

**REPORT ON EXAMINATION**  
**OF**  
**SOUTHERN FIDELITY INSURANCE**  
**COMPANY, INC.**  
**TALLAHASSEE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2013**

**BY THE**  
**FLORIDA OFFICE OF INSURANCE REGULATION**

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November 7, 2014

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, Rule 69O-138.005, Florida Administrative Code, 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, 2013, of the financial condition and corporate affairs of:

**SOUTHERN FIDELITY INSURANCE COMPANY, INC.  
2255 KILLEARN CENTER BLVD  
TALLAHASSEE, FLORIDA 32309**

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

## **SCOPE OF EXAMINATION**

This examination covered the period of January 1, 2009, through December 31, 2013, and was conducted simultaneously with examinations for Capitol Preferred Insurance Company, Inc. and Southern Fidelity Property & Casualty, Inc., which are affiliated through common management pursuant to Section 624.10(1)(b), Florida Statutes. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2008. This examination commenced with planning at the Office on July 21, 2014, to July 25, 2014. The fieldwork commenced on July 28, 2014, and concluded as of November 07, 2014.

This financial examination was a multi-state examination conducted in accordance with the NAIC 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.

The Financial Condition Examiners Handbook requires that the examination be planned and performed 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 used to mitigate those risks. An 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 and annual statement instructions when applicable to domestic state regulations.

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

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

## **SUMMARY OF SIGNIFICANT FINDINGS**

### **Current Exam Findings**

There were no material findings or exceptions noted during the examination as of December 31, 2013.

### **Prior Exam Findings**

There were no material findings or exceptions noted during the examination as of December 31, 2008.

## **SUBSEQUENT EVENTS**

The Company was approved (in accordance with consent order 144858-13-CO) to take out up to 10,000 policies during the February 2014 Citizens Property Insurance Corporation (Citizens) take-out. In November 2014, the Company participated in an assumption of Citizen's policies. The Company was approved for up to a total of 30,000 assumed policies for the November take-out under Consent Order 159614-14-CO.

## HISTORY

### General

The Company was incorporated in Florida on March 15, 2005, and commenced business on April 7, 2005 as Southern Fidelity Insurance Company, Inc.

The Company was authorized to transact the following insurance coverage in Florida on various dates beginning in 2005 and continued to be authorized as of December 31, 2013:

Homeowners multi peril	Fire
Commercial multi peril	

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

### Dividends to Stockholders

The Company did not declare or pay any dividends during the period of this examination.

### Capital Stock and Capital Contributions

As of December 31, 2013, the Company's capitalization was as follows:

Number of authorized common capital shares	20,000
Number of shares issued and outstanding	16,000
Total common capital stock	\$1,600,000
Par value per share	\$100

Control of the Company was maintained by its parent, Southern Fidelity Holding, LLC, who owned 100% of the stock issued by the Company.

## **Surplus Notes**

The Company received regulatory approval in 2006 to participate in the Insurance Capital Build-Up Incentive Program. Under this program, the Company obtained a \$25 million surplus note from the State Board of Administration of Florida. In addition, the Company obtained matching funds of \$25 million contributed by investors. The Company began paying down the principal of the surplus note in 2009 and the carrying value at December 31, 2013 was \$16,544,118. The Company obtained approval from the Office to pay down the surplus note.

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

The Company had no acquisitions, mergers, disposals, and purchase or sales through reinsurance during the period of this examination.

## **CORPORATE RECORDS**

The recorded minutes of the Shareholder, Board of Directors (Board) and certain internal committees 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 compliance with the NAIC Financial Condition Examiners Handbook adopted by Rule 690-138.001, Florida Administrative Code, including the authorization of investments as required by Section 625.304, Florida Statutes.

## **Conflict of Interest**

The Company adopted a policy statement requiring periodic disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

## **MANAGEMENT AND CONTROL**

### **Management**

The annual shareholder meeting for the election of directors was held in accordance with Section 628.231, Florida Statutes. Directors serving as of December 31, 2013, were:

#### **Directors**

<b>Name and Location</b>	<b>Principal Occupation</b>
James Anthony Graganella Tallahassee, Florida	Chief Executive Officer and President, Southern Fidelity Insurance Company, Inc.
Keith Edward Martin Tallahassee, Florida	Vice President and Chief Financial Officer, Southern Fidelity Insurance Company, Inc.
Byron Hamelin Wells Tallahassee, Florida	Vice President, Southern Fidelity Insurance Company, Inc.
Catherine Mashburn Amos Cumming, Georgia	Manager, Mashburn Farms
Timothy Lee Smith Bainbridge, Georgia	Partner, Tim Smith & Associates and Financial Services
William Ronald Cox, Sr. Bainbridge, Georgia	Consultant, Cox Funeral Homes
Charles Howard Keaton Marietta, Georgia	Retired
John Adams Dowdy, Jr. Bainbridge, Georgia	Partner, Dowdy & Whittaker CPA's

Henry Coleman Satterfield, III  
Tallahassee, Florida

Engineer, City of Tallahassee

Charles William Whittaker  
Bainbridge, Georgia

Partner, Dowdy & Whittaker CPA's

Ralph Powell, Jr.  
Bainbridge, Georgia

Insurance Executive, Tim Smith &  
Associates and Financial Services

In accordance with the Company's bylaws, the Board appointed the following senior officers:

#### **Senior Officers**

<b>Name</b>	<b>Title</b>
James Anthony Graganella	President & CEO
Keith Edward Martin	Vice President, Treasurer & CFO
Byron Hamelin Wells	Vice President
Kristie Beavers Mock	Secretary

Following were the principal internal Board committees and their members as of December 31, 2013:

#### **Audit Committee**

Henry Coleman Satterfield  
William Ronnie Cox  
John Adams Dowdy, Jr. <sup>1</sup>

<sup>1</sup> Chairman

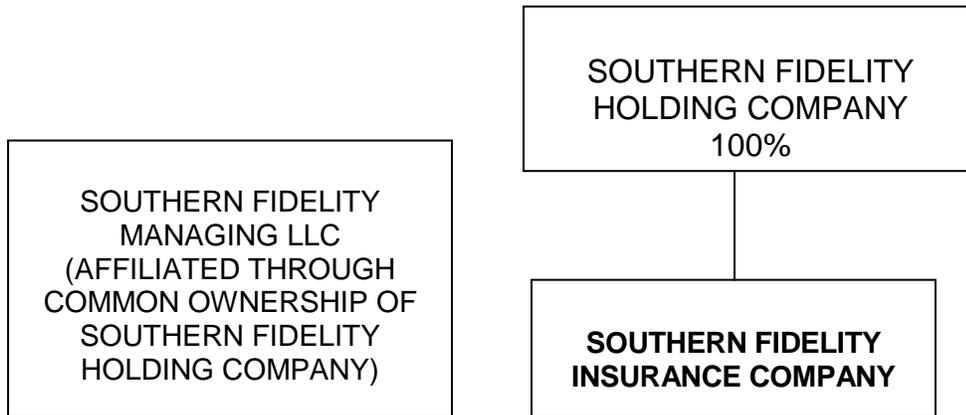
#### **Affiliated Companies**

The most recent holding company registration statement was filed with the State of Florida on February 25, 2014, as required by Section 628.801, Florida Statutes.

An organizational chart as of December 31, 2013, reflecting the holding company system, is shown below. Schedule Y of the Company's 2013 annual statement provided a list of all related companies of the holding company group.

**SOUTHERN FIDELITY INSURANCE COMPANY, INC.  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2013**



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

### **Tax Allocation Agreement**

The Company, along with its parent, filed a consolidated federal income tax return. On December 31, 2013, the method of allocation between the Company and its parent was based on separate return calculations with current credit for net losses.

### **Managing General Agent Agreement**

The Company entered into a Managing General Agency Agreement with Southern Fidelity Managing Agency, LLC (Agency) on January 13, 2005. The Agency was affiliated by common ownership and common management. The Agency provided claims and policy administration services on behalf of the Company. The Agency received for its services an MGA policy fee of \$25 per policy written by the Company and a commission of 31% of the gross earned premium of the Company. The agreement continues in force for a term of five years and will automatically renew for successive five-year periods, unless otherwise terminated within the guidelines of the agreement. Fees incurred under this agreement during 2013 amounted to \$54,409,573.

### **Management Agreement**

The Company entered into a management agreement on February 22, 2005, with Preferred Managing Agency, Inc. (Preferred), a party related by common management, along with Agency, whereby Preferred provided assistance in the information and development of policies and procedures of the Company. The Company did not incur fees directly under these agreements; fees were incurred by the Agency.

## **Policy Management Services Agreement**

The Company entered into a policy management services agreement on February 22, 2005, with Preferred, a party related by common management, along with Agency, whereby Preferred provided various policy administration services, including premium billing and collection. The Company did not incur fees directly under these agreements; fees were incurred by Agency.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained fidelity bond coverage up to \$3,000,000 with a deductible of \$25,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained management liability insurance and professional liability insurance with coverage with limits of \$2,000,000 and deductibles ranging from \$0 to \$250,000, as well as commercial umbrella liability coverages.

## **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Company had no employees and therefore no pension, stock ownership or insurance plans.

## **TERRITORY AND PLAN OF OPERATIONS**

The Company was authorized to transact insurance in the following states:

Florida  
South Carolina

Louisiana

Mississippi

## **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.

## **COMPANY GROWTH**

The Company experienced steady growth in gross premiums and net premiums during the examination period. Over the examination period, the Company experienced underwriting losses in all years except 2013, which recognized an underwriting gain due to improvements in sinkhole incurred losses, reduced reinsurance costs, a lack of catastrophic weather events and revenue earned from prior rate increases. The Company experienced net income in all years under examination, which fluctuated largely in line with net underwriting results. Surplus grew approximately \$9.3 million over the examination period.

## 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.

	2013	2012	2011	2010	2009
Premiums Earned	108,297,780	99,583,309	89,951,949	80,682,349	74,927,139
Net Underwriting Gain/(Loss)	11,708,221	(516,746)	(3,286,063)	(2,971,464)	(1,632,575)
Net Income	9,237,447	2,475,089	692,015	270,299	2,559,562
Total Assets	182,635,028	181,776,907	174,084,147	163,541,155	154,949,858
Total Liabilities	110,529,227	117,477,903	111,896,583	100,450,203	91,676,001
Surplus As Regards Policyholders	72,105,801	64,299,004	62,187,564	63,090,952	63,273,857

## LOSS EXPERIENCE

During the current examination period, the Company showed favorable development overall. The one and two-year net loss developments at the end of the current examination period were both favorable at \$4.0 million and \$4.5 million, respectively.

## 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 assumed \$232,000 during 2013 from unaffiliated companies.

## **Ceded**

As of December 31, 2013, the Company's ceded reinsurance program consisted of catastrophe and per risk excess of loss reinsurance provided by agreements with various commercial reinsurers through reinsurance intermediaries Towers Watson and Aon Benfield. The Company also participated in the Florida Hurricane Catastrophe Fund (FHCF).

The Company's per risk excess reinsurance agreement provided coverage of \$1,500,000 in excess of \$500,000 on each loss, subject to a per loss occurrence limit of \$1,500,000.

The Company had the following catastrophe excess of loss coverage through commercial reinsurers and the FHCF as of December 31, 2013, resulting in coverage of ultimate net losses of \$242,093,829 for the first event:

- First Catastrophe Excess of Loss Reinsurance - \$37,026,659 in private reinsurance coverage with a retention limit of \$6,000,000
- Second Catastrophe Excess of Loss Reinsurance - \$52,462,544 in private reinsurance coverage with a retention limit \$43,026,659
- Florida Catastrophe Hurricane Fund - \$101,093,829 payout limit with an attachment point of \$41,026,422
- Third Catastrophe Excess of Loss Reinsurance - \$51,510,797 in private reinsurance coverage with a retention limit of \$95,489,203

The Company reinsured second and third events with retention of \$3,000,000 each, and fourth event had a retention limit of \$6,000,000.

The Company executed reinsurance premiums protection agreements to reinsure the reinstated premium payment obligations which accrued to the Company under the commercial catastrophe excess of loss agreements. The coverage was limited to 100% of the original contracted reinsurance placement.

For the third and fourth event coverage, the Company reinsured up to \$141,000,000 in coverage for each event.

There were no ceded incurred losses during the year ended December 31, 2013.

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 Tallahassee, Florida. The Company's accounting records were maintained on a computerized system.

The Company and non-affiliates had the following agreements:

### **Custodial Agreement**

The Company maintained custodial agreements with the Suntrust Bank amended on February 7, 2008, Merrill Lynch, Pierce, Fenner & Smith Incorporated executed on August 16, 2011 and

Branch Banking and Trust amended on October 19, 2012. The agreements were in compliance with Rule 69O-143.042, Florida Administrative Code.

### **Independent Auditor Agreement**

An independent CPA audited the Company's statutory basis financial statements annually 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.

### **INFORMATION TECHNOLOGY REPORT**

Scott Langstein, CISA, IT Manager, of Cerebres, LLC performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology 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 and with various state officials as required or permitted by law:

STATE	Description	Par Value	Market Value
FL	Cash	<u>\$ 300,000</u>	<u>\$ 300,000</u>
TOTAL FLORIDA DEPOSITS		\$ 300,000	\$ 300,000
LA	CD, 0.20%, 09/24/14	\$ 100,000	\$ 100,000
LA	*Insure LA Incentive Prog. Grant	\$ 1,400,000	\$ 1,400,000
SC	FNMA, 2.625%, 11/20/14	<u>1,600,000</u>	<u>1,634,992</u>
TOTAL OTHER DEPOSITS		<u>\$ 3,100,000</u>	<u>\$ 3,134,992</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 3,400,000</u>	<u>\$ 3,434,992</u>

\* The Insure Louisiana Incentive Program passed in the 2007 Legislative Session to address property insurance availability and affordability concerns following Hurricanes Katrina and Rita. This economic development plan is designed to attract more property and casualty insurers to Louisiana and to increase the private market capacity by 15%. It provides matching funds to qualified property insurance companies from a \$100 million state fund.

## FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2013, 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 FIDELITY INSURANCE COMPANY, INC.**

**Assets**

**DECEMBER 31, 2013**

	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Bonds	\$124,076,882		\$124,076,882
Real Estate:			
Properties			
occupied by company	4,890,544		4,890,544
Cash and short-term investments	38,125,193		38,125,193
Agents' balances:			
Uncollected premium	765,137		765,137
Deferred premium	8,901,465		8,901,465
Reinsurance recoverable	29,317		29,317
Net deferred tax asset	3,865,210		3,865,210
Interest and dividend income due & accrued	638,651		638,651
Aggregate write-in for other than invested assets	1,342,629		1,342,629
	<hr/>		<hr/>
Totals	\$182,635,028	\$0	\$182,635,028

**SOUTHERN FIDELITY INSURANCE COMPANY, INC.**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2013**

	Per Company	Examination Adjustments	Per Examination
Losses	\$17,322,294		\$17,322,294
Loss adjustment expenses	1,949,367		1,949,367
Commissions payable	763,911		763,911
Other expenses	387,600		387,600
Taxes, licenses and fees	2,495,977		2,495,977
Current federal/foreign income tax	4,967,787		4,967,787
Unearned premium	52,393,305		52,393,305
Advance premium	3,663,893		3,663,893
Funds held under reinsurance treaties	1,183,434		1,183,434
Amounts withheld	36,980		36,980
Provision for reinsurance	10,000		10,000
Ceded reinsurance premiums payable	23,264,357		23,264,357
Aggregate write-ins for liabilities	<u>2,090,322</u>		<u>2,090,322</u>
Total Liabilities	\$110,529,227	\$0	\$110,529,227
Aggregate write-ins for special surplus funds	\$1,140,956		\$1,140,956
Common capital stock	1,600,000		1,600,000
Surplus notes	16,544,118		16,544,118
Gross paid in and contributed surplus	30,900,000		30,900,000
Unassigned funds (surplus)	<u>21,920,727</u>		<u>21,920,727</u>
Surplus as regards policyholders	<u>\$72,105,801</u>	\$0	<u>\$72,105,801</u>
Total liabilities, surplus and other funds	<u><u>\$182,635,028</u></u>	<u>\$0</u>	<u><u>\$182,635,028</u></u>

**SOUTHERN FIDELITY INSURANCE COMPANY, INC.**  
**Statement of Income**

**DECEMBER 31, 2013**

**Underwriting Income**

Premiums earned		\$108,297,780
	<b>Deductions:</b>	
Losses incurred		\$33,282,139
Loss expenses incurred		5,273,391
Other underwriting expenses incurred		58,034,029
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$96,589,559
Net underwriting gain		\$11,708,221

**Investment Income**

Net investment income earned		\$3,091,106
Net realized capital gains or (losses)		0
Net investment gain		\$3,091,106

**Other Income**

Net loss from agents' or premium balances charged off		(\$81,018)
Finance and service charges not included in premiums		439,192
Aggregate write-ins for miscellaneous income		0
Total other income		\$358,174
Net income before dividends to policyholders and before federal & foreign income taxes		\$15,157,501
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$15,157,501
Federal & foreign income taxes		5,920,054
Net Income		\$9,237,447

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year		\$64,299,004
Net Income		\$9,237,447
Change in net deferred income tax		750,504
Change in non-admitted assets		31,728
Change in provision for reinsurance		(7,000)
Change in surplus notes		(2,205,882)
Surplus adjustments: Paid in		0
Aggregate write-ins for gains and losses in surplus		0
Examination adjustment		0
Change in surplus as regards policyholders for the year		\$7,806,797
Surplus as regards policyholders, December 31 current year		\$72,105,801

A comparative analysis of changes in surplus is shown below.

**SOUTHERN FIDELITY INSURANCE COMPANY, INC.  
Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2013**

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, 2013, per Annual Statement \$72,105,801

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment			
LIABILITIES:			
No adjustment			
Net change in surplus:			<u>0</u>
Surplus as regards policyholders December 31, 2013, per examination			<u><u>\$72,105,801</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

**Losses and Loss Adjustment Expenses** \$19,271,661

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, 2013, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office consulting actuaries, Greg Wilson, FCAS, MAAA, and Patrick Glenn, ACAS, ASA, MAAA, of Lewis & Ellis, Inc., reviewed the loss and loss adjustment expense work papers provided by the Company and they were in concurrence with this opinion.

### Capital and Surplus

The amount of capital and surplus reported by the Company of \$72,105,801 exceeded the minimum of \$10,187,697 required by Section 624.408, Florida Statutes.

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Southern Fidelity Insurance Company, Inc.** as of December 31, 2013, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$72,105,801, which exceeded the minimum of \$10,187,697 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Patricia Casey Davis, CFE, CPA, INSRIS, Exam Manager; Sarah Lucibello, CPA, CFE, Examiner-In-Charge, Lewis and Ellis, Inc., Amy Carter, AFE, CPA, Participating Examiner, Lewis and Ellis, Inc., David Palmer, CFE, Participating Examiner, Lewis and Ellis, Inc., and Kate Bolbas, CPA, CFE, Participating Examiner, Lewis and Ellis, Inc. participated in the examination. Greg Wilson, FCAS, MAAA, consulting actuary of Lewis & Ellis, Inc., Patrick Glenn, ACAS, ASA, MAAA, consulting actuary of Lewis & Ellis, Inc., and Scott Langstein, CISA, IT Manager of Cerebres, LLC also participated in the examination. In addition, Mikhael Goldgisser, Reinsurance Financial Specialist, of the Office participated in the examination.

Respectfully submitted,

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Robin Brown, CFE  
Chief Examiner  
Florida Office of Insurance Regulation