

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

**AS OF**  
**DECEMBER 31, 2007**

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

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Tallahassee, Florida

June 26, 2008

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2007, of the financial condition and corporate affairs of:

**SOUTHERN OAK INSURANCE COMPANY  
200 WEST FORSYTH STREET  
SUITE 1200  
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, 2007 through December 31, 2007. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2006. This examination commenced, with planning at the Office, on April 7, 2008, to April 11, 2008. The fieldwork commenced on April 14, 2008, and was concluded as of June 26, 2008.

This financial examination was a statutory financial examination conducted in accordance with the NAIC Financial Condition Examiners Handbook (NAIC 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 NAIC 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 NAIC 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.

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

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

### **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, 2006, along with resulting action taken by the Company in connection therewith.

### **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). On June 25, 2008, Merrill Lynch provided the Company with an updated addendum to the custodial agreement for compliance with the above Rule.

## 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 No. 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 authorized to transact the following insurance coverage in Florida on December 31, 2007:

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, 2007, 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, which 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.

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Premiums Earned	26,842,631	(2,467,681)	5,556,831
Net Underwriting Gain/(Loss)	4,158,714	(3,665,115)	176,411
Net Income	2,620,792	(2,886,614)	(134,333)
Total Assets	42,700,660	28,848,009	15,505,866
Total Liabilities	32,691,862	21,877,370	9,179,184
Surplus As Regards Policyholders	10,008,789	6,970,639	6,326,682

## Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2007.

## 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, 2007, 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**

<b>Name</b>	<b>Title</b>
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, 2007:

**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

\*These members are not directors

The Company appointed non-board members to serve on the audit committee in violation of Section 624.424(8)(c), Florida Statutes. Section 624.424(8)(c), Florida Statutes requires that members of the audit committee are either directors of the Company or a director of an affiliate.

### **Conflict of Interest Procedure**

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Handbook.

### **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.

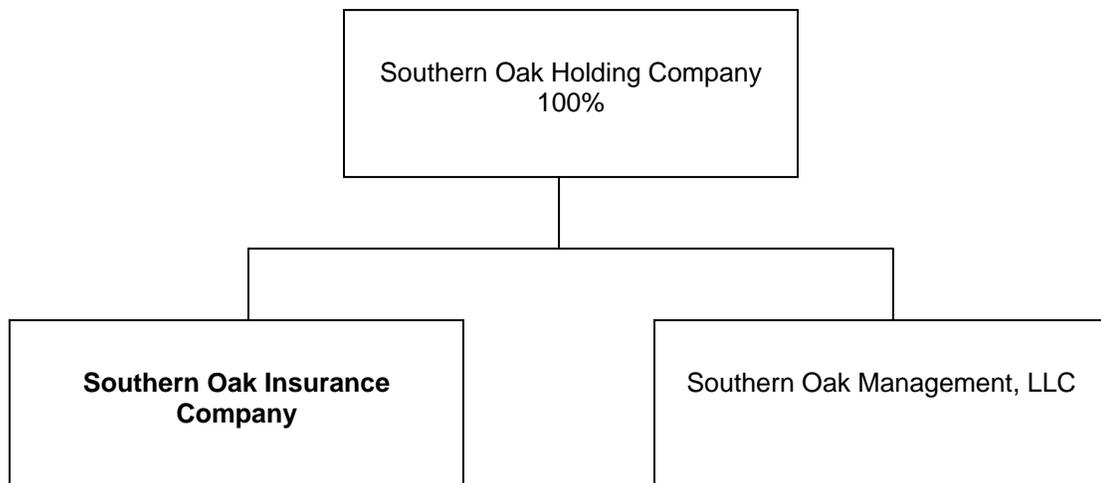
### **AFFILIATED COMPANIES**

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 21, 2008, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2007, reflecting the holding company system, is shown below. Schedule Y of the Company's 2007 annual statement provided a list of all related companies of the holding company group.

**SOUTHERN OAK INSURANCE COMPANY  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2007**



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, 2007. 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 did not adequately cover the suggested minimum amount of coverage for the Company as recommended by the NAIC.

**Subsequent Event:**

On February 2, 2008, the Company increased their per occurrence coverage to \$700,000 which adequately covered the suggested minimum amount as recommended by the NAIC.

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

The Company had no employees at December 31, 2007.

### **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	\$ 337,901	\$ 337,901
<b>TOTAL FLORIDA DEPOSITS</b>		<b><u>\$ 337,901</u></b>	<b><u>\$ 337,901</u></b>

## **PLAN OF OPERATION**

### **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) (i) 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 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 and received additional approval in 2006 to remove up to 60,000 policies.

**Subsequent Event:**

On May 21, 2008, the Company received approval to remove up to 75,000 policies.

**Ceded**

The Company ceded risk on a quota share and catastrophe excess of loss basis to authorized and unauthorized reinsurers. All unauthorized reinsurers utilized a trust agreement or letter of credit.

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 2006 and 2007, 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.

### **Information Technology (IT) Report**

INS Services, Inc. performed a limited-scope computer systems evaluation on the Company. Results of the evaluation were noted in the Information Technology (IT) report provided to the Company.

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 690-143.042 (2), Florida Administrative Code, subsections (c), (d), (g), (h), (i), (k) and (l). This was a repeat violation from the prior examination.

**Subsequent Event:**

The Company received an amended custodial agreement from Merrill Lynch on June 25, 2008, which complied with the above Rule.

**FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2007, 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, 2007**

	Per Company	Examination Adjustments	Per Examination
Bonds	\$11,314,780		\$11,314,780
Stocks:			
Preferred	1,000,000		1,000,000
Common	2,122,082		2,122,082
Cash:	23,541,397		23,541,397
Investment income due and accrued	293,872		293,872
Agents' Balances:			
Uncollected premium	1,422,030		1,422,030
Reinsurance recoverable	369,680		369,680
Other amounts receivable under reinsurance contracts	13,514		13,514
Net deferred tax asset	1,662,589		1,662,589
Electronic data processing equipment	9,705		9,705
Receivable from parents, subsidiaries and affiliates	57,913		57,913
Aggregate write-in for other than invested assets	893,098		893,098
Totals	\$42,700,660	\$0	\$42,700,660

**SOUTHERN OAK INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2007**

	Per Company	Examination Adjustments	Per Examination
Losses	\$1,837,276		\$1,837,276
Loss adjustment expenses	160,429		160,429
Other expenses	21,064		21,064
Taxes, licenses and fees	315,685		315,685
Current federal and foreign income taxes	356,411		356,411
Borrowed money	80,090		80,090
Unearned premium	26,725,202		26,725,202
Advance premiums	678,905		678,905
Ceded reinsurance premiums payable	939,461		939,461
Amounts withheld or retained by company for account of others	379,449		379,449
Aggregate write-ins for liabilities	1,197,890		1,197,890
<b>Total Liabilities</b>	<b>\$32,691,862</b>		<b>\$32,691,862</b>
Common capital stock	\$6,500,100		\$6,500,100
Surplus notes	3,100,000		3,100,000
Unassigned funds (surplus)	408,689		408,689
Surplus as regards policyholders	\$10,008,789		\$10,008,789
<b>Total liabilities, surplus and other funds</b>	<b>\$42,700,651</b>	<b>\$0</b>	<b>\$42,700,651</b>

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

**DECEMBER 31, 2007**

<b>Underwriting Income</b>		
Premiums earned		\$26,842,631
	<b>Deductions:</b>	
Losses incurred		\$6,144,656
Loss expenses incurred		10,772,426
Other underwriting expenses incurred		5,766,835
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		<u>\$22,683,917</u>
Net underwriting gain or (loss)		\$4,158,714
<b>Investment Income</b>		
Net investment income earned		\$73,068
Net realized capital gains or (losses)		36,762
Net investment gain or (loss)		<u>\$109,830</u>
<b>Other Income</b>		
Net gain or (loss) from agents' or premium balances charged off		\$1,409
Finance and service charges not included in premiums		31,160
Total other income		\$32,569
Net income before dividends to policyholders and before federal & foreign income taxes		\$4,301,113
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		<u>\$4,301,113</u>
Federal & foreign income taxes		<u>1,680,321</u>
Net Income		\$2,620,792
<b>Capital and Surplus Account</b>		
Surplus as regards policyholders, December 31 prior year		\$6,970,640
Net Income		\$2,620,792
Net unrealized capital gains or losses		(49,262)
Change in net deferred income tax		411,514
Change in non-admitted assets		55,107
Examination Adjustment		0
Change in surplus as regards policyholders for the year		<u>\$3,038,151</u>
Surplus as regards policyholders, December 31 current year		<u><u>\$10,008,791</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

<b>Losses and Loss Adjustment Expenses</b>	<u>\$1,997,705</u>
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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, 2007, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The actuary for INS Consultants, Inc. reviewed work papers provided by the Company and was in concurrence with this opinion. The loss and loss adjustment expense reserves were in compliance with Section 625.041(1) and 625.101, Florida Statutes.

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

**DECEMBER 31, 2007**

Surplus as regards policyholders  
December 31, 2007, per Annual Statement \$10,008,789

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>	
ASSETS:	No Adjustment		0	
LIABILITIES:	No Adjustment		0	
Net Change in Surplus:			<u>0</u>	

Surplus as regards policyholders  
December 31, 2007, per Examination \$10,008,789

## SUMMARY OF FINDINGS

### **Compliance with previous directives**

The Company has taken the necessary actions to comply with the comments made in the 2006 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, 2007.

### **Audit Committee**

The Company was not in compliance with Section 624.424(8)(c), Florida Statutes. **We recommend that the Company's audit committee contain three or more directors in accordance with Section 624.424(8)(c), Florida Statutes.**

## 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** as of December 31, 2007, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$10,008,789 in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, the following individuals participated in the examination: Barry Armstrong, CFE, Supervisor, Vince Dyal, CFE, EIC, of INS Regulatory Services, Inc., Jerry Golden, Financial Examiner/Analyst and Mike Morrow, FCAS, of INS Consultants, Inc. and INS Services, Inc.

Respectfully submitted,

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