

**REPORT ON EXAMINATION**  
**OF**  
**SUNSHINE STATE INSURANCE COMPANY**  
**PONTE VEDRA BEACH, FLORIDA**

**AS OF**  
**DECEMBER 31, 2003**

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

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Tallahassee, Florida  
January 6, 2005

Kevin M. McCarty  
Commissioner  
Office of Insurance Regulation  
State of Florida  
Tallahassee, Florida 32399-0329

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (FS), 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, 2003, of the financial condition and corporate affairs of:

**SUNSHINE STATE INSURANCE COMPANY  
814 A1A NORTH, SUITE 200  
PONTE VEDRA BEACH, FLORIDA 32082-9973**

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, 2001 through December 31, 2003. The Florida Office of Insurance Regulation (Office) last examined the Company as of December 31, 2000. This examination commenced with planning at the Office on November 1, 2004. The fieldwork commenced on November 3, 2004 and was concluded as of January 7, 2005. 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 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 (FAC), 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 and the Company's independent audit reports 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, 2003. Transactions subsequent to year-end 2003 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination was 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, 2000, along with resulting action taken by the Company in connection therewith.

#### **General and Management**

The Company did not amend its Articles of Incorporation and By-Laws to reflect its present corporate address.

**Resolution:** The Company amended its Articles of Incorporation to reflect its correct address.

#### **Managing General Agent (MGA) Agreement**

On June 9, 2000, the MGA agreement was amended to state that Sunshine State Holding Corporation would handle claims processing. The Company did not request approval from the Office as required by Consent Order 21501-97-C.

**Resolution:** The Company subsequently requested and obtained permission from the Office.

## HISTORY

### General

The Company was incorporated November 4, 1997, under the laws of the State of Florida, as a stock property and casualty insurer. The Company commenced business on November 21, 1997, as Sunshine State Insurance Company.

In accordance with Section 624.401(1), FS, the Company was authorized to transact insurance coverage in the State of Florida for the following lines:

- Fire
- Allied Lines
- Home Owners Multi-Peril
- Inland Marine
- Other Liability

The Company did not write fire or other liability types of business during 2003. This was not in compliance with Section 624.430(1), FS.

### Capital Stock

As of December 31, 2003, the Company's capitalization was as follows:

Number of authorized common capital shares	5,000,000
Number of shares issued and outstanding	1,000
Total common capital stock	\$ 2,000,000
Par value per share	\$ 2,000.00

The Company listed the par value of its common shares at \$2,000. This par value amount is not in compliance with Section 628.081(3)(d), FS, which limits the maximum par value of capital stock to \$100.00.

The Company was 100 percent owned by Sunshine State Holding Corporation (SSHC), a Delaware corporation. SSHC was in turn owned by the following:

Arch Reinsurance Company	21.288%
The Seibels Bruce Group, Inc.	21.288%
**X.L. Re, Ltd.	21.288%
Fenelon Ventures, LLC	15.183%
Insurance Group of Brevard	12.136%
Management	<u>8.817%</u>
	<u>100.000%</u>

\*\* Foreign investor located in Bermuda.

### **Profitability of Company**

As of December 31, 2003, the Company reported an underwriting loss and net loss of \$413,666 and \$81,452, respectively.

The Company's surplus for 2001, 2002, and 2003 was \$5,374,168, \$6,150,487, and \$6,053,274 respectively. The Company stated that the cost of reinsurance had a material impact on the Company's operations. Also, the Company did not have a quota share reinsurance agreement in effect to offset the Company's increase in premiums written. This had a material impact on the Company's Risk Based Capital level.

### **Risk-Based Capital (RBC)**

The Company's RBC is 1.58, which is less than the 2.0 minimum required by Section 624.4085(3)(a), FS, and placed the Company at a company action level.

## **Dividends to Stockholders**

The Company did not declare or pay dividends during this examination period.

## **Management**

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. Directors serving as of December 31, 2003, were:

### **Directors**

<b>Name and Location</b>	<b>Principal Occupation</b>
Bruce K. Howson Ponte Vedra Beach, FL	Chairman/President Sunshine State Insurance Company
Robert L. Nason Stamford, CT	Vice President, Director SSHC/SSIC XL Global Services, Inc.
Joseph N. King Morristown, NJ	Vice President, Director SSHC/SSIC Arch Reinsurance Company
Brian R. McGuire New York, NY	Vice President, Director SSHC/SSIC U.S. Re Corporation
Franklin D. Hutchinson Columbia, SC	Vice President, Director SSHC/SSIC The Seibels Bruce Group, Inc.

In accordance with the Company's bylaws, the board of directors appointed the following senior officers:

### **Senior Officers**

<b>Name</b>	<b>Title</b>
Bruce K. Howson	President
Richard L. Ervin, Jr.	Treasurer/Secretary
Michael R. Cratem	Vice President

John E. Rogan

Vice President

Jeffery Alan Vanderpool

Vice President

The Company's Board appointed internal committees in accordance with Section 607.0825, FS.

The Board also established an audit committee in accordance with Section 624.424 (8), FS.

The following are members of the committees as of December 31, 2003:

**Compensation Committee**

**Investment Committee**

**Audit Committee**

Franklin D. Hutchinson  
Joseph N. King

Joseph N. King  
Franklin D. Hutchinson  
Robert L. Nason  
Bruce K. Howson  
Richard L. Ervin

Brian R. McGuire  
Robert L. Nason  
Franklin D. Hutchinson

**Conflict of Interest Procedure**

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

**Corporate Records**

The recorded minutes of the shareholder, board of directors, and committee meetings 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, FS, including the authorization of investments as required by Section 625.304, FS.

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

There were no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance.

### **Subsequent Event:**

The Company was approved by the Office on December 31, 2004 to merge with QualSure Insurance Corporation and to file one annual statement for the surviving entity, the Company, for the year ended December 31, 2004.

### **Surplus Debentures**

The Company had no surplus debentures at December 31, 2003.

## **AFFILIATED COMPANIES**

The Company was a member of an insurance holding company system as defined by Rule 690-143-045(3), FAC. The latest holding company registration statement was filed with the State of Florida, with an effective date of January 1, 2004, as required by Section 628.801, FS, and Rule 690-143.046, FAC.

On December 31, 2003, the following agreements were in effect between the Company and its affiliates:

### **Tax Allocation Agreement**

The Company, along with its parent, filed a consolidated federal income tax return. As of December 31, 2003, the method of allocation between the Company and its parent was based upon a separate return calculation. An inter-company tax balance was established and was to be settled upon completion of the final consolidated federal income tax return.

### **Management Agreement**

The Company had a management agreement in place since December 31, 2000 with its parent. The agreement called for the Company to pay the parent for services rendered, including: administrative, reinsurance, marketing, data processing, accounting, and all other miscellaneous services that would be incidental to the operation of an insurance company. The parent received a fee based on 2% of direct written premium, less return and cancellation premium.

### **Managing General Agent (MGA) Agreement**

The Company had been under an agreement with its parent, SSHC and Apex Managers, Inc., (Apex) since November 26, 1997, to provide services in connection with the operations of the Company. These services include policy issuance, premium billing and collection, commission handling and claims processing.

The Company, in consideration for the services rendered, agreed to pay Apex a \$25.00 per policy MGA fee plus a percentage of premium such that the total compensation equaled 8% of written premium; plus a loss adjustment expense equal to 7% of earned premium. On June 9, 2000, this 7% was reduced to 3%, to reflect the change in claims handling. In addition, Apex was compensated for applications, renewals and endorsements handled directly with the

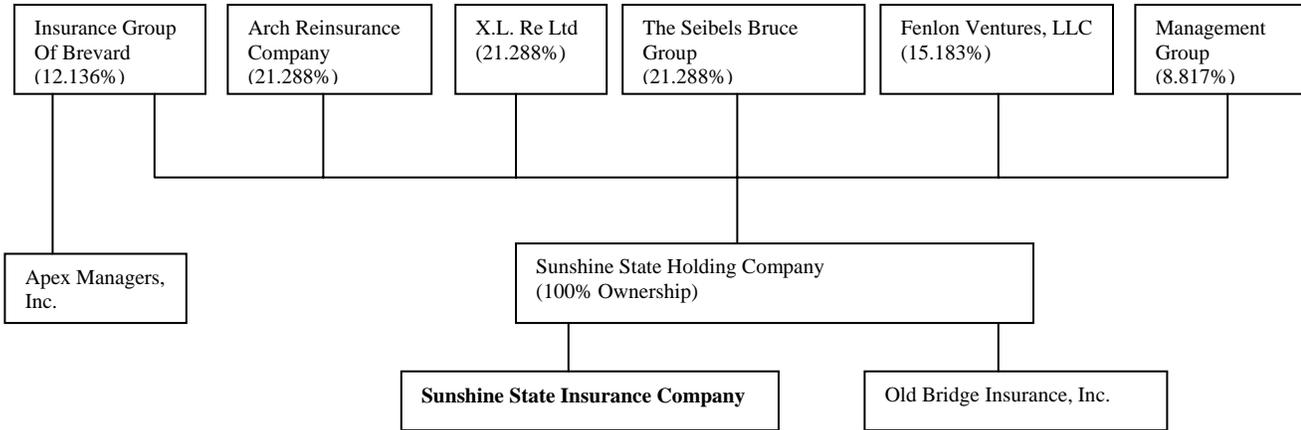
insured at the rate of 5% of written premium. Apex was a wholly owned subsidiary of The Insurance Group of Brevard, which owned 12% of SSHC.

A simplified organizational chart as of December 31, 2003 reflecting the holding company system is shown below. Schedule Y of the Company's 2003 annual statement provided a list of all related companies of the holding company group.

**SUNSHINE STATE INSURANCE COMPANY**

**ORGANIZATIONAL CHART**

**DECEMBER 31, 2003**



## FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$1,000,000 with a deductible of \$100,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC. The Company maintained other insurance coverage usual to the operation of an insurer.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no employees.

## STATUTORY DEPOSITS

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

<b>State</b>	<b>Description</b>	<b>Par Value</b>	<b>Market Value</b>
FL	Union Electric Company	<u>\$ 460,000</u>	<u>\$ 472,998</u>
TOTAL FLORIDA DEPOSITS		\$ 460,000	\$ 472,998
SC	Certificate of Deposit	<u>\$ 125,000</u>	<u>\$ 125,000</u>
TOTAL OTHER DEPOSITS		\$ 125,000	\$ 125,000
TOTAL SPECIAL DEPOSITS		<u>\$ 585,000</u>	<u>\$ 597,998</u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operation**

At December 31, 2003, the Company was authorized to transact insurance in Florida only in accordance with Section 624.401(2), FS:

### **Treatment of Policyholders**

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS. The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim.

## **REINSURANCE**

The reinsurance agreements were reviewed for compliance with NAIC standards with respect to the standard insolvency clause, arbitration clause, and transfer of risk, reporting and settlement information deadlines.

### **Assumed**

During 2003, the Company did not assume risk.

### **Ceded**

During 2003, the Company ceded risk as follows:

### **Excess of Loss Agreement**

The Company ceded risk through excess of loss treaties with various reinsurers. U.S. Re was the intermediary for these reinsurance treaties. Appropriate letters of credit were secured with X.L. Re,

ACE and SPS Reinsurance. The Company also reinsured under 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.

The Company provided documentation as to whether reinsurance contracts provided adequate transfer of risk in both underwriting and timing aspects.

### **ACCOUNTS AND RECORDS**

An independent CPA audited the Company's statutory basis financial statements annually for the years 2001, 2002 and 2003, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-4-137.002, FAC.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

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

The Company and non-affiliates had the following in-force agreements:

**Custodial Agreement**

The Company amended its custodial agreement with Fleet National Bank on January 18, 2001. The amended agreement met the requirements of Rule 69O-143.042, FAC.

**Investment Management Agreement**

On April 12, 2000, the Company entered into an asset management agreement with General Re – New England Asset Management, Inc. for investment advice, portfolio management, and investment accounting and reporting services for an annual fee, paid quarterly in arrears. The annual fees payable by the Company were calculated on the basis points assessed to asset value at the close of the billing period at 0.2% of the first \$50 million and 0.15% in excess of \$50 million, payable quarterly.

**FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2003, 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."

**SUNSHINE STATE INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2003**

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$17,191,504		\$17,191,504
Cash:			
On deposit	6,884,488		6,884,488
Short-term investments	717,376		717,376
Investment income due and accrued	189,303		189,303
Agents' Balances:	639,158		639,158
Reinsurance recoverable	271,375		271,375
Federal income tax recoverable	140,306		140,306
Net deferred tax asset	996,749		996,749
EDP Equipment	19,723		19,723
Aggregate write-in for other than invested assets	9,876		9,876
Totals	<u>\$27,059,858</u>	<u>\$0</u>	<u>\$27,059,858</u>

**SUNSHINE STATE INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2003**

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$4,386,298		\$4,386,298
Loss adjustment expenses	626,683		626,683
Commissions payable, contingent commissions	232,015		232,015
Other expenses	45,966		45,966
Taxes, licenses and fees	47,224		47,224
Unearned premium	13,060,431		13,060,431
Ceded reinsurance premiums payable	911,997		911,997
Provision for reinsurance	28,312		28,312
Payable to parent, subsidiaries and affiliates	366,441		366,441
Aggregate write-ins for liabilities	1,301,217		1,301,217
Total Liabilities	\$21,006,584		\$21,006,584
Common capital stock	\$2,000,000		\$2,000,000
Gross paid in and contributed surplus	3,750,000		3,750,000
Unassigned funds (surplus)	303,274		303,274
Surplus as regards policyholders	\$6,053,274		\$6,053,274
Total liabilities, capital and surplus	\$27,059,858	\$0	\$27,059,858

**SUNSHINE STATE INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2003**

**Underwriting Income**

Premiums earned	\$19,085,179
DEDUCTIONS:	
Losses incurred	7,228,235
Loss expenses incurred	2,043,413
Other underwriting expenses incurred	10,227,197
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$19,498,845</u>
Net underwriting gain or (loss)	(\$413,666)

**Investment Income**

Net investment income earned	\$453,214
Net realized capital gains or (losses)	(47)
Net investment gain or (loss)	<u>\$453,167</u>

**Other Income**

Aggregate write-ins for miscellaneous income	\$65,740
Total other income	<u>\$65,740</u>
Net income before dividends to policyholders and before federal & foreign income taxes	\$105,241
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$105,241
Federal & foreign income taxes	<u>186,693</u>
Net Income	(\$81,452)

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year	\$6,150,488
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**Gains and (Losses) in Surplus**

Net Income	(\$81,452)
Change in net unrealized capital gains or losses	0
Change in non-admitted assets	(177,631)
Change in provision for reinsurance	24,690
Change in deferred income tax	137,179
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>(\$97,214)</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$6,053,274</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

<b>Losses and Loss Adjustment Expenses</b>	<b><u>\$5,012,981</u></b>
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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, 2003 make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

**SUNSHINE STATE INSURANCE COMPANY  
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

**DECEMBER 31, 2003**

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, 2003, Annual Statement	\$6,053,274
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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>
<b>ASSETS:</b>			
No adjustment needed.			
<b>LIABILITIES:</b>			
No adjustment needed.			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2003, Per Examination			\$6,053,274

## SUMMARY OF FINDINGS

### **Compliance with previous directives**

The Company has taken the all the necessary actions to comply with the comments made in the 2000 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, 2003.

### **Risk Based Capital**

The Company's RBC level was less than the level allowed by Section 624.4085(3)(a), FS. **It is recommended that the Company monitor its RBC level and continue to take appropriate actions to maintain the minimum of 2.0 level required.**

### **Lines of Business**

The Company was not in compliance with Section 624.430(1), FS. **It is recommended that the Company either write fire and other liability lines of business or request that these two lines be removed from its Certificate of Authorization.**

### **Par Value of Capital Stock**

The Company was not in compliance with Section 628.081(3)(d), FS. **It is recommended that the Company restate its par value and outstanding shares to be in compliance with Section 628.081(3)(d), FS.**

## **SUBSEQUENT EVENTS**

- The Company submitted the following plan to the Office to bring its RBC to a satisfactory level: On March 1, 2004, the Company executed a 25% quota share reinsurance treaty with Aspen Reinsurance Company, an authorized reinsurer in the State of Florida. The quota share treaty covered the Company's homeowners' line of business and had a 40% fixed ceding commission.
  
- On January 1, 2004, the Company entered into a MGA agreement with its parent, SSHC. The contract with Apex Managers was terminated effective December 31, 2003.
  
- On July 20, 2004, Qualsure Insurance Corporation (Qualsure), a Florida domestic insurer, acquired the Company's parent, SSHC. The Office approved the acquisition on June 30, 2004.
  
- On November 19, 2004, the Company submitted an application to merge with Qualsure. The application also included the appropriate filing fees and articles of merger. The merged company was to retain the name as Sunshine State Insurance Company. Each common share of Qualsure was to be converted to 100 share of SSHC common stock, amounting to \$2,000,000.
  
- On January 3, 2005, the Office approved the merger of Qualsure and the Company. The consent order among the Office, Qualsure, and the Company required that Qualsure obtain an infusion of new capital in the amount of \$2,425,000 on or before January 3, 2005 and

another \$3,075,000 by January 7, 2005. Qualsure received the \$2,425,000 on January 3, 2005 and the \$3,075,000 was received by January 7, 2005.

- In January 2005, the Company restated the par value of its common stock to comply with Florida Statutes.
- During 2004, four major hurricanes have impacted the insurance industry in the State of Florida. These hurricanes occurred subsequent to the period of this examination and may have affected the Company's financial position. This examination does not include any assessment of the potential impact on the Company of the hurricanes; however, based upon preliminary information, anticipated losses are not expected to result in regulatory violations.

## **CONCLUSION**

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of SUNSHINE STATE INSURANCE COMPANY as of December 31, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$6,053,274, which was in compliance with Section 624.408, FS.

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

Respectfully submitted,

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James D. Collins  
Financial Examiner/Analyst II  
Florida Office of Insurance Regulation