

REPORT ON EXAMINATION
OF
SOUTHERN FIDELITY PROPERTY
& CASUALTY, INC.
TALLAHASSEE, FLORIDA
AS OF
DECEMBER 31, 2012

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION.....	1
SUMMARY OF SIGNIFICANT FINDINGS	2
CURRENT EXAM FINDING.....	2
SUBSEQUENT EVENTS.....	2
HISTORY.....	3
GENERAL	3
DIVIDENDS TO STOCKHOLDERS.....	4
CAPITAL STOCK AND CAPITAL CONTRIBUTIONS.....	4
SURPLUS NOTES	4
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASE OR SALES THROUGH REINSURANCE	4
CORPORATE RECORDS	4
CONFLICT OF INTEREST.....	5
MANAGEMENT AND CONTROL.....	5
MANAGEMENT	5
AFFILIATED COMPANIES	7
ORGANIZATIONAL CHART	8
TAX ALLOCATION AGREEMENT.....	9
MANAGING GENERAL AGENT AGREEMENT.....	9
FIDELITY BOND	9
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS	10
TERRITORY AND PLAN OF OPERATIONS.....	10
TREATMENT OF POLICYHOLDERS	10
COMPANY GROWTH	10
PROFITABILITY OF COMPANY	11
LOSS EXPERIENCE	11
REINSURANCE.....	11
ASSUMED	11
CEDED	12
ACCOUNTS AND RECORDS	13
CUSTODIAL AGREEMENT	13
INDEPENDENT AUDITOR AGREEMENT	14
INFORMATION TECHNOLOGY REPORT	14
STATUTORY DEPOSITS	15

FINANCIAL STATEMENTS PER EXAMINATION.....16
ASSETS.....17
LIABILITIES, SURPLUS AND OTHER FUNDS18
STATEMENT OF INCOME19
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS20
COMMENTS ON FINANCIAL STATEMENTS.....21
LIABILITIES21
CAPITAL AND SURPLUS21
CONCLUSION.....22

February 28, 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 690-138.005, 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, 2012, of the financial condition and corporate affairs of:

**SOUTHERN FIDELITY PROPERTY & CASUALTY, INC.
2255 KILLEARN CENTER BOULEVARD
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 6, 2012 through December 31, 2012. This examination commenced with planning at the Florida Office of Insurance Regulation (Office) from December 2, 2013 to December 6, 2013. The fieldwork commenced on December 9, 2013 and concluded as of February 28, 2014.

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.

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 Finding

The finding noted during this examination period has been resolved by the Company subsequent to the examination date. However, the finding is discussed in detail in the body of the examination report. This was the first year examination of the Company; therefore, there are no prior findings to discuss in the examination report.

SUBSEQUENT EVENTS

The examination team noted the following significant events that occurred subsequent to the examination date of December 31, 2012:

At the December 17, 2013 Annual Stockholders Meeting, two additional members were elected to the Board of Directors (Board). John Adams Dowdy, Jr. and Ralph Powell were appointed to serve on the Board effective January 1, 2014.

In 2013, the Company participated in a fourth assumption of Citizens Property Insurance Corporation (Citizen's) policies.

HISTORY

General

The Company was incorporated in Florida on January 6, 2012, and commenced business on January 12, 2012, as Southern Fidelity Property & Casualty, Inc.

The Company was party to Consent Order 122861-12-CO filed January 6, 2012, regarding the application for the issuance of a Certificate of Authority.

The Company was also party to the following Consent Orders requesting the assumption of selected policies from Citizens.

<u>Consent Order Number</u>	<u>Filing Date</u>	<u>Number of Policies Approved</u>
122964-12-CO	1/18/2012	60,000
124213-12-CO	3/21/2012	20,000
128413-12-CO	9/6/2012	30,000

The Company was authorized to transact the following insurance coverages in Florida on January 12, 2012, and continued to be authorized as of December 31, 2012:

Homeowners multi-peril
Other liability
Fire
Inland marine
Allied lines

The Articles of Incorporation and the Bylaws were not amended during the period covered by the 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, 2012, the Company's capitalization was as follows:

Number of authorized common capital shares	30,000
Number of shares issued and outstanding	20,000
Total common capital stock	\$ 2,000,000
Par value per share	\$ 100

Control of the Company was maintained by its parent, SFPC Holding Company, LLC (Parent) who owned 100% of the stock issued by the Company. The Parent contributed \$18,000,000 in cash to the company as of December, 31 2012.

Surplus Notes

The Company did not have any surplus notes during the period of this examination.

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 Shareholders, Board of Directors (Board) and Audit Committee 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 69O-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, 2012, were:

Directors

Name and Location	Principal Occupation
James Anthony Graganella Tallahassee, Florida	Director, President, and CEO, Southern Fidelity Property and Casualty Insurance Company
Keith Edward Martin Tallahassee, Florida	Director, Vice President, Treasurer, Southern Fidelity Property and Casualty Insurance Company
Kristie Beavers Mock Tallahassee, Florida	Executive Administrator, Preferred Managing Agency
Timothy Lee Smith Bainbridge, Georgia	Partner, Tim Smith & Associates Insurance and Financial Services
Byron Hamlin Wells Tallahassee, Florida	IT Manager, Capitol Preferred Insurance Company IT Manager, Preferred Managing Agency
Charles William Whittaker Bainbridge, Georgia	Partner, Dowdy & Whittaker CPAs

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

Senior Officers

Name	Title
James Anthony Graganella	President and CEO
Keith Edward Martin	Vice President and Treasurer
Byron Hamlin Wells	Vice President
Kristie Beavers Mock	Secretary

The Company's Board appointed the following internal committees. The following were the principal Board committees and their members as of December 31, 2012:

Executive Committee	Audit Committee	Investment Committee
Timothy Lee Smith	John Adams Dowdy, Jr. ¹	James Anthony Graganella ¹
Charles William Whittaker ¹	Timothy Lee Smith	John Troy Krause
	Charles William Whitaker	Keith Edward Martin

¹ Chairman

On December 31, 2012, the Audit Committee was comprised of two directors independent of management and a third member who was not a director; therefore, the Company was not in compliance with Section 624.424(8)(c), Florida Statutes, which states that the board shall establish an audit committee of three or more directors. **Subsequent Event:** On December 17, 2013, the member of the Audit Committee who was not a director during the examination period, John Dowdy, was elected to the Board, effective January 1, 2014 and continues to serve on the Audit Committee. His election satisfied the requirement of Section 624.424(8)(c), Florida Statutes, in regards to audit committee membership requirements.

Affiliated Companies

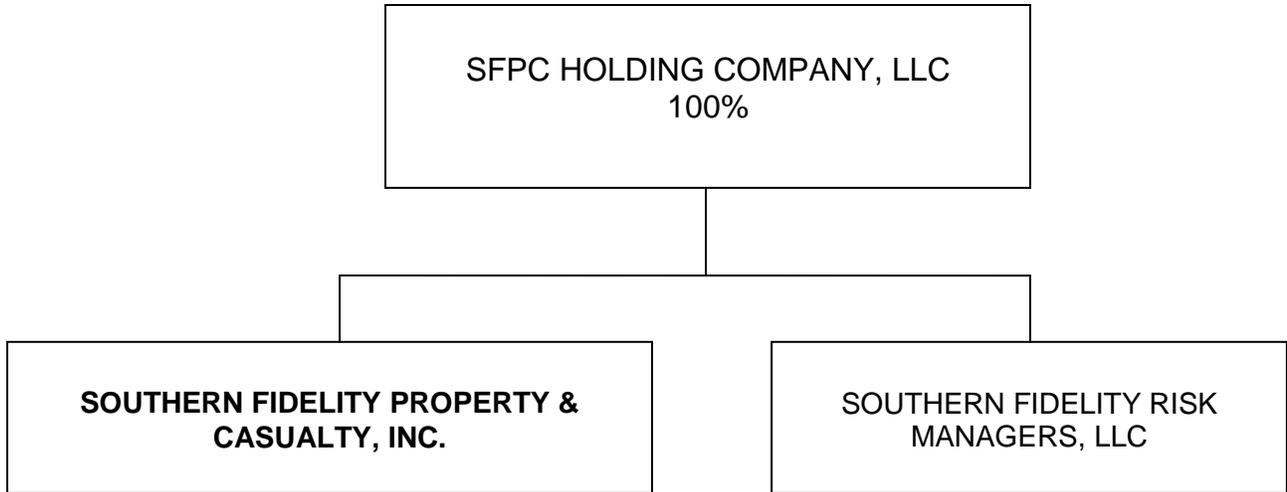
The most recent holding company registration statement was filed with the State of Florida on February 26, 2013 as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

An organizational chart as of December 31, 2012, reflecting the holding company system, is shown on the following page. Schedule Y of the Company's 2012 annual statement provided a list of all related companies of the holding company group.

SOUTHERN FIDELITY PROPERTY & CASUALTY, INC.

Organizational Chart

DECEMBER 31, 2012



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

Tax Allocation Agreement

The Company, along with its parent, SFPC Holding Company, LLC, filed a consolidated federal income tax return. On December 31, 2012, the method of allocation between the Company and its parent was on a separate entity basis. The Company recorded an intercompany income tax payable with its parent. Within ninety (90) days of the remittance by the parent of any income tax payment to taxing authorities, the intercompany tax payable was settled.

Managing General Agent Agreement

The Company entered into a Managing General Agency Agreement with its affiliate, Southern Fidelity Risk Managers, LLC (Agency) on January 6, 2012. The Agency was affiliated by common management. The agreement continues in force for a term of three years and will automatically renew for successive three-year periods, unless otherwise terminated within the guidelines of the agreement. Agency fees were based on 31% of earned direct premium and included the \$25 policy fee. Underwriting guidelines and claims administration services were included in the agreement. An addendum executed on February 27, 2013, retroactively adjusted the commission percentage from 31% to 27.5% for the calendar year commencing January 1, 2012. Commissions incurred under this agreement during 2012 amounted to \$13,733,796.

FIDELITY BOND

The Company maintained fidelity bond coverage up to \$1,000,000 which reached the suggested minimum as recommended by the NAIC.

The Company also maintained Directors and Officers (D&O) liability insurance coverage with limits of \$1,000,000 with a deductible of \$50,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

There were no pension, stock ownership, or insurance plans in place at the Company during the period of this examination.

TERRITORY AND PLAN OF OPERATIONS

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

Treatment of Policyholders

The Company established procedures for handling written complaints in accordance with Section 626.9541(1)(j), Florida Statutes. The Company maintained claims procedure manuals 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 commenced business in January of 2012. The Company only operates in the state of Florida. During the examination year, the Company's only source of business was through assumptions of Citizen's policies. The Company participated in three policy assumptions during 2012.

Profitability of Company

The following table shows the profitability (in dollars) of the Company for the period of operations, as reported in the filed annual statements.

	2012
Premiums Earned	34,357,871
Net Underwriting Gain/(Loss)	3,373,897
Net Income	278,747
Total Admitted Assets	78,819,964
Total Liabilities	56,324,944
Surplus As Regards Policyholders	22,495,020

LOSS EXPERIENCE

Since the examination period covered the first year of the Company's operations, there was no initial estimate of reserves against which to measure emergence. As such, this metric did not apply for this examination.

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 policies during 2012 under a policy assumption agreement with Citizens.

Ceded

As of December 31, 2012, 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 \$500,000 in excess of \$500,000 on each loss, subject to a per loss occurrence limit of \$500,000. The Company's aggregate loss limit was \$3,000,000.

The Company had the following catastrophe excess of loss coverage through commercial reinsurers and the FHCF as of December 31, 2012, resulting in coverage of ultimate net losses of \$134,934,769:

- First Catastrophe Excess of Loss Reinsurance - \$24,543,928 in private reinsurance coverage with a retention limit of \$3,000,000
- Second Catastrophe Excess of Loss Reinsurance - \$7,047,721 in private reinsurance coverage with a retention limit \$27,543,928
- Florida Catastrophe Hurricane Fund (embedded within second and third layers of private reinsurance coverage) - \$70,221,289 payout limit with an attachment point of \$29,294,509
- Third Catastrophe Excess of Loss Reinsurance - \$9,428,858 in private reinsurance coverage with a retention limit of \$34,591,649
- Fourth Catastrophe Excess of Loss Reinsurance - \$26,693,000 in private reinsurance coverage with a retention limit of \$44,020,507

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.

There were no ceded incurred losses during the year ended December 31, 2012.

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.

An independent CPA audited the Company's statutory basis financial statements for 2012, 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 and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained custodial agreements with Branch, Banking, and Trust Company and Merrill Lynch which were executed on October 13, 2012 and February 12, 2012, respectively. The agreements were in compliance with Rule 69O-143.042, Florida Administrative Code.

Independent Auditor Agreement

The Company contracted with an external independent CPA firm to perform the annual audit of its financial statements as required by Rule 69O-137.002 (7) (c), Florida Administrative Code.

Reinsurance Intermediaries Agreements

The Company maintained agreements with reinsurance intermediaries Towers Watson and Aon Benfield which were executed on October 12, 2012 and July 6, 2012 respectively. The reinsurance intermediary agreements met the requirements of Section 626.7492(4)(5), Florida Statutes.

INFORMATION TECHNOLOGY REPORT

David Mills, CISA, CGEIT, CRISC, MCSE, IT Consulting Partner of Carr, Riggs, & Ingram, 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:

STATE	Description	Par Value	Market Value
FL	Certificate of Deposit	<u>\$ 300,000</u>	<u>\$ 300,000</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 300,000</u>	<u>\$ 300,000</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2012, 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 PROPERTY & CASUALTY, INC.

Assets

DECEMBER 31, 2012

	Per Company	Examination Adjustments	Per Examination
Bonds	\$20,491,111		\$20,491,111
Cash and Short-Term Investments	52,794,153		52,794,153
Agents' Balances:			
Uncollected premium	214,281		214,281
Deferred premium	2,948,516		2,948,516
Net deferred tax asset	2,220,906		2,220,906
Interest and dividend income due & accrued	150,997		150,997
	<hr/>		<hr/>
Totals	<u>\$78,819,964</u>		<u>\$78,819,964</u>

SOUTHERN FIDELITY PROPERTY & CASUALTY, INC.
Liabilities, Surplus and Other Funds

DECEMBER 31, 2012

	Per Company	Examination Adjustments	Per Examination
Losses	\$7,168,743		\$7,168,743
Loss adjustment expenses	769,473		769,473
Commission payable	222,822		222,822
Other expenses	35,000		35,000
Taxes, licenses and fees	724,944		724,944
Current federal income taxes	143,220		143,220
Unearned premium	30,841,595		30,841,595
Advance premium	2,033,929		2,033,929
Ceded reinsurance premiums payable	11,841,359		11,841,359
Amounts withheld	41,579		41,579
Aggregate write-ins for liabilities	2,502,280		2,502,280
Total Liabilities	\$56,324,944		\$56,324,944
Common capital stock	\$2,000,000		\$2,000,000
Gross paid in and contributed surplus	18,000,000		18,000,000
Unassigned funds (surplus)	2,495,020		2,495,020
Surplus as regards policyholders	\$22,495,020		\$22,495,020
Total liabilities, surplus and other funds	\$78,819,964		\$78,819,964

SOUTHERN FIDELITY PROPERTY & CASUALTY, INC.
Statement of Income

DECEMBER 31, 2012

Underwriting Income

Premiums earned		\$34,357,871
	Deductions:	
Losses incurred		\$14,831,372
Loss expenses incurred		1,829,731
Other underwriting expenses incurred		14,322,871
Total underwriting deductions		\$30,983,974
Net underwriting gain or (loss)		\$3,373,897

Investment Income

Net investment income earned		\$408,825
Net investment gain or (loss)		\$408,825

Other Income

Net gain or (loss) from agents' or premium balances charged off		(\$13,359)
Finance and service charges not included in premiums		52,604
Total other income		\$39,245

Net income before dividends to policyholders and before federal & foreign income taxes		\$3,821,967
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$3,821,967
Federal & foreign income taxes		3,543,220
Net Income		\$278,747

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2011		\$0
Net Income		\$278,747
Change in net deferred income tax		2,236,192
Change in non-admitted assets		(19,919)
Capital changes: Paid in		2,000,000
Surplus adjustments: Paid in		18,000,000
Examination Adjustment		0
Change in surplus as regards policyholders for the year		\$22,495,020
Surplus as regards policyholders, December 31, 2012		\$22,495,020

A comparative analysis of changes in surplus is shown below.

SOUTHERN FIDELITY PROPERTY AND CASUALTY, INC.
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2012

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, 2012, per Annual Statement	\$22,495,020
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	<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, 2012, Per Examination			<u><u>\$22,495,020</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$ 7,938,216

An outside actuarial firm appointed by the Board of Directors rendered an opinion that the amounts carried on the balance sheet as of December 31, 2012 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's consulting actuary, Matthew Merlino, FCAS, MAAA, of Merlino & Associates, reviewed the loss and loss adjustment expense work papers provided by the Company and he was in concurrence with this opinion.

Capital and Surplus

The amount of capital and surplus reported by the Company of \$22,495,020 exceeded the minimum of \$15,000,000 required by Section 624.408(1)(f), 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 Property & Casualty, Inc.** as of December 31, 2012, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$22,495,020 which exceeded the minimum of \$15,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, R. Dale Miller, CPA, CFE, CFF, Examiner-In-Charge, and Breanne Hancock, CPA, Thomas Montalbano, CPA, Michael Whitney, CPA, and Sharon Stuber, Participating Examiners, of Carr, Riggs & Ingram, LLC, also participated in the examination. Members of the Office who participated in the examination included Jonathan Frisard, Examination Manager, and Connie Hare, Participating Examiner. Additionally, Matthew Merlino, FCAS, MAAA, consulting actuary of Merlino & Associates and David Mills, CISA, CGEIT, CRISC, MCSE, Lead IT Specialist of Carr, Riggs & Ingram, LLC, are recognized for participation in the examination.

Respectfully submitted,

Robin Brown, CFE
Chief Examiner
Florida Office of Insurance Regulation