

REPORT ON EXAMINATION
OF
STAR & SHIELD INSURANCE
EXCHANGE
TALLAHASSEE, FLORIDA

AS OF
DECEMBER 31, 2009

BY THE
OFFICE OF INSURANCE REGULATION

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TALLAHASSEE, FLORIDA

July 9, 2010

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, and Chapter 629 of the 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, 2009, of the financial condition and corporate affairs of:

**STAR & SHIELD INSURANCE EXCHANGE
3717 APALACHEE PARKWAY, SUITE 201
TALLAHASSEE, FLORIDA 32311**

Hereinafter referred to as, the "Reciprocal". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of April 7, 2009, through December 31, 2009. This was the Reciprocal's first examination. This examination commenced with planning at the Office on March 29, 2010, to April 1, 2010. The fieldwork commenced on April 25, 2010 and concluded as of July 9, 2010.

This financial examination was a statutory financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Reciprocal by obtaining information about the Reciprocal including corporate governance, identifying and assessing inherent risks within the Reciprocal, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Reciprocal were considered in accordance with the risk-focused examination process.

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

SUMMARY OF SIGNIFICANT FINDINGS

Current Exam Findings

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during this examination.

Actuarial Finding – Treatment of Salvage and Subrogation

The consulting actuary for this exam disagreed with the opining actuary's decision to reduce the Reciprocal's anticipated Salvage and Subrogation, (S&S), of \$47,101 to arrive at its net loss and LAE reserves. He stated that the loss ratios used by the opining actuary already reflected loss costs net of S&S. While the differences between selected loss and LAE reserves and those for the opining actuary and the Reciprocal are significant percentagewise, the majority of the differences are attributable to the treatment of the Reciprocal's anticipated S&S of \$47,101. The differences were relatively insignificant as a percentage of the Reciprocal's reported surplus of approximately \$8 million as of 12/31/2009. **Subsequent Event:** After discussion with the opining actuary, he reissued his and refiled with the Office a revised actuarial report which corrected the issue.

SUBSEQUENT EVENTS

Subsequent to the examination date and on January 20, 2010, Mr. Ronald Rufus Parrish was elected as a member of the Exchange's Subscribers' Advisory Committee.

HISTORY

General

The Reciprocal was a domestic insurance exchange, incorporated in Florida on April 7, 2009, and commenced business on June 29, 2009, as Star & Shield Insurance Exchange. The Reciprocal was an unincorporated aggregation of subscribers governed by the Subscribers Advisory Committee (Committee) which is similar to a Board of Directors.

The Reciprocal's Attorney-In-Fact was Star & Shield Risk Management LLC (SSRM) in accordance with Section 629.091, Florida Statutes.

The Reciprocal was party to Consent Order 103560-09-CO, filed April 7, 2009, with the Office regarding the application for the issuance of a Certificate of Authority.

The Reciprocal was authorized to transact the following insurance coverage in Florida on December 31, 2009:

Homeowners multi peril	Fire
Private passenger auto physical damage	Private passenger auto liability

Dividends to Stockholders

The Reciprocal, as an unincorporated aggregate, had no stockholders.

Capital Stock

The Reciprocal had no capital stock.

Surplus Debentures

On April 15, 2009, the Reciprocal issued \$10,000,000 in surplus notes in exchange for cash to the Star & Shield Holdings LLC. The surplus notes had an interest rate of the three month London Interbank Offered Rate (LIBOR) plus 7% per annum on the unpaid principal balance. The note required prior approval from the Office before any payment of interest or repayment of principal.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales Through Reinsurance

The Reciprocal had no acquisitions, mergers, disposals, dissolutions, and purchase or sale through reinsurance for the period under examination.

CORPORATE RECORDS

The recorded minutes of the Committee and certain internal committees were reviewed for the period under examination and adequately documented its meetings and approval of the Reciprocal's transactions and events in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

Conflict of Interest

The Reciprocal adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

MANAGEMENT AND CONTROL

Management

The Committee members were selected in accordance with Section 629.201, Florida Statutes.

Members serving as of December 31, 2009, were:

Subscribers Advisory Committee Members

Name and Location	Principal Occupation
Allen Davis Durham Tallahassee, Florida	President and CEO, Star & Shield Risk Management LLC
Wallace Lamar McLendon Tallahassee, Florida	Retired US Marshal
Donald Francis Eslinger Lake Mary, Florida	Sheriff, Seminole County, FL

The Committee appointed the Star & Shield Risk Management LLC as Attorney-in-Fact (AIF). The senior officers of the AIF were:

Name	Title
Allen Davis Durham	President and CEO
Jonathon Brent Palmquist	EVP, General Counsel & Secretary
John Edwin Hunt Jr.	Executive Chairman
Jaipersad Heerah	Chief Underwriter

The Committee appointed an internal audit committee in accordance with Sections 607.0825, and 624.424(8) (c), Florida Statutes. Following are the members as of December 31, 2009:

Audit Committee

Wallace Lamar McLendon

Donald Francis Eslinger

Affiliated Companies

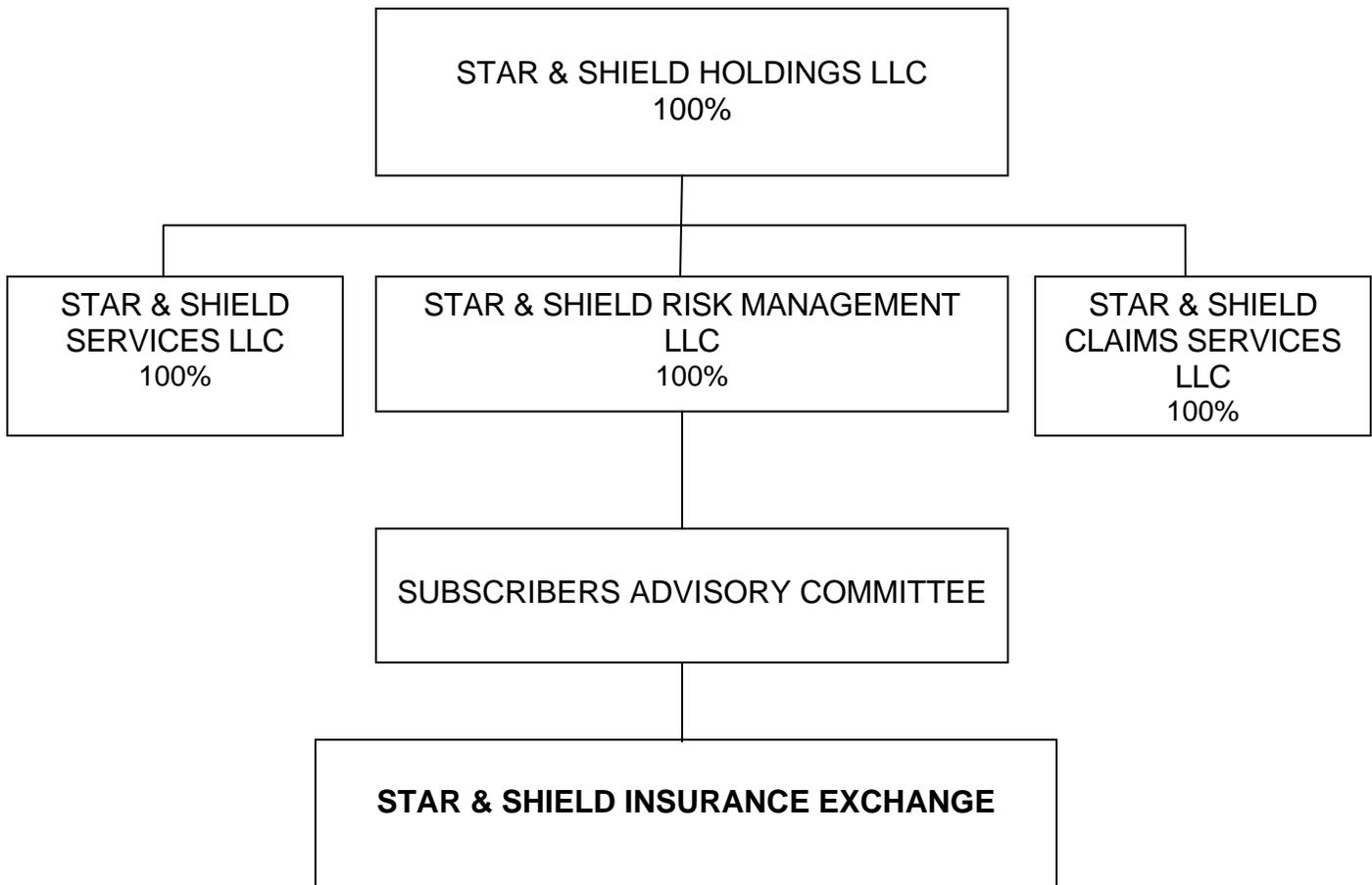
In accordance with Section 629.061, Florida Statutes, the Reciprocal was managed by the AIF pursuant to the terms of an attorney-in-fact agreement between the Reciprocal and the AIF. The AIF was owned and managed by Star & Shield Holdings LLC, a Delaware LLC (SSH). SSH was owned by Flagstone Reassurance Suisse SA (45.02%) and Benfield Holdings Inc. (45.02%), with the balance owned by 8 other individuals (9.96%). Benfield Holdings Inc., a subsidiary of Aon Corporation, was merged on April 27, 2009, into Aon Re Global, Inc. and the name was changed to Aon Benfield Global, Inc., also a subsidiary of Aon Corporation.

The Reciprocal 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 (HCR) statement was filed with the State of Florida on April 8, 2010, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code. The Reciprocal did not file an updated HCR statement to report subsequent changes in affiliates, as required by Rule 69O-143.046 (4), Florida Administrative Code. **Subsequent event:** On August 13, 2010, the Company filed an updated HCR statement that reflected those changes.

An organizational chart as of December 31, 2009, reflecting the holding company system, is shown below. Schedule Y of the Reciprocal's 2009 annual statement provided a list of all related companies of the holding company group.

**STAR & SHIELD INSURANCE EXCHANGE
ORGANIZATIONAL CHART**

DECEMBER 31, 2009



Star & Shield Risk Management LLC serves as the Attorney-In-Fact (AIF) for Star & Shield Insurance Exchange.

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

Subscribers Agreement and Power of Attorney

The Reciprocal set the Powers of the Subscribers Advisor Committee in a document dated April 14, 2009, in accordance with Section 629.201, Florida Statutes. Each new subscriber signed a Subscriber's Agreement and Power of Attorney which appointed Star & Shield Risk Management LLC as the AIF, which allowed the AIF to conduct the lawful business of the Reciprocal.

Attorney-In-Fact Agreement

The Reciprocal entered into an Attorney-In-Fact Agreement with Star & Shield Risk Management LLC, a Florida Limited Liability Corporation on April 15, 2009.

Managing General Agent Agreement

The Reciprocal had a Managing General Agent agreement (MGA) with Star & Shield Services LLC. The MGA audit report was obtained and no significant findings were noted.

Service Agreement

The Reciprocal entered into a service agreement with Aon Corporation on April 21, 2009.

Reinsurance Agreements

The Reciprocal was party to an excess catastrophic reinsurance program with various parties as noted in the Reinsurance section of this report.

The Reciprocal was a party to quota share and excess of loss reinsurance agreements as noted in the Reinsurance section of this report.

FIDELITY BOND AND OTHER INSURANCE

The Reciprocal maintained fidelity bond coverage up to \$300,000 with a deductible of \$25,000, which reached the suggested minimum recommended by the NAIC. The Reciprocal also maintained a Commercial General Liability Umbrella Policy with limits of \$10,000,000 and self insured retention of \$10,000, Directors and Officers (D&O) liability insurance and Errors and Omissions (E&O) coverage with limits of \$5,000,000 and deductibles ranging from \$100,000 to \$200,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Reciprocal had no employees and therefore had no pension, stock ownership or insurance plans.

TERRITORY AND PLAN OF OPERATIONS

The Reciprocal was authorized to transact insurance only in the State of Florida at December 31, 2009.

Treatment of Policyholders

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

The Reciprocal 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.

COMPANY GROWTH

Profitability of Reciprocal

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

	2009
Premiums Earned	(938,485)
Net Underwriting Gain/(Loss)	(1,931,262)
Net Income	(1,923,367)
Total Assets	8,855,128
Total Liabilities	881,820
Surplus As Regards Policyholders	7,973,309

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 Reciprocal had no assumed business at December 31, 2009.

Ceded

The Reciprocal ceded risk on a quota share and excess of loss basis to various third party reinsurers. Effective June 1, 2009, a Quota share agreement was entered into for the residential property lines of business for both non-catastrophe and catastrophe losses and for auto physical damage losses associated with a catastrophic event. Also effective June 1, 2009, the Reciprocal purchased Florida Catastrophe Fund (FHCF) reinsurance and property excess of loss reinsurance for catastrophic events. The Reciprocal purchased a related reinstatement premium protection contract for the excess of loss reinsurance effective June 1, 2009. Effective October 1, 2009, the Reciprocal cancelled its third layer of catastrophe reinsurance protection and corresponding reinsurance premium protection with approval from the Office. All reinsurance agreements other than the FHCF were handled through Aon Benfield, the Reciprocal's designated reinsurance intermediary.

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

ACCOUNTS AND RECORDS

The Reciprocal maintained its principal operational offices in Tallahassee, Florida, where this examination was conducted.

An independent CPA audited the Reciprocal's statutory basis financial statements for 2009, 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 Reciprocal's accounting records were maintained on a computerized system. The Reciprocal's balance sheet accounts were verified with the line items of the annual statements submitted to the office.

The Reciprocal and non-affiliates had the following agreements:

Custodial Agreement

The Reciprocal entered into a custodial agreement with First Tennessee Bank National Association on April 15, 2009. The agreement contained all the requirements of Rule 69O-143.042, Florida Administrative Code.

Managing General Agent Agreement

The Reciprocal had a MGA agreement with Star & Shield Services LLC on April 15, 2009.

Attorney-In-Fact Agreement

The Reciprocal, an unincorporated aggregation of subscribers as prescribed by Chapter 629, Florida Statutes, entered into an Attorney-in-Fact agreement with the AIF on April 15, 2009. The agreement provided, in general, that the AIF manage the affairs of the Reciprocal.

Independent Auditor Agreement

The Reciprocal engaged Johnson Lambert & Company LLP to perform the statutory audits of its financial statements for the year under examination, as required by Section 624.424(8), Florida Statutes and Rule 69O-137.002, Florida Administrative Code.

Information Technology Report

Jenny Jeffers, CISA, AES performed an evaluation of the information technology and computer systems of the Reciprocal. Results of the evaluation were noted in the Information Technology Report provided to the Reciprocal.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes and with various state officials as required or permitted by law:

STATE	Description	Par Value	Market Value
FL	Cash	<u>\$ 300,000</u>	<u>\$ 300,000</u>
	TOTAL FLORIDA DEPOSITS	\$ 300,000	\$ 300,000
	TOTAL SPECIAL DEPOSITS	<u>\$ 300,000</u>	<u>\$ 300,000</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Reciprocal's financial position as of December 31, 2009, 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."

STAR & SHIELD INSURANCE EXCHANGE
Assets

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Bonds	\$1,406,764		\$1,406,764
Cash	7,115,827		7,115,827
Invested income due and accrued	8,752		8,752
Agents' Balances:			
Premiums and considerations:			
Uncollected premiums, agents' balances in the course of collections	60,178		60,178
Deferred premiums, agents' balances & Inst. booked but deferred & not yet due	263,607		263,607
	\$8,855,128		\$8,855,128
Totals	\$8,855,128	\$0	\$8,855,128

STAR & SHIELD INSURANCE EXCHANGE
Liabilities, Surplus and Other Funds

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Losses	\$38,199		\$38,199
Loss adjustment expenses	15,646		15,646
Other expenses	75,980		75,980
Taxes, licenses and fees	17,220		17,220
Unearned premium	66,152		66,152
Advance Premiums	14,233		14,233
Ceded Reinsurance Premiums Payable	607,258		607,258
Payable to parent, subsidiaries and affiliates	47,132		47,132
	<hr/>		
Total Liabilities	\$881,820	\$0	\$881,820
Surplus Notes	\$10,000,000		10,000,000
Unassigned funds (surplus)	(2,026,691)		(2,026,691)
	<hr/>		
Surplus as regards policyholders	\$7,973,309		\$7,973,309
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Total liabilities, surplus and other funds	\$8,855,129	\$0	\$8,855,129
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STAR & SHIELD INSURANCE EXCHANGE
Statement of Income

DECEMBER 31, 2009

Underwriting Income	
Premiums earned	(\$938,485)
Deductions:	
Losses incurred	106,838
Loss expenses incurred	26,161
Other underwriting expenses incurred	859,778
Total underwriting deductions	<u>\$992,777</u>
Net underwriting gain or (loss)	(\$1,931,262)
Investment Income	
Net investment income earned	<u>\$7,895</u>
Net investment gain or (loss)	<u>\$7,895</u>
Net income before dividends to policyholders and before federal & foreign income taxes	<u>(\$1,923,367)</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$1,923,367)
Net Income	<u><u>(\$1,923,367)</u></u>
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	
Net Income	(\$1,923,367)
Change in net deferred income tax	304,004
Change in non-admitted assets	(407,328)
Change in excess statutory over statement reserves	
Change in Surplus notes	10,000,000
Change in surplus as regards policyholders for the year	<u>\$7,973,309</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$7,973,309</u></u>

A comparative analysis of changes in surplus is shown below.

STAR & SHIELD INSURANCE EXCHANGE
Comparative Analysis of Changes In Surplus

DECEMBER 31, 2009

The following is a reconciliation of Surplus as regards policyholders between that reported by the Reciprocal and as determined by the examination.

Surplus as Regards Policyholders December 31, 2009, per Annual Statement	\$7,973,309
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			\$0
No Adjustments			
LIABILITIES:			\$0
No Adjustments			
Net Change in Surplus:			<u>\$0</u>
Surplus as Regards Policyholders December 31, 2009, Per Examination			<u>\$7,973,309</u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$53,845

An outside actuarial firm appointed by the Reciprocal, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2009, made a reasonable provision for all unpaid loss and loss expense obligations of the Reciprocal under the term of its policies and agreements.

The Office engaged an independent actuarial firm, Global Insurance Enterprise Inc., to review the Statutory Premium Reserve carried in the Reciprocal's balance sheet as of December 31, 2009 and was not in concurrence with this opinion, based on the opining actuary's decision to reduce the Reciprocal's anticipated Salvage and Subrogation (S&S) of \$47,101 to arrive at the net loss and LAE reserves. **Subsequent event:** After discussion with the opining actuary, he reissued his and refiled with the Office a revised actuarial report which corrected the issue.

Capital and Surplus \$7,973,309

The amount reported by the Reciprocal of \$7,973,309, exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Star & Shield Insurance Exchange**, as of December 31, 2009, consistent with the insurance laws of the State of Florida.

Per examination findings, the Reciprocal's Surplus as regards policyholders was \$7,973,309 in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Maurice Fuller, Examiner and James Pafford, Jr., Financial Examiner/Analyst Supervisor, with the Office and Roshanak Fekrat, CFE, CPA, CIA, Gary Farmer, CPA, CFE, AES, Aram Morvari, MBA, Jenny Jeffers, CISA, AES and Richard Lo, FCAS, MAAA, FCA with Global Insurance Enterprises Inc., participated in the examination.

Respectfully submitted,

Mary M. James
Chief Examiner
Florida Office of Insurance Regulation