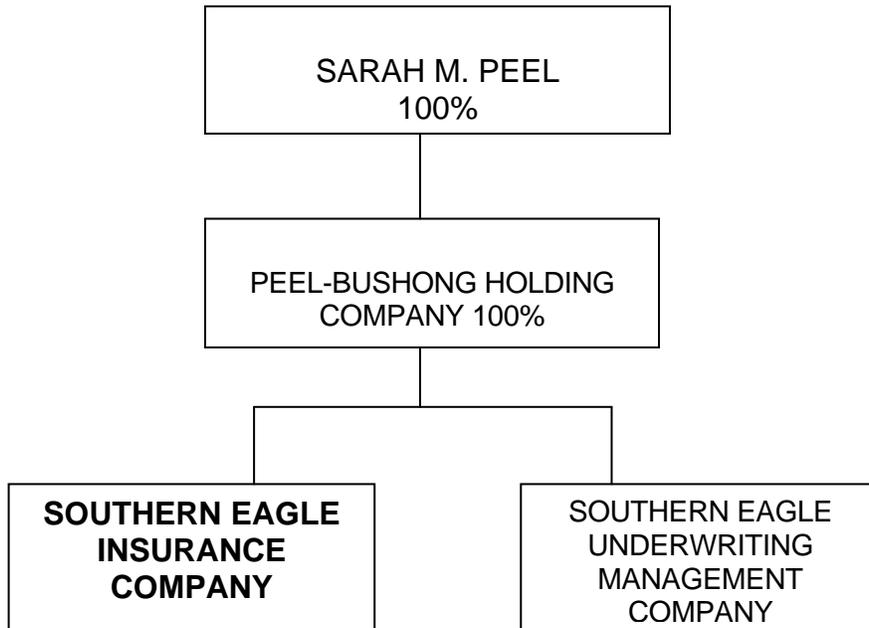
AFFILIATED COMPANIES

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 May 4, 2005 as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2006, reflecting the holding company system, is shown below. Schedule Y of the Company's 2006 annual statement provided a list of all related companies of the holding company group.

**SOUTHERN EAGLE INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2006



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

Tax Allocation Agreement

The Company, along with its parent, filed a 2005 consolidated federal income tax return. There was no tax allocation agreement prepared or approved by the Board of Directors. In 2006, the Company did not file a consolidated return but rather filed a separate federal income tax return.

Premiums Written

Substantially all of the Company's insurance premiums were derived from one master insurance policy, covering Workers' compensation and Employers' liability risks, written with Administrative Concepts Corp., a company owned by the Company's ultimate shareholder. The policy was subject to a retrospective rating provision on policy expiry.

Commissions Agreement

Commissions were paid and payable under a commission agreement, dated March 1, 2005, with the Company's sister company, Southern Eagle Underwriting Management Co., calculated at a rate of 6.5% of premiums written. This agreement was not disclosed in the notes to the financial statements as an affiliated company transaction.

FIDELITY BOND AND OTHER INSURANCE

The Company did not maintain the minimum fidelity bond coverage of \$250,000, which was the suggested minimum amount of coverage for the Company as recommended by the NAIC, during either 2005 or 2006.

Subsequent Event:

The Company obtained the necessary fidelity bond coverage in the amount of \$250,000, with a \$25,000 deductible, effective January 18, 2008.

The Company maintained Directors and officers (D&O) liability insurance and an Employer's practices liability policy with a limit of \$3,000,000 and with a deductible of \$25,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company did not offer a pension plan or a stock ownership plan to its employees. A 401(k) retirement savings plan was offered through an affiliated company, together with a major medical health plan.

STATUTORY DEPOSITS

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

State	Description	Par Value	Market Value
FL	Cash	<u>\$ 250,000</u>	<u>\$ 250,000</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 250,000</u>	<u>\$ 250,000</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company was authorized to transact only Workers' compensation and Employers' liability insurance.

Territory

The Company was authorized to transact insurance in the State of Florida only.

Treatment of Policyholders

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

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) (i) 3a, Florida Statutes.

Plan of Operation

Substantially all of the Company's written premiums were derived from writing Workers' compensation and Employers' liability insurance to its affiliated company, Administrative Concepts Corp., a professional employer organization (PEO). A PEO, also referred to as an employee leasing company or staff leasing company, provides human resources and administrative services to businesses that elect to outsource functions such as, human resources support, benefits administration, payroll, and federal and state employment tax filings. Additionally, a PEO purchases workers' compensation coverage for all leased employees.

Total written premiums (in dollars) during the scope of the examination were broken down as follows:

Year	Total Written Premium	PEO Business Written Premium	Percentage of PEO Premium to Total Premium
2006	\$18,608,930	\$18,603,467	99%

Policies were issued by the Company's third party administrator Meadowbrook, Inc. Certificates of insurance were issued by the PEO.

Proof of coverage was forwarded manually by the PEO to the State of Florida, Division of Workers' Compensation on the Company's behalf.

The Company required the PEO to provide within its acceptance criteria, the most recent year-end financial reports and the most recent interim financial report, organization structure and any subsidiary or affiliated companies, including the names of officers and managers, with biographical summary of each key officer, including the Risk Manager or Safety Director. The current and two prior years' payroll breakdown by class code were also required. In addition, copies of the PEO's license, client application, client agreement, safety manual, marketing materials, employee benefit booklets, description of client services, list of prior workers' compensation carriers and three years' claims history were required.

Payroll and classification codes were electronically submitted by the PEO on a weekly basis. The experience modification factors were documented in the files reviewed.

There were no policies with large deductibles.

Claims were handled by Florida Preferred Administrators, Inc., a third party administrator (TPA). Loss results were monitored by the Company on a monthly or more frequent basis. Claim performance reviews were performed by the Company with the insured and TPA on a monthly basis. Safety issue reviews were also performed by the Company on a monthly basis. The National Council on Compensation Insurance (NCCI) classification reviews were conducted during loss control visits.

Policy Review

The Company wrote 3 policies: 1 PEO policy and 2 non-PEO policies during the scope of the examination. The PEO policy provided coverage to 1,828 client employers.

Of the 3 policies selected, 100 client employers with 160 class codes were reviewed.

Seven errors were found, involving all 3 policies.

The errors were broken down as follows:

Three errors were due to the Company's failure to obtain a notarized application. Rule 69O-189.003(2)(b), Florida Administrative Code requires that the applicant's signature is notarized.

Subsequent Event:

The applications that were provided were signed and notarized on January 23, 2008.

Three errors were due to the Company's failure to perform a timely audit. Section 627.191, Florida Statutes, states that no insurer shall issue a contract or policy except in accordance with the filings which are in effect for such insurer. Florida Miscellaneous Rules of the NCCI manual requires that the audit be completed within 90 days of the policy expiration. Additionally, as a result of no premium audits being performed by the Company, we were unable to determine if any earned but unbilled premiums (EBUB) existed. However, based on the Company's practice of obtaining actual payroll on a weekly basis and adjusting premium accordingly, the EBUB amount would most likely have been minimal.

One error was due to the Company's failure to obtain quarterly reports. Rule 690-189.003(4)(b)(1), Florida Administrative Code, states that each employer shall submit a copy of the quarterly earning report required by Chapter 443, Florida Statutes, to the carrier at the end of each quarter.

Client Employers

One hundred certificates of insurance were reviewed and 132 errors were found.

The errors were broken down as follows:

Ninety-four errors were due to the Company's failure to submit proof of coverage information to the Division of Workers' Compensation electronically. Rule 69L-56-100, Florida Administrative Code, requires that policy file information be filed electronically rather than by paper as previously required.

Thirty-three errors were due to the insured's failure to verify if new client employers owed any premiums to previous insurer. Section 627.192(8) Florida Statutes, states that a lessee shall not enter into an employee leasing relationship or be eligible for workers' compensation coverage in the voluntary market if the lessee owed its current or a prior insurer any premium for workers' compensation insurance, or if the lessee owed its current or prior employee leasing company amounts due under the service agreement, except for premium or amounts due that were subject to dispute, and that a lessor may rely on a sworn statement by the lessee that the lessee has met any and all prior premium or fee obligations, unless the lessor had actual knowledge to the contrary.

Five errors were due to the Company's failure to maintain records. The Company was unable to provide all requested files as required by Section 627.318, Florida Statutes.

Cancellation/Nonrenewal Review

There were no policies cancelled or non-renewed during the scope of the examination. There were 802 client employer certificates terminated during the scope period.

Thirty-four terminations were reviewed and 84 errors were found.

The errors were broken down as follows:

Thirty errors were due to the insured's failure to notify the Company on a timely basis of client employer terminations. Section 627.192(6), Florida Statutes, states that the insured shall notify the Company of its intent to terminate a client employer prior to the termination when feasible. When prior notice is not feasible, the insured shall notify its insurer within 5 days following actual termination.

Thirty-four errors were due to the Company's failure to submit terminations information to the Division of Workers' Compensation electronically. Rule 69L-56-100, Florida Administrative Code, requires that information relating to terminations be filed electronically rather than by filing on paper forms, as previously required.

Twenty errors were due to the Company's failure to provide timely notice of coverage termination to third party certificate holders. The certificate of insurance stated that in the event of a termination, the Company would endeavor to notify the certificate holder within 30 days of termination.

Complaints Review

The Company did not receive any complaints during the scope of the examination.

Risk Management Services Review

The Company provided risk management services to insureds. These services were performed by the Company's loss control staff. There were 6 loss control representatives located throughout the state of Florida.

The Company required onsite safety assessments on certain exposures, either pre-approval or after a new client was bound. In some exposures the Company also required safety surveys to be completed by the proposed client employer prior to acceptance.

Construction risks with a premium greater than \$5,000 and non-construction risks with premiums greater than \$15,000 required pre-inspection. In addition, 45 to 90 days follow-up visits were done on open recommendations. There was a minimum schedule of one visit per year, and based on premium volume, loss ratios and exposures selected, such risks may be visited monthly or quarterly. Payrolls and Class codes were reviewed on each loss control survey.

The Company provided periodic training to its loss control staff. Training materials were provided by the Company.

REINSURANCE

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

Assumed

The Company did not assume any reinsurance business during the period of the examination.

Ceded

The Company ceded risks on an excess of loss basis to several Lloyd's syndicates and to London and Bermuda market reinsurers. The Company obtained a letter of credit for the one reinsurer which was not authorized. The Company retained the first \$250,000 per occurrence (\$750,000 in aggregate) and reinsured the balance in four layers from excess of \$250,000 to a limit of \$20 million.

ReSource Intermediaries, Inc. acted as the Company's licensed reinsurance intermediary. A representative of this reinsurance intermediary, Mr. Robert Kennedy, was also a Board member of the Company.

The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

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

An independent CPA firm audited the Company's statutory basis financial statements annually for the period June 1, 2005 to December 31, 2005 and for the year ended December 31, 2006, in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA firm as required by Rule 69O-137.002, Florida Administrative Code.

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

The Company had the following agreements with non-affiliated companies:

Custodial Agreement

The Company entered into an agreement, dated June 30, 2005, with Wachovia Bank National Association (now U.S. Bank) for the provision of custodial services. This agreement did not contain certain provisions that were required under Rule 69O-143.042(2) (g), (h), (i), (j) and (l), Florida Administrative Code which are defined as follows:

(g) The custodian and its agents shall be required to send to the insurance company all reports which they receive from a clearing corporation their respective systems of internal accounting control and reports prepared by outside auditors on the custodians or its agent's internal accounting control of custodied securities that the insurance company may reasonably request.

(h) The custodian shall maintain records sufficient to determine and verify information relating to custodied securities that may be reported in the insurance company's Annual Statement and supporting Schedules and information required in any audit of the financial statements of the insurance company.

(i) The custodian shall provide, upon written request from the Office or from an appropriate officer of the insurance company, the appropriate affidavits, on Forms OIR-A1-341 (A), (B), or (C) (rev. 12-07), or substantially similar forms with respect to custodied securities. Forms OIR-A1-341 (A), (B) and (C) (rev. 12-07), entitled "Custodian Affidavit," are hereby incorporated by reference. These forms shall become effective on the effective date of these rules and may be obtained from the Office of Insurance Regulation, Larson Building, Tallahassee, Florida.

(j) A national bank, state bank or trust company shall secure and maintain insurance protection in an adequate amount covering the bank's or trust company's duties and activities as custodian for the insurer's assets, and shall state in the custody agreement that protection is in compliance with the requirements of the custodian's banking regulator. A broker/dealer shall secure and maintain insurance protection for each insurance company's custodied securities in excess of that provided by the Securities Investor Protection Corporation in an amount equal to or greater than the market value of each respective insurance company's custodied securities.

(l) In the event that there is a loss of custodied securities for which the custodian shall be obligated to indemnify the insurance company as provided in paragraph (k) above, the custodian shall promptly replace the securities or the value thereof and the value of any loss of rights or privileges resulting from said loss of securities.

Independent Auditor Agreement

The Company entered into an agreement, dated November 27, 2006 with Thomas Howell Ferguson, CPA, PA for the provision of tax and annual statutory audit services.

Premiums Processing and Other Services Agreement

The Company entered into an agreement, dated May 1, 2005 with Meadowbrook, Inc. (a company under common ownership with Florida Preferred Administrators, Inc.) for the provision of premium processing, general ledger, quarterly and annual statement preparation and other related services.

The agreement was subsequently renewed on July 1, 2007. The agreement specified that the fees were based on 6.5% of premiums written, with a minimum monthly payment of \$80,000.

Claims Processing Agreement

The Company entered into an agreement dated June 1, 2005 with Florida Preferred Administrators, Inc. (a company under common ownership with Meadowbrook, Inc.) for the provision of claims processing and claims accounting and reporting services. The agreement was subsequently renewed on January 1, 2007. The fee amounts were based on a per claim basis, depending on the type of claim processed.

Office Lease

The Company entered into a lease for office premises on May 1, 2005 with C & S Properties, at a monthly rental of \$5,665. The expiry date of the lease was August 31, 2007, subsequent to which the lease was continued on a month to month basis.

Information Technology Report

John Grec, AES, CFE of Examination Resources, LLC, performed a computer systems evaluation on the Company. A summary of significant findings were as follows:

1. Several of the information systems functions were carried out by Administrative Concepts Corporation a company under common ownership. However, no written agreement existed between the Company and Administrative Concepts Corporation with respect to these services.
2. Backup copies of data files and programs were not stored in a locked and waterproof and fireproof storage area.
3. All claims processing and reporting functions were performed under contract by Florida Preferred Administrators, Inc. while all statutory reporting was by a contract with Meadowbrook, Inc. Meadowbrook, Inc. however, did not produce SAS 70 reports for its clients, nor had the Company performed any audits of its own on the systems at Meadowbrook, Inc. As a result, most of the internal controls at Meadowbrook Inc. could not be relied on for reducing risk associated with the information systems supporting the applications and security relating to the Company's operations. SAS 70 reports are

advantageous to user organizations, because they can assess a service organization's controls and safeguards. SAS 70 reports that user organizations receive contain details describing the service organizations specific controls, and in the case of SAS 70 Type II reports, the report provides whether the controls and safeguards are effective.

4. The Company did not provide evidence of a business continuity plan in case of failure of operations at its Bradenton, Florida office.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2006, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

SOUTHERN EAGLE INSURANCE COMPANY
Assets

DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Bonds	\$11,739,059		\$11,739,059
Common Stocks	484,818		484,818
Cash	2,393,323		2,393,323
Receivables for securities	19,500		19,500
Investment income due and accrued	93,534		93,534
Accrued retrospective premiums	4,062,057		4,062,057
Receivable under reinsurance contracts	2,045,844		2,045,844
Net deferred tax asset	137,255		137,255
Electronic data processing equipment	6,725		6,725
Aggregate write-in for other than invested assets	53,600	(\$53,600)	-
Totals	<u>\$21,035,715</u>	<u>(\$53,600)</u>	<u>\$20,982,115</u>

SOUTHERN EAGLE INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Losses	\$8,281,598		\$8,281,598
Loss adjustment expenses	1,423,962		1,423,962
Commissions payable	296,139		296,139
Other expenses	139,623		139,623
Taxes, licenses and fees	237,334	\$181,927	419,261
Current federal income taxes	530,936		530,936
Payable for securities	32,880		32,880
Aggregate write-ins for liabilities	117,500		117,500
Total Liabilities	\$11,059,972	\$181,927	\$11,241,899
Common capital stock	\$500,000		\$500,000
Gross paid in and contributed surplus	6,500,000		6,500,000
Unassigned funds (surplus)	2,975,743	(\$235,527)	2,740,216
Surplus as regards policyholders	\$9,975,743	(\$235,527)	\$9,740,216
Total liabilities, surplus and other funds	\$21,035,715	(\$53,600)	\$20,982,115

SOUTHERN EAGLE INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2006

Underwriting Income

Premiums earned		\$16,635,046
	Deductions:	
Losses incurred		7,536,132
Loss expenses incurred		1,260,816
Other underwriting expenses incurred		4,565,374
Total underwriting deductions		<u>\$13,362,322</u>
Net underwriting gain or (loss)		\$3,272,724

Investment Income

Net investment income earned		\$565,943
Net realized capital gains		9,577
Net investment gain or (loss)		<u>\$575,520</u>

Net income before dividends to policyholders and before federal & foreign income taxes		\$3,848,244
Federal & foreign income taxes		<u>1,389,522</u>

Net Income		<u>\$ 2,458,722</u>
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Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$ 6,041,580
Net Income		2,458,722
Net unrealized capital gains		23,979
Change in non-admitted assets		(80,353)
Change in provision for reinsurance		523,948
Change in deferred income tax		7,867
Surplus adjustments: Paid in		1,000,000
Examination Adjustments		(235,527)
Change in surplus as regards policyholders for the year		<u>\$3,698,636</u>
Surplus as regards policyholders, December 31 current year		<u>\$ 9,740,216</u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Accrued retrospective premiums \$4,062,057

The Company booked as an Accrued retrospective premium receivable, an amount of \$4,062,057 in its annual statement. This amount was due from Administrative Concepts Corp., an affiliated company, and was in relation to a contractual obligation for retrospective premiums payable by Administrative Concepts Corp. to the Company in accordance with the master insurance policy agreement. However, under SSAP No. 4, Paragraphs 2 and 3, \$2,062,057 of the total amount booked of \$4,062,057, did not meet the requirements of an admitted asset due to insufficient shareholder's equity in Administrative Concepts Corp. at December 31, 2006 to pay this amount to the Company.

Subsequent event:

The Company has taken steps, prior to completion of the examination, to obtain additional collateral in the form of an additional \$2 million letter of credit at December 31, 2007 (totaling \$4 million in letters of credit) to ensure that the amounts receivable relating to Accrued retrospective premiums met the requirements of an admitted asset as defined in SSAP No. 4.

Disclosures

The Company answered "Not Applicable" in Note 24 to the Notes to Financial Statements, in response to Part C - Amount and Percent of net retrospective premium and Part D - Calculation of nonadmitted accrued retrospective premiums. This disclosure did not adequately address the disclosure requirements of SSAP No. 66, Paragraphs 12 and 13, which required certain further disclosures with respect to both the method and calculation required to determine the estimated Retrospective premium adjustment.

Aggregate write-ins for other than invested assets \$0

The Company invested \$53,600 in an interest bearing note from BioMotion, LLC. Subsequent to December 31, 2006, this loan became non-performing. SSAP No. 20, Paragraph 4(b), requires that such assets, if deemed to be impaired, shall be written off. Accordingly, we made an examination adjustment to non-admit this balance totaling \$53,600 at December 31, 2006. Also the Board of Directors failed to approve this investment when it was made.

Liabilities

Commissions payable \$296,139

The Company included in Commissions payable an amount of \$296,139 to its affiliate, Southern Eagle Underwriting Management Co., as Commissions payable at December 31, 2006. This amount was not properly disclosed as required by SSAP No. 25, Paragraph 17.

Taxes, licenses and fees \$419,261

The Company did not accrue all of the Florida Premium taxes and Workers' compensation assessments that were payable at December 31, 2006. SSAP No. 67, Paragraph 2, requires accrual of all such taxes and fees. Accordingly, we made an examination adjustment, totaling \$181,927, to increase this liability at December 31, 2006.

Losses and loss adjustment expenses \$9,685,560

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2006, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

Glenn Walker, ACAS, the contracted consulting actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

Capital and Surplus

The amount reported by the Company of \$9,975,743, exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

SOUTHERN EAGLE INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS
DECEMBER 31, 2006

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

Surplus as Regards Policyholders December 31, 2006, per Annual Statement	\$9,975,743
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	<u>PER COMPANY</u>	<u>PER EXAM</u>		<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:				
Aggregate write in for invested assets	\$53,600	\$0		(\$53,600)
LIABILITIES:				
Taxes, licenses and fees	237,334	419,261	\$	(181,927)
Net Change in Surplus:				(235,527)
Surplus as Regards Policyholders December 31, 2006, Per Examination				\$9,740,216

SUMMARY OF FINDINGS

Current examination comments and corrective action

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

Information Technology Report

Several of the information systems functions at the Company were administered by Administrative Concepts Corp. However, no written agreement existed between the Company and Administrative Concepts Corp. with respect to these services. **We recommend that the Company enter into a written agreement with Administrative Concepts Corp. with respect to information systems, and that the roles and duties of all services provided to the Company are well defined.**

Backup copies of data files and programs were not maintained in a locked and waterproof and fireproof storage area. **We recommend that backup copies of all data files and programs are kept in a locked fireproof and waterproof storage area.**

All claims processing and reporting functions were performed by contract with Florida Preferred Administrators, Inc. All statutory reporting functions were performed by contract with Meadowbrook, Inc. Meadowbrook, Inc. however, did not produce SAS 70 reports for its clients, nor had the Company performed any audits of its own on the systems at Meadowbrook Inc. **We recommend that the Company obtain from Meadowbrook, Inc. a Type II SAS 70 report listing the key IS controls and safeguards and the test results of those controls and safeguards.**

The Company did not provide evidence of a business continuity plan in case of failure of operations at its Bradenton, Florida office. **We recommend that the Company develop and maintain its own business continuity plan that is tested and based on a business impact analysis, and addresses all significant business activities including financial functions, telecommunication services, data processing and network services.**

Management

The Company did not appoint Thomas Howell Ferguson, PA as the Company's audit firm in the Board of Directors minutes. **We recommend that the Company comply with Section 624.424(8)(c), Florida Statutes, which requires the Board to appoint the Company's CPA's annually.**

The Company did not hold an annual shareholder's meeting as required under Section 607.0701(1), Florida Statutes and the Company by-laws. **We recommend that the Company comply with the terms of Section 607.0701(1), Florida Statutes, and the Company by-laws with respect to its annual shareholder's meeting.**

The Company did not appoint annually its consulting actuaries, Milliman, Inc., in its Board of Directors minutes, as required by the NAIC Annual Statement Instructions and Rule 69O-138.042, Florida Administrative Code. **We recommend that the Company follow the NAIC Annual Statement Instructions and Rule 69O-138.042, with regard to the annual appointment of the Company's consulting actuaries.**

The Company did not approve all investment transactions during the period of the examination. **We recommend that the Company comply with Section 625.304, Florida Statutes, with regard to the approval of all investment transactions.**

The Company had not yet adopted a policy statement requiring annual disclosure of conflicts of interest as recommended by the NAIC Financial Condition Examiners Handbook. **We recommend the Company adopt and maintain a conflict of interest policy with annual reporting in conflict of interest statements to comply with the NAIC Financial Condition Examiners Handbook.**

The Company's custodial agreement with the custodian bank, U.S. Bank, did not contain several key safeguard clauses, as stated in Rule 69O-140.042,(2) (g), (h), (i), (j) and (l), Florida Administrative Code. See the Custodial Agreement Section for details. **We recommend that the Company amend the custodial agreement with U.S. Bank to comply with Rule 69O-140.042, Florida Administrative Code.**

Accounting

The Company answered Not Applicable in note 24 to the Notes to Financial Statements, in response to Part C - Amount and Percent of Net Retrospective Premium and Part D - Calculation of Nonadmitted Accrued Retrospective Premiums. However, this disclosure did not adequately address the disclosure requirements of SSAP No. 66, paragraphs 12 and 13, which required certain further disclosures with respect to both the method required to calculate the estimated retrospective premium adjustment and the calculation thereof. **We recommend that**

the Company comply with SSAP No. 66, Paragraphs 12 and 13, with respect to the disclosure requirements.

The Company did not accrue \$181,927 of the Florida Premium taxes and Workers' compensation assessments that were payable at December 31, 2006 as required by SSAP No. 67, Paragraph 2. **We recommend that the Company comply with the provisions of SSAP No. 67, Paragraph 2, with regard to accrual of all licenses and fees.**

The Company did not disclose in the Notes to the financial statements that commissions of \$826,333 (\$255,309 in 2005) were paid to an affiliated company, Southern Eagle Underwriting Management Co. and also the Commissions payable balance of \$296,139 at December 31, 2006. **We recommend that the Company comply with the provisions of SSAP No. 25, Paragraph 17, which requires disclosure of all related party transactions.**

The Company invested \$53,600 in an interest bearing note from BioMotion, LLC. Subsequent to December 31, 2006, this loan became non-performing. SSAP No. 20, paragraph 4(b) requires that such assets, if deemed to be impaired, shall be written off. Accordingly, we made an examination adjustment to non-admit this balance totaling \$53,600 at December 31, 2006. **We recommend that the Company comply with the provisions of SSAP No. 20, Paragraph 4(b), with regard to admitted assets.**

Operational Review

As a part of this examination, we undertook an operational review of the Company's underwriting and premium processing operations for the year 2006. We discovered deficiencies in a number of areas as noted below.

Policy Review

The three policies written by the Company in 2006 had not been subjected to timely audit. Section 227.191, Florida Statutes, requires that no insurer shall issue a contract or policy except in accordance with the filings which are in effect for such insurer. The Florida Miscellaneous Rules of the NCCI manual requires that the audit be completed within 90 days of the policy's expiration. **We recommend that Section 227.191, Florida Statutes, and the NCCI requirements relating to premium audits be followed.**

One error was discovered due to the Company's failure to obtain quarterly reports in accordance with Rule 69O-189.003(4)(b)(1), Florida Administrative Code, which requires that each employer shall submit a copy of the quarterly earning report, required by Section 443, Florida Statutes, to the carrier at the end of each quarter. **We recommend that the Company comply with the provisions of Rule 69O-189.003(4)(b)(1), Florida Administrative Code, with regard to such filings.**

Client Employers

Ninety-four errors were due to the Company's failure to submit proof of coverage information to the Division of Workers' Compensation electronically. Rule 69L-56-100, Florida Administrative

Code, requires that policy file information be filed electronically rather than by filing on paper forms, as previously required. **We recommend that the Company comply with the provisions of Rule 69L-56-100, Florida Administrative Code, with regard to electronic filing.**

Thirty-three errors were due to the insured's failure to verify if new client employers owed any premiums to previous insurer. Section 627.192(8) Florida Statutes, states that a lessee shall not enter into an employee leasing relationship or be eligible for workers' compensation coverage in the voluntary market if the lessee owes its current or a prior insurer or leasing company any amounts relating to premiums. **We recommend that the Company comply with the provisions of Section 627.192(8), Florida Statutes, with regard to amounts owing to prior Workers' compensation carriers.**

Five errors were due to the Company's failure to maintain records. The Company was unable to provide all requested files as required by Section 627.318, Florida Statutes. **We recommend that the Company comply with the provisions of Section 627.318, Florida Statutes, with regard to record retention.**

Cancellation/Nonrenewal Review

Thirty errors were due to the insured's failure to notify the Company on a timely basis of client employer terminations. Section 627.192(6), Florida Statutes, states that the insured shall notify the Company of its intent to terminate a client employer prior to the termination when feasible. When prior notice is not feasible, the insured shall notify its insurer within 5 days following actual termination. **We recommend that the Company comply with the provisions of Section 627.192(6), Florida Statutes with regard to termination notices.**

Thirty-four errors were due to the Company's failure to submit terminations information to the Division of Workers' Compensation electronically. Rule 69L-56-100, Florida Administrative Code, requires that information relating to terminations be filed electronically rather than by paper, as previously required. **We recommend that the Company comply with the provisions of Rule 69L-56-100, Florida Administrative Code, with regard to electronic filing.**

Twenty errors were due to the Company's failure to provide timely notice of coverage termination to third party certificate holders. The certificate of insurance stated that in the event of a termination, the Company will endeavor to notify the certificate holder within 30 days of termination. **We recommend that the Company comply with the provisions of the insurance certificates with regard to proper termination notice.**

CONCLUSION

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

Per examination findings, the Company's Surplus as regards policyholders was \$9,740,216, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, David Schleit, CPA, CFE, Examination Resources, LLC; Victor Negrón, AIE, Examination Resources, LLC; Terry Corlett, CFE, Examination Resources, LLC; John Grec, AES, CFE, Examination Resources, LLC; Todd Fatzinger, CFE, Examination Resources, LLC and Glenn Walker, ACAS, Taylor-Walker & Associates, Inc., participated in this examination.

Respectfully submitted,

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