

REPORT ON EXAMINATION
OF
SOUTHERN OAK INSURANCE
COMPANY, INC.
JACKSONVILLE, FLORIDA

AS OF
DECEMBER 31, 2006

BY THE
OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION.....	1
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION	2
HISTORY	3
GENERAL	3
CAPITAL STOCK	4
PROFITABILITY OF COMPANY	5
DIVIDENDS TO STOCKHOLDERS	5
MANAGEMENT	5
CONFLICT OF INTEREST PROCEDURE.....	7
CORPORATE RECORDS	7
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASE OR SALES THROUGH REINSURANCE.....	7
SURPLUS DEBENTURES	7
AFFILIATED COMPANIES	8
ORGANIZATIONAL CHART	9
MANAGING GENERAL AGENCY AGREEMENT.....	9
FIDELITY BOND.....	10
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS	10
STATUTORY DEPOSITS.....	10
INSURANCE PRODUCTS.....	11
TERRITORY	11
TREATMENT OF POLICYHOLDERS.....	11
REINSURANCE	11
ASSUMED.....	11
CEDED	12
ACCOUNTS AND RECORDS.....	12
PROGRAM MANAGEMENT AGREEMENT	13
CUSTODIAL AGREEMENT	13
FINANCIAL STATEMENTS PER EXAMINATION.....	14
ASSETS	15
LIABILITIES, SURPLUS AND OTHER FUNDS	16
STATEMENT OF INCOME.....	17
COMMENTS ON FINANCIAL STATEMENTS.....	18
LIABILITIES	18

COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS..... 19
SUMMARY OF FINDINGS 20
CONCLUSION 21

Tallahassee, Florida

August 31, 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, 2006, of the financial condition and corporate affairs of:

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

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

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2006 through December 31, 2006. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2005. This examination commenced, with planning at the Office, on June 11, 2007, to June 15, 2007. The fieldwork commenced on June 22, 2007, and was concluded as of August 31, 2007.

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.

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, 2006, as those balances affect the financial solvency of the Company.

Transactions subsequent to year-end 2006 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.

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2005, along with resulting action taken by the Company in connection therewith.

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 was required to request to have this line of insurance removed from its certificate of authority.

Resolution: The Company requested and received approval to remove the inland marine product line 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. **Resolution:** Senate Bill 562 was signed into law by the Governor of Florida on June 15, 2007. The Senate Bill included a broker or dealer in the definition of 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. **Resolution:** The Company increased its fidelity bond coverage to \$600,000 with a \$15,000 deductible which exceeds the recommended amount in accordance with the NAIC Financial Condition Examiners Handbook.

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.

The Company was party to Consent Order 77214-04-CO filed November 24, 2004 with the Office regarding the application for the issuance of a certificate of authority. The Company complied with all provisions of this consent order.

The Company was party to Consent Order 86634-06-CO filed June 29, 2006 with the Office regarding the application to increase their depopulation capacity from Citizens Property Insurance Corporation (Citizens) from 40,000 policies to 60,000 policies.

In accordance with Section 624.401(1), Florida Statutes, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2006:

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

Capital Stock

As of December 31, 2006, 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 (Parent), a limited liability company, who owned 100% 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 statements.

	2006	2005	2004
Premiums Earned	(2,467,681)	5,556,831	0
Net Underwriting Gain/(Loss)	(3,665,115)	176,411	(1,000,000)
Net Income	(2,886,614)	(134,333)	(992,265)
Total Assets	28,848,009	15,505,866	5,507,835
Total Liabilities	21,877,370	9,179,184	0
Surplus As Regards Policyholders	6,970,639	6,326,682	5,507,835

Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2006.

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, 2006, were:

Directors

Name and Location

Stephen John Pajcic III
Jacksonville, Florida

Anne Kelley Pajcic
Jacksonville, Florida

Sallyn Shilling Pajcic
Jacksonville, Florida

Principal Occupation

Partner
Pajcic & Pajcic

Homemaker

Homemaker

Tony Alexander Loughman
Jacksonville, Florida

President
Southern Oak Insurance Company

Ronald Everett Natherson, Jr.
Jacksonville, Florida

Vice President
Southern Oak Insurance Company

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

Senior Officers

Name	Title
Tony Alexander Loughman	President
Sallyn Shilling Pajcic	Secretary
Stephen John Pajcic III	Treasurer
Ronald Everett Natherson, Jr.	Vice President
Edwin Joe Lee	Vice President
Daniel Michael Kutzer	Chief Financial Officer

The Company's board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following are the principal internal board committees and their members as of December 31, 2006:

Executive Committee

Stephen John Pajcic III, Chairman
Tony Alexander Loughman

Audit Committee

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

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook. No exceptions to the policy statement were noted during this examination period.

Corporate Records

The recorded minutes of the shareholder, Board of Directors, 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 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 the Parent. The subordinated surplus debenture had an interest rate of prime plus 2.5% 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.

On June 30, 2006, the Company received approval from the Office and retired the initial \$600,000 subordinated surplus debenture and issued a \$3,100,000 subordinated surplus debenture, in exchange for cash, to the Parent. The subordinated surplus debenture had an interest rate of prime plus 2.5%, 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.

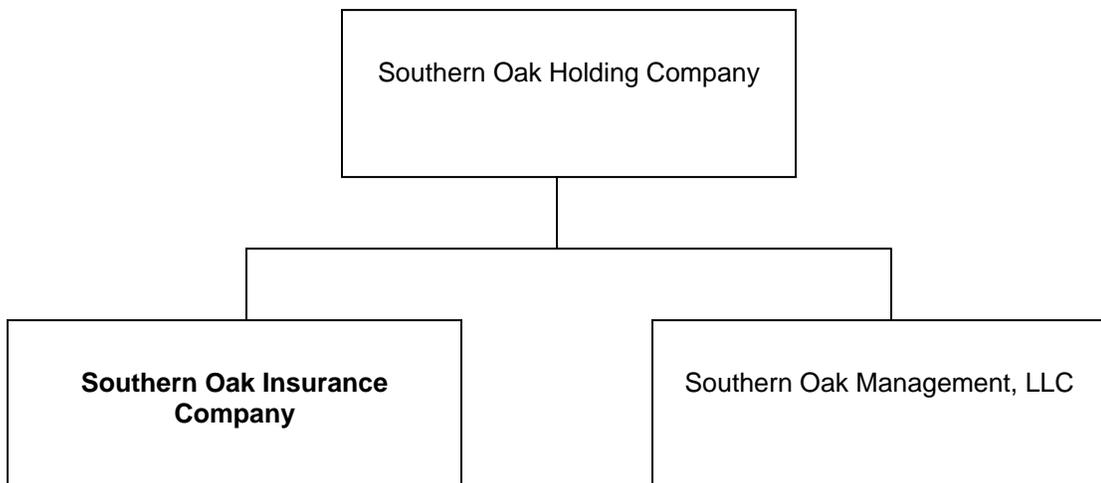
AFFILIATED COMPANIES

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 May 29, 2007, 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 OAK INSURANCE COMPANY, INC.
ORGANIZATIONAL CHART**

DECEMBER 31, 2006



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

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 (Southern Oak Management), at December 31, 2006. The Company appointed Southern Oak Management as its exclusive general agent to administer the processing and production of homeowners and dwelling fire policies as outlined in the agreement. The agreement stipulated that Southern Oak Management would administer all

premium transactions including the collection of premium and the cancellation of policies. The agreement also outlined the responsibility of Southern Oak Management to investigate, evaluate, handle, adjust and settle claims. Southern Oak Management was compensated with a \$25 policy fee and a commission based on all premiums collected.

FIDELITY BOND

The Company maintained a fidelity bond with a per occurrence coverage up to \$600,000 with a deductible of \$15,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no employees at December 31, 2006.

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	Cash	<u>\$ 324,097</u>	<u>\$ 324,097</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 324,097</u>	<u>\$ 324,097</u>

INSURANCE PRODUCTS

Territory

The Company was licensed 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 a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) 3a, 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 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 and received additional approval in 2006 to remove up to 60,000 policies.

Ceded

The Company ceded risk on a quota share and catastrophe excess of loss basis to authorized and unauthorized reinsurers. The primary reinsurers were Everest Reinsurance Company and Transatlantic Reinsurance Company, both authorized 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

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

An independent CPA audited the Company's statutory basis annual financial statements for the years 2005 and 2006, 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 and non-affiliates had the following agreements:

Program Management Agreement

The Company and Southern Oak Management 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. Southern Oak Management was responsible for compensating MG for all services attributable to this agreement. There was no responsibility of the Company 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. The Company's custodial agreement was not in compliance with Rule 69O-143.042 (2), Florida Administrative Code, subsections (c), (d), (g), (h), (i), (k) and (l), defined as follows:

- (c) All custodied securities that are registered shall be registered in the name of the company or in the name of a nominee of the company or in the name of the custodian or its nominee or, if in a clearing corporation, in the name of the clearing corporation or its nominee;
- (d) Custodied securities shall be held subject to the instructions of the insurance company and shall be withdrawable upon the demand of the insurance company, except that custodied securities used to meet the deposit requirements set forth in Section 624.411, F.S., shall, to the extent required by that section, be under the control of the Director and shall not be withdrawn by the insurance company without the approval of the Director;
- (g) During the course of the custodian's regular business hours, any officer or employee of the insurance company, any independent accountant selected by the insurance company and any representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, the custodian's records relating to custodied securities, but only upon furnishing the custodian with written instructions to that effect from an appropriate officer of the insurance company;
- (h) The custodian and its agents shall be required to send to the insurance company all reports which they receive from a clearing corporation or the Federal Reserve book-entry system on their respective systems of internal accounting control and reports prepared by outside auditors on the custodians or its agent's internal accounting control of securities that the insurance company may reasonably request;

- (i) 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;
- (k) The custodian shall be obligated to indemnify the insurance company for any loss of custodied securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction;
- (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.

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 OAK INSURANCE COMPANY, INC.
Assets

DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Bonds	\$4,387,956		\$4,387,956
Stocks:			
Preferred	1,000,000		1,000,000
Common	1,139,533		1,139,533
Cash:	15,628,437		15,628,437
Investment income due and accrued	135,815		135,815
Agents' Balances:			
Uncollected premium	789,165		789,165
Reinsurance recoverable	635,334		635,334
Other amounts receivable under reinsurance contracts	1,184,749		1,184,749
Current federal and foreign income tax recoverable	613,603		613,603
Net deferred tax asset	1,335,346		1,335,346
EDP Equipment	47,134		47,134
Receivable from parents, subsidiaries and affiliates	1,500,000		1,500,000
Aggregate write-in for other than invested assets	450,936		450,936
Totals	<u>\$28,848,009</u>	<u>\$0</u>	<u>\$28,848,009</u>

SOUTHERN OAK INSURANCE COMPANY, INC.
Liabilities, Surplus and Other Funds

DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Losses	\$780,268		\$780,268
Loss adjustment expenses	65,015		65,015
Other expenses	130,518		130,518
Taxes, licenses and fees	278,295		278,295
Borrowed money	83,997		83,997
Unearned premium	18,733,751		18,733,751
Advance premiums	1,331,666		1,331,666
Ceded reinsurance premiums payable	264,062		264,062
Amounts withheld or retained by company for account of others	209,799		209,799
Total Liabilities	<u>\$21,877,370</u>		<u>\$21,877,370</u>
Common capital stock	\$6,500,100		\$6,500,100
Surplus notes	3,100,000		3,100,000
Unassigned funds (surplus)	<u>(2,629,461)</u>		<u>(2,629,461)</u>
Surplus as regards policyholders	<u>\$6,970,639</u>		<u>\$6,970,639</u>
Total liabilities, surplus and other funds	<u>\$28,848,009</u>	<u>\$0</u>	<u>\$28,848,009</u>

SOUTHERN OAK INSURANCE COMPANY, INC.
Statement of Income

DECEMBER 31, 2006

Underwriting Income		
Premiums earned		(\$2,467,681)
	Deductions:	
Losses incurred		\$3,223,844
Loss expenses incurred		2,223,496
Other underwriting expenses incurred		(4,249,907)
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		<u>\$1,197,433</u>
Net underwriting gain or (loss)		(\$3,665,114)
Investment Income		
Net investment income earned		\$247,459
Net realized capital gains or (losses)		10,115
Net investment gain or (loss)		<u>\$257,574</u>
Other Income		
Net gain or (loss) from agents' or premium balances charged off		(\$296)
Finance and service charges not included in premiums		16,280
Aggregate write-ins for miscellaneous income		436,067
Total other income		<u>\$452,052</u>
Net income before dividends to policyholders and before federal & foreign income taxes		(\$2,955,489)
Dividends to policyholders		<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes		(\$2,955,489)
Federal & foreign income taxes		<u>(88,875)</u>
Net Income		(\$2,866,614)
Capital and Surplus Account		
Surplus as regards policyholders, December 31 prior year		\$6,326,681
Net Income		(\$2,866,614)
Net unrealized capital gains or losses		88,225
Change in net deferred income tax		963,469
Change in non-admitted assets		34,310
Change in surplus notes		2,500,000
Aggregate write-ins for gains and losses in surplus		(75,432)
Examination Adjustment		0
Change in surplus as regards policyholders for the year		<u>\$643,958</u>
Surplus as regards policyholders, December 31 current year		<u><u>\$5,970,639</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$845,283

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.

The Office actuary reviewed the outside actuarial firm's work papers and was in concurrence with this opinion.

**SOUTHERN OAK INSURANCE COMPANY, INC.
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	\$6,970,639
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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:			0
Surplus as regards policyholders December 31, 2006, per Examination			\$6,970,639

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2005 examination report issued by the Office.

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.

Custodial Agreement

The Company was not in compliance with Rule 69O-143.042 (2), Florida Administrative Code, Subsections (c), (d), (g), (h), (i), (k) and (l). See the Custodial Agreement Section for details. **We recommend that the Company amend its custodial agreement to include all the required provisions in accordance with Rule 69O-143.042 (2), Florida Administrative Code.**

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Southern Oak Insurance Company, Inc.** 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 \$6,970,639, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Michael Hampton, CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor, and Joe Boor, FCAS, Office Actuary, participated in the examination.

Respectfully submitted,

Richard A. Shaffer
Financial Specialist
Florida Office of Insurance Regulation