

**REPORT ON EXAMINATION**  
**OF**  
**SOUTHERN OAK INSURANCE**  
**COMPANY**  
**JACKSONVILLE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2005**

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

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Tallahassee, Florida

February 19, 2007

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2005, of the financial condition and corporate affairs of:

**SOUTHERN OAK INSURANCE COMPANY  
76 S. LAURA STREET, SUITE 1702  
JACKSONVILLE, FLORIDA 32202**

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, 2005 through December 31, 2005. The Company had not previously been examined by representatives of the Florida Office of Insurance Regulation (Office) as 2005 was the Company's first full year of operations. This examination commenced with planning at the Office on November 6, 2006, to November 9, 2006. The fieldwork commenced on November 13, 2006, and was concluded as of January 12, 2007. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

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 assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

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 report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the integrity of the balances of the Company's assets and liabilities as reported in its annual statement as of December 31, 2005, as those balances affect the financial solvency of the Company.

Transactions subsequent to year-end 2005 were reviewed where relevant and deemed significant to the Company's financial condition.

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.

## **HISTORY**

### **General**

The Company was incorporated in Florida on November 30, 2004 and commenced business on December 1, 2004 as Southern Oak Insurance Company. It was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code.

In accordance with Section 624.401(1), Florida Statutes, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2005:

Fire  
Homeowners Multi Peril

Inland Marine

The Company had not written insurance coverage in 2005 or subsequently in 2006 in the Inland Marine line of business. In accordance with Section 624.430, FS, the Company is required to request to have this line of insurance removed from its certificate of authority.

The articles of incorporation and bylaws were not amended during the period covered by this examination.

### **Capital Stock**

As of December 31, 2005, the Company's capitalization was as follows:

Number of authorized common capital shares	100,000
Number of shares issued and outstanding	65,001
Total common capital stock	\$6,500,100
Par value per share	\$100.00

Control of the Company was maintained by its parent, Southern Oak Holding Company (SOHC), a Limited Liability Company, who owned 100 percent of the stock issued by 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 Statement.

	<b>2005</b>	<b>2004</b>
Premiums Earned	5,556,831	0
Net Underwriting Gain/(Loss)	176,411	(1,000,000)
Net Income/(Loss)	(134,333)	(992,265)
Total Assets	15,505,866	5,507,835
Total Liabilities	9,179,184	0
Surplus As Regards Policyholders	6,326,682	5,507,835

### **Dividends to Stockholders**

The Company did not declare or pay dividends to its stockholder in 2005.

### **Management**

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2005, were:

#### **Directors**

##### **Name and Location**

##### **Principal Occupation**

Stephen John Pajcic III  
Jacksonville, Florida

Partner  
Pajcic & Pajcic

Anne Kelley Pajcic  
Jacksonville, Florida

Pajcic & Pajcic

Gary Curtis Pajcic (a)  
Jacksonville, Florida

Partner  
Pajcic & Pajcic

Tony Alexander Loughman  
Jacksonville, Florida

President  
Southern Oak Insurance Company

Ronald Everett Natherson Jr.  
Jacksonville, Florida

Vice President  
Southern Oak Insurance Company

(a) Deceased on August 1, 2006

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

### Senior Officers

<b>Name</b>	<b>Title</b>
Tony Alexander Loughman	President
Gary Curtis Pajcic (a)	Secretary
Stephen John Pajcic III	Treasurer
Ronald Everett Natherson Jr.	Vice President
Edwin Joe Lee	Vice President
Daniel Michael Kutzer	Chief Financial Officer

(a) Deceased on August 1, 2006

The Company's board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following are the principal internal board committees and their members as of December 31, 2005:

#### **Audit Committee**

Stephen John Pajcic III, Chairman  
Tony Alexander Loughman  
Daniel Michael Kutzer  
Julie W. Wild

#### **Executive Committee**

Stephen John Pajcic III, Chairman  
Tony Alexander Loughman

#### **Conflict of Interest Procedure**

The Company adopted a policy statement requiring annual disclosure of conflicts of interest.

#### **Corporate Records**

The recorded minutes of the shareholders and Board of Directors meetings were reviewed for the period under examination. The recorded minutes adequately documented its meetings and

approval of Company transactions in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

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

The Company had no acquisitions, mergers, disposals, dissolutions, purchase or sales through reinsurance during the period under examination.

### **Surplus Debentures**

On June 30, 2005, the Company issued a \$600,000 subordinated surplus debenture, in exchange for cash, to its parent, SOHC. The subordinated surplus debenture had an interest rate of prime plus 2 1/2 % with a maturity date of November 1, 2009. Interest was payable quarterly beginning October 1, 2005. The Company was required to obtain approval from the Office prior to all principal and interest payments.

#### **Subsequent Event:**

On June 30, 2006, The Company retired the initial \$600,000 subordinated surplus debenture and issued a \$3,100,000 subordinated surplus debenture, in exchange for cash, to its parent, SOHC. The subordinated surplus debenture had an interest rate of prime plus 2 1/2%, not to exceed 12% per annum, with a maturity date of December 31, 2009. Interest was payable quarterly beginning October 1, 2006. The Company was required to obtain approval from the Office prior to all principal and interest payments.

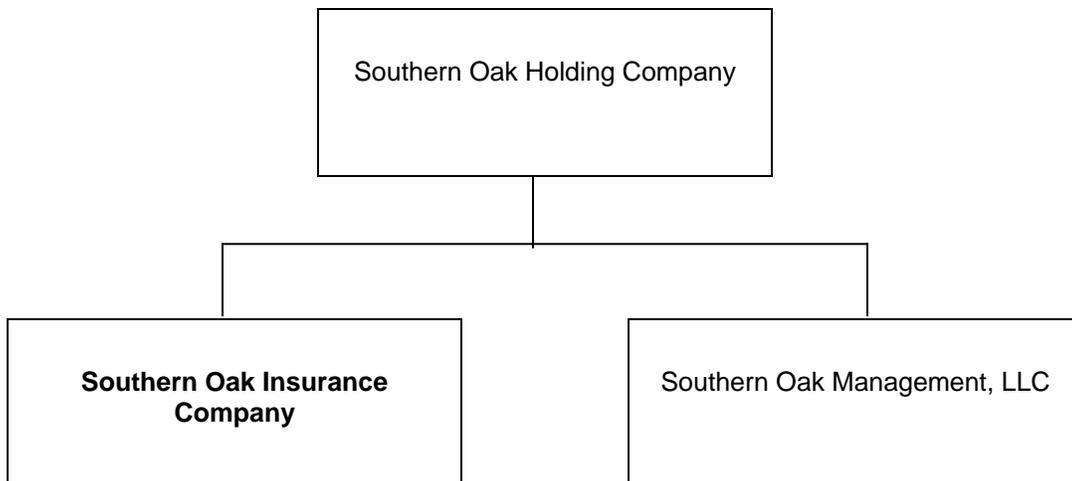
## AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on March 15, 2006, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

An organizational chart as of December 31, 2005, reflecting the holding company system, is shown below.

### SOUTHERN OAK INSURANCE COMPANY ORGANIZATIONAL CHART

DECEMBER 31, 2005



The following agreement was in effect between the Company and its affiliate:

### **Managing General Agency and Claims Administration Agreement**

The Company had a Managing General Agency and Claims Administration Agreement with its affiliate, Southern Oak Management, LLC (SOM), at December 31, 2005. The Company appointed SOM as its exclusive managing general agent for producing and handling policies for the authorized lines of business. The agreement stated that SOM would also provide the policy administration including the collection of premium and cancellation of policies, as well as investigate, evaluate, handle, adjust and settle claims. SOM charged a \$25 policy fee and received a commission on all premiums collected.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained \$250,000 of fidelity bond coverage with a deductible of \$15,000; however the coverage was not sufficient for all of the companies listed on the policy for National Union Fire Insurance Company of Pittsburgh, Pa. It is recommended that the Company increase fidelity bond coverage to \$350,000 as recommended by the National Association of Insurance Commissioners.

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

The Company had no employees at December 31, 2005.

### **STATUTORY DEPOSITS**

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

<u>State</u>	<u>Description</u>	<u>Par Value</u>	<u>Market Value</u>
FL	Cash	<u>\$ 311,426</u>	<u>\$ 311,426</u>
	TOTAL FLORIDA DEPOSITS	<u>\$ 311,426</u>	<u>\$ 311,426</u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory**

The Company was licensed only in the State of Florida.

### **Treatment of Policyholders**

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

## **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 risk from Citizens Property Insurance Corporation (Citizens) in various take outs beginning on February 2, 2005. The Company had approval from the Office and Citizens to remove up to 40,000 policies over eighteen months.

## **Ceded**

The Company ceded risk on a quota share and catastrophe excess of loss basis to authorized and unauthorized reinsurers. The primary reinsurers were Quanta Reinsurance LTD, an authorized unaffiliated reinsurer and Renaissance Reinsurance LTD and Davinci Reinsurance LTD, unauthorized unaffiliated reinsurers. The Company participated in the Florida Hurricane Catastrophe Fund.

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

## **ACCOUNTS AND RECORDS**

An independent certified public accountant (CPA) audited the Company's statutory basis financial statements annually for the years 2005 and 2004, in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

The Company's accounting records were maintained on 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 maintained its principal operational office in Jacksonville, Florida, where this examination was conducted.

The Company and non-affiliates had the following agreements at December 31, 2005:

### **Program Management Agreement**

The Company and SOM had a program management agreement with MacNeill Group, Inc. (MG) to handle the policy administration of the Company which included the billing and collection of all premiums. SOM was responsible to compensate MG for all services attributable to this Agreement. The Company did not have any responsibility to compensate MG for any sums payable under the Agreement.

### **Custodial Agreement**

The Company's investments were held by Merrill Lynch, Pierce, Fenner & Smith, Inc., a registered securities broker/dealer. A broker/dealer does not meet the requirements of a custodian as defined in Rule 69O-143.041(2), Florida Administrative Code. A custodian must be a national bank, state bank or trust company which has at all times aggregate capital, surplus and undivided profits of not less than \$500,000 and which is regulated by the state banking laws or is a member of the Federal Reserve System and is legally qualified to accept custody of securities in accordance with the standards set forth in Rule 69O-143.042, Florida Administrative Code. However, recent legislation passed by the Florida Legislature in April 2007, would allow a broker/dealer as a custodian if signed into law.

### **Independent Auditor Agreement**

The Company had an agreement with PricewaterhouseCoopers LLP to perform an audit of its GAAP and Statutory financial statements for the year 2004 and 2005.

### **Risk-Based Capital**

The Company reported its risk-based capital at an adequate level.

## **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2005, 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 OAK INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2005**

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$4,404,327		\$4,404,327
Stocks	420,534		420,534
Cash:			
On deposit	8,217,397		8,217,397
Interest and dividend income due & accrued	154,369		154,369
Uncollected premiums and agents' balances in course of collection	258,081		258,081
Amts. recoverable from reinsurers	1,290,305		1,290,305
Net deferred tax asset	427,021		427,021
EDP equipment & software	126,157		126,157
Amts. recoverable from reinsurers	207,675		207,675
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Totals	\$15,505,866		\$15,505,866
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**SOUTHERN OAK INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2005**

<b>Liabilities</b>	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Losses	\$718,776		\$718,776
Loss adjustment expenses	88,410		88,410
Other expenses (excluding taxes, licenses and fees)	27,491		27,491
Taxes, licenses and fees	158,488		158,488
Current federal income taxes	584,990		584,990
Unearned premiums	5,992,710		5,992,710
Advance premiums	719,741		719,741
Ceded reinsurance premiums payable	(252,259)		(252,259)
Funds held by company under reinsurance treaties	1,140,837		1,140,837
<b>Total Liabilities</b>	<b>\$9,179,184</b>		<b>\$9,179,184</b>
Common capital stock	6,500,100		6,500,100
Surplus notes	600,000		600,000
Unassigned funds (surplus)	(773,418)		(773,418)
Surplus as regards policyholders	6,326,682		6,326,682
<b>Total liabilities, capital and surplus</b>	<b>\$15,505,866</b>		<b>\$15,505,866</b>

**SOUTHERN OAK INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2005**

**Underwriting Income**

Premiums earned	\$5,556,831
DEDUCTIONS:	
Losses incurred	3,803,663
Loss expenses incurred	882,141
Other underwriting expenses incurred	694,616
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$5,380,420</u>
Net underwriting gain or (loss)	\$176,411

**Investment Income**

Net investment income earned	\$271,729
Net realized capital gains or (losses)	(3,820)
Net investment gain or (loss)	<u>\$267,909</u>

**Other Income**

Net gain or (loss) from agents' or premium balances charged off	\$47
Finance and service charges not included in premiums	7,450
Aggregate write-ins for miscellaneous income	0
Total other income	<u>\$7,497</u>

Net income before dividends to policyholders and before federal & foreign income taxes	\$451,817
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	<u>\$451,817</u>
Federal & foreign income taxes	<u>586,150</u>
Net Income	(\$134,333)

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year	\$5,507,835
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**Gains and (Losses) in Surplus**

Net Income	(\$134,333)
Change in net deferred income tax	442,966
Change in net unrealized capital gains	29,612
Change in nonadmitted assets	(119,398)
Change in surplus notes	600,000
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$818,847</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$6,326,682</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### **Losses and Loss Adjustment Expenses**

\$807,186

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, 2005, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office actuary reviewed work papers provided by the Company and no reportable adjustments were recommended.

**SOUTHERN OAK INSURANCE COMPANY  
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

**DECEMBER 31, 2005**

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 per December 31, 2005, Annual Statement	\$6,326,682
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<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
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No adjustments needed

0

Surplus as Regards Policyholders December 31, 2005, Per Examination	<u><u>\$6,326,682</u></u>
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## 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, 2005.

### **Lines of Business**

The Company had not written insurance coverage in 2005 or subsequently in 2006 in the Inland Marine line of business. In accordance with Section 624.430, Florida Statutes, the Company is required to request to have this line of insurance removed from its certificate of authority. **It is recommended that the Company request the removal of the Inland Marine line of business from its certificate of authority.**

### **Custodial Agreement**

The Company's investments were held by Merrill Lynch, Pierce, Fenner & Smith, Inc., a registered securities broker/dealer. A broker/dealer does not meet the requirements of a custodian as defined in Rule 69O-143.041(2), Florida Administrative Code; however, recent legislation passed by the Florida Legislature in April 2007 would allow a broker/dealer as a custodian if signed into law. **The Company should enter into an agreement for the safe keeping of its securities with a custodian who meets the requirements of Rule 69O-143.041(2), Florida Administrative Code and who is legally qualified to accept custody of securities in accordance with the standards set forth in Rule 69O-143.042, Florida Administrative Code; unless Senate Bill 562 is signed into law allowing a broker/dealer as a custodian.**

### **Fidelity Bond Coverage**

The Company maintained \$250,000 of fidelity bond coverage with a deductible of \$15,000; however, the coverage was not sufficient for all of the companies listed on the policy. **It is recommended that the Company increase the fidelity bond coverage to \$350,000 as recommended by the National Association of Insurance Commissioners (NAIC) in accordance with the (NAIC) Financial Condition Examiners Handbook.**

## CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Southern Oak Insurance Company** as of December 31, 2005, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$6,326,682 which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, John Berry, Financial Examiner/Analyst Supervisor and Joe Boor, FCAS, Office Actuary, participated in the examination.

Respectfully submitted,

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Donna Letterio, CFE, CPA, MS  
Financial Specialist  
Florida Office of Insurance Regulation