

**REPORT ON EXAMINATION**  
**OF**  
**ST. JOHNS INSURANCE COMPANY, INC.**  
**ORLANDO, FLORIDA**

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

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

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Tallahassee, Florida

November 17, 2006

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:

**ST. JOHNS INSURANCE COMPANY, INC.  
6675 WESTWOOD BOULEVARD  
SUITE 360  
ORLANDO, FLORIDA 32821**

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. This examination commenced, with planning at the Office, on August 16, 2006. The fieldwork commenced on August 22, 2006, and was concluded as of November 17, 2006. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2004. 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 Examiner's 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 A.M. Best 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 amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2005. 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.

Based on the review of the Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPAs, after verifying the statutory requirements, for the following accounts:

**Current federal & foreign income taxes**  
**Net deferred tax asset**  
**Electronic data processing equipment & software**

### **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, 2004, along with resulting action taken by the Company:

#### **Corporate Records**

The recorded minutes of the Board of Directors and shareholders did not adequately document its meetings and approval of Company transaction in accordance with Section 607.0701, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes and the timely recording of the minutes of the Board of Directors and shareholders' meetings.

**Resolution:** The Company complied with this directive and timely recorded the minutes of the Board of Directors and shareholders' meetings including the authorization of investments.

#### **Office Actuary Review**

The Office Actuary did not receive a full and complete actuarial report.

**Resolution:** The Company provided the Office Actuary a full and complete actuarial report for the period ended 2005.

The actuarial opinion incorrectly indicated that there was no significant likelihood of a material adverse deviation (losses costing significantly more than the booked reserves).

**Resolution:** The Company filed a memo with the Office explaining why reserves developed significantly in the September 30, 2006 quarterly statement.

## **HISTORY**

### **General**

The Company was incorporated on November 25, 2003, as a stock property and casualty insurer under the applicable provisions of the State of Florida and commenced business on December 24, 2004 with the name St. Johns Insurance Company, Inc.

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  
Commercial Multi Peril  
Mobile Home Multi Peril

Allied Lines  
Inland Marine  
Other Liability

The Company did not write business in all authorized lines as of December 31, 2005. The Company formally requested consideration to write in all lines at a later time due to the 2004 and 2005 hurricane seasons alteration of their plans.

The Articles of Incorporation were not amended during the period covered by this examination. The Company amended Article I, Paragraph 2 of the by-laws to document the address change of its principal place of business.

### **Capital Stock**

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

Number of authorized common capital shares	35,000
Number of shares issued and outstanding	1,000
Total common capital stock	\$1,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, St. Johns Financial Holding Company, Inc., (SJFHC) who owned 100 percent of the stock issued by the Company. SJFHC, in turn, was 80% owned by St. James Financial Holding Company, Inc. (St. James), and 20% owned by Seibels, Bruce & Company (SBC), a South Carolina Company. St. James was formerly known as Braishfield Holding Company, Inc.

## 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 of the Company.

	2005	2004	2003
Premiums Earned	2,010,705	1,070,064	-0-
Net Underwriting Gain/(Loss)	(8,608,180)	(8,819,293)	(400,890)
Net Income/(Loss)	(6,540,955)	(8,398,672)	(389,637)
Total Assets	26,961,942	11,507,158	12,792,155
Total Liabilities	16,779,292	6,642,482	738,483
Surplus As Regards Policyholders	10,182,650	5,044,676	12,053,672

## Dividends to Stockholders

No dividends were declared or paid to the stockholders during the period covered by this examination.

## 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

Reese I. Bowen  
Orlando, Florida

Michael A. Culbertson  
Columbia, South Carolina

#### Principal Occupation

Vice President  
St. James Insurance Group

President  
The Seibels Bruce Group, Inc.

Robert P. Lucas  
Orlando, Florida

Executive VP  
St. James Insurance Group

James J. McCahill  
Orlando, Florida

Chairman  
St. James Insurance Group

Christopher J. McHattie  
Kinnelon, New Jersey

Attorney  
Christopher J. McHattie, Esq.

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

### Senior Officers

<b>Name</b>	<b>Title</b>
James J. McCahill	President
Reese I. Bowen <sup>(a)</sup>	Vice President
Edward D. Falzarano	Secretary and Treasurer
Scot E. Moore	Chief Financial Officer
Russell Beck	Chief Claims Officer

(a) Reese I. Bowen appointed as President in August of 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:

<b>Audit Committee</b>	<b>Compensation Committee</b>
Christopher J. McHattie <sup>1</sup>	Robert P. Lucas <sup>1</sup>
Robert P. Lucas	Reese I. Bowen
Reese I. Bowen	Michael A. Culbertson

<sup>1</sup> Chairman

### **Conflict of Interest Procedure**

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, Florida Statutes. No exceptions were noted during this examination period.

### **Corporate Records**

The recorded minutes of the shareholders and Board of Directors were reviewed for the period under examination. The recorded minutes of the Board 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**

There were no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance during the period under examination.

### **Surplus Debentures**

On December 30, 2004, the Company issued a \$1,500,000 surplus note in return for cash to its parent, SJFHC. The surplus note had an interest rate of prime plus 2 ¾% with a maturity date of December 31, 2009. Interest was payable quarterly beginning April 1, 2005. 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 February 22, 2005, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

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

### **Tax Allocation Agreement**

The Company, along with its parent and affiliated Managing General Agent filed a consolidated federal income tax return. On December 31, 2005, the method of allocation among companies was based on a separate tax liability as if the Company had filed a separate tax return.

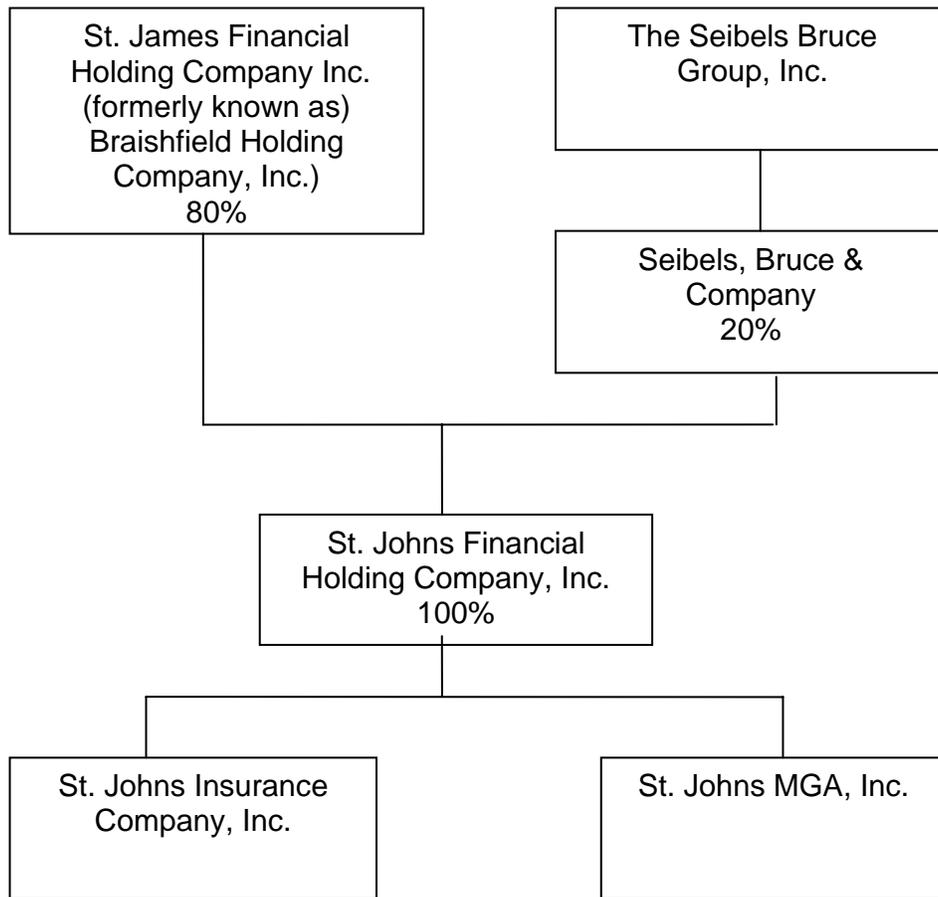
### **Managing General Agency (MGA) and Claims Administration Agreement**

The Company entered into an MGA and Claims Administration Agreement with its affiliate, St. Johns MGA, Inc. (SJMGA) effective November 23, 2003, appointing SJMGA as its agent and representative for producing and handling policies for the authorized lines of business. The agreement provided that SJMGA had authority to provide services which included but were not limited to: accept applications, issue and service policies, collect premiums, and cancel policies, as well as investigate, evaluate, handle, adjust and settle claims. The MGA charged a \$25 policy fee.

An organizational chart as of December 31, 2005, reflecting the holding company system, is shown below. Schedule Y of the Company's 2005 annual statement provided a list of related companies of the holding company group.

**ST. JOHNS INSURANCE COMPANY, INC.  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2005**



## FIDELITY BOND AND OTHER INSURANCE

As of year-end 2005, SJFHC, SJMGA, and the Company were joint insureds on a crimeshield policy with coverage of \$3,000,000, and a deductible of \$50,000. This insurance adequately covered the suggested minimum amount of coverage for the Company, as recommended by the NAIC.

The Company also maintained Directors and Officers (D&O), Errors & Omissions (E&O), and general liability and property coverage usual to the operation of an insurer.

## PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company's full time employees were eligible to participate in the St. James 401(k) plan, with discretionary contributions by St. James. There were no discretionary contributions for 2005.

In addition, the Company's employees participated in certain health care and life insurance benefit plans offered by St. James. Expenses of these plans were initially paid by St. James. St. James was then reimbursed by 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	Cash	\$250,618	\$250,618
Total Special Deposits		<u>\$250,618</u>	<u>\$250,618</u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory**

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 a claims procedure manual that included detailed procedures for handling each type of claim.

## **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 did not assume any risk during the period covered by this examination.

### **Ceded**

The Company ceded approximately 87% of its premiums on a quota share and catastrophe excess of loss basis to authorized and unauthorized reinsurers. The primary reinsurers were Arch Reinsurance Company, an authorized unaffiliated reinsurer (57%), Hannover Reinsurance Ltd., an

unauthorized foreign reinsurer (22%) and E S Reinsurance, Ltd. (6%), who was also an unauthorized foreign reinsurer.

The unauthorized reinsurers utilized letters of credit.

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 CPA audited the Company's statutory basis financial statements for the year 2005, 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, with the exception of adjustment to line item as noted within this report.

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

The Company and non-affiliates had the following agreements:

#### **Custodial Agreement**

The Company maintained a custodial agreement with Branch Banking & Trust Company of Florida (BB&T), which was in compliance with the Rule 69O-143.042, Florida Administrative Code.

**Independent Auditor Agreement**

The Company engaged Dixon Hughes, PLLC for the statutory audit of its financial statements.

**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."

**ST. JOHNS INSURANCE COMPANY, INC.**  
**Assets**

**DECEMBER 31, 2005**

	Per Company	Examination Adjustments	Per Examination
Bonds	\$8,192,479		\$8,192,479
Cash:			
On deposit	1,998,890		1,998,890
Short-term investments	10,801,914		10,801,914
Investment income due & accrued	65,603		65,603
Agents' Balances:			
Uncollected premium	3,294,490		3,294,490
Deferred premiums	1,396,642		1,396,642
Reinsurance recoverable	697,246		697,246
Net deferred tax asset	477,500		477,500
EDP	37,178		37,178
Totals	\$26,961,942	\$0	\$26,961,942

**ST. JOHNS INSURANCE COMPANY, INC.**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2005**

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$1,151,564	\$893,000	\$2,044,564
Loss adjustment expenses	522,601		522,601
Commissions payable	3,251,587		3,251,587
Other expenses	53,624		53,624
Taxes licenses and fees	464,571		464,571
Current federal & foreign income taxes	27,500		27,500
Unearned premiums	8,885,539		8,885,539
Ceded reinsurance premiums payable	2,068,152		2,068,152
Amounts withheld or retained by co. for account of other	8,959		8,959
Payable to parent, subsidiaries and affiliates	345,195		345,195
<b>Total Liabilities</b>	<b>\$16,779,292</b>	<b>\$893,000</b>	<b>\$17,672,292</b>
Common capital stock	\$1,000		\$1,000
Surplus notes	1,500,000		1,500,000
Gross paid in and contributed surplus	23,574,000		23,574,000
Unassigned funds (surplus)	(14,892,350)		(14,892,350)
Surplus as regards policyholders	\$10,182,650	(\$893,000)	\$11,075,650
<b>Total liabilities, capital and surplus</b>	<b>\$26,961,942</b>	<b>\$0</b>	<b>\$28,747,942</b>

**ST. JOHNS INCURANCE COMPANY, INC.**  
**Statement of Income**

**DECEMBER 31, 2005**

Premiums earned	\$2,010,705
DEDUCTIONS:	
Losses incurred	4,743,775
Loss expenses incurred	1,469,195
Other underwriting expenses incurred	4,405,915
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$10,618,885</u>
Net underwriting gain or (loss)	(\$8,608,180)
<b>Investment Income</b>	
Net investment income earned	\$348,864
Net realized capital gains or (losses)	<u>(13,282)</u>
Net investment gain or (loss)	\$335,582
<b>Other Income</b>	
Net gain or (loss) from agents' or premium balances charged off	(\$76,083)
Finance and service charges not included in premiums	0
Aggregate write-ins for miscellaneous income	125
Total other income	<u>(\$75,958)</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$8,348,555)
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$8,348,555)
Federal & foreign income taxes	<u>(1,807,600)</u>
Net Income	(\$6,540,955)
<b>Capital and Surplus Account</b>	
Surplus as regards policyholders, December 31 prior year	\$5,044,676
<b>Gains and (Losses) in Surplus</b>	
Net Income	(\$6,540,955)
Net unrealized capital gains or losses	0
Change in net deferred income tax	731,500
Change in non-admitted assets	(127,571)
Surplus adjustments: Paid in	11,075,000
Exam adjustment	(893,000)
Change in surplus as regards policyholders for the year	\$4,244,974
Surplus as regards policyholders, December 31 current year	<u><u>\$9,289,650</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

#### Losses and Loss Adjustment Expenses \$2,567,165

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, 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 work papers provided by the Company and was not in concurrence with this opinion. The Office Actuary stated that the Company did not adequately establish loss and loss adjustment expenses at year-end 2005, and that Loss and Loss adjustment reserves were deficient by \$893,000. The Company was in violation of Sections 625.041 (1) and 625.101, Florida Statutes.

#### Subsequent event:

During the summer of 2006 the Company realized that Loss and Loss Adjustment Reserves were not adequately reserved at December 31, 2005. Accordingly, the Company increased its reserves to compensate for the deficiency and has fully absorbed this deficiency in its 2006 statutory financial statements.

**ST. JOHNS INSURANCE COMPANY, INC.  
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	\$10,182,650
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
<b>ASSETS:</b>			
No adjustments needed			
<b>LIABILITIES:</b>			
Loss & Loss adjustment expenses	\$1,674,165	\$2,567,165	(\$893,000)
Net Change in Surplus:			(893,000)
Surplus as Regards Policyholders December 31, 2005, Per Examination			\$9,289,650

## SUMMARY OF FINDINGS

### **Compliance with previous directives**

The Company has taken the necessary actions to comply with the comments made in the 2004 examination report issued by the Office.

### **Current examination comments and corrective action**

The following is a brief summary of item of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2005:

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### **Loss & Loss adjustment Reserves**

Loss and Loss adjustment expense reserves were deficient by \$893,000 as noted in the actuarial opinion issued by the Office Actuary. **We recommend that the Company adequately establish Loss and Loss adjustment expense reserves in accordance with Sections 625.041 (1) and 625.101, Florida Statutes.**

### Subsequent event:

During the summer of 2006 the Company realized that Loss and Loss Adjustment Reserves were not adequately reserved at December 31, 2005. Accordingly, the Company increased its reserves to compensate for the deficiency and has fully absorbed this deficiency in its 2006 statutory financial statements.

## **SUBSEQUENT EVENTS**

The following changes have been made to the management of the Company subsequent to the examination date:

Reese Irwin Bowen was appointed President effective July of 2006.

On July 31, 2006, the Company received a loan in the form of a \$20 million Surplus Note from the State Board of Administration of Florida (SBA) to write new homeowners' business insurance policies under a provision SB 1980 passed by the Legislature during 2006. The Company received a \$20M capital infusion from its parent, enabling it to qualify for a loan under the state program. The SBA administers the program.

## CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **St. Johns Insurance Company, Inc.**, 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 \$9,289,650 which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Kethessa Carpenter, CPA, Financial Examiner/Analyst Supervisor, and Joseph Boor, FCAS, Actuary participated in the examination.

Respectfully submitted,

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Samita Lamsal  
Financial Examiner/Analyst II  
Florida Office of Insurance Regulation