

**REPORT ON EXAMINATION**  
**OF**  
**TOWER HILL SELECT INSURANCE**  
**COMPANY**

**GAINESVILLE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2006**

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

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Tallahassee, Florida

March 25, 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, 2006, of the financial condition and corporate affairs of:

**TOWER HILL SELECT INSURANCE COMPANY  
7201 NW 11<sup>TH</sup> PLACE  
GAINESVILLE, FLORIDA 32605**

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, 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 August 27, 2007, to August 31, 2007. The fieldwork commenced on September 4, 2007, and was concluded as of March 26, 2008.

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 as of December 31, 2006. Transactions subsequent to year-end 2006 were reviewed where relevant and deemed significant to the Company's financial condition.

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 A.M. Best Report, 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.

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:

Other invested assets  
Other expenses  
Taxes, licenses and fees

### **Status of Adverse Findings from Prior Examination**

There were no significant adverse findings contained in the Office's prior examination report as of December 31, 2005.

## **HISTORY**

### **General**

The Company is a domestic insurer that was licensed to write insurance only in the State of Florida. It incorporated on April 16, 2004 and commenced writing business on June 24, 2004 with the issuance of their Certificate of Authority as an authorized domestic insurer in the State of Florida. The Company was to transact the following insurance coverage in Florida on December 31, 2006:

Fire  
Homeowners multi-peril

Allied lines  
Inland marine

Tower Hill Holdings, Inc. (Parent) owned 100% of the Company. As of December 31, 2006 the Company was not rated by A.M. Best or by Standard & Poor's.

### **Capital Stock**

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

Number of authorized common capital shares	100,000
Number of shares issued and outstanding	100,000
Total common capital stock	\$100,000
Par value per share	\$1.00

The Company was party to Consent Orders 75375-04-CO filed March 25, 2004, 76793-04-CO filed June 24, 2004 and 80666-05 filed March 24, 2005 with the Office regarding the issuance of a permit, the application for the issuance of a certificate of authority and the application for an indirect acquisition of the Company.

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

### **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>2006</b>	<b>2005</b>	<b>2004</b>
Premiums Earned	25,748,898	6,581,745	463,174
Net Underwriting Gain/(Loss)	(7,458,032)	(28,735)	(334,752)
Net Income	(5,536,210)	58,614	(371,475)
Total Assets	63,749,356	34,265,850	14,111,629
Total Liabilities	47,276,868	20,246,638	8,327,523
Surplus As Regards Policyholders	16,472,488	14,019,212	5,784,106

### **Dividends to Stockholders**

In accordance with Section 628.371, Florida Statutes, the Company declared and paid no 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**

##### **Principal Occupation**

William J. Shively  
Gainesville, Florida

CEO, Tower Hill Insurance Group, Inc.

Phillip M. Thomasson  
Gainesville, Florida

President, Tower Hill Select Insurance Co.

Donald C. Matz, Jr.  
Gainesville, Florida

President, Tower Hill Insurance Group, Inc.

Keyton Benson  
Gainesville, Florida

Chief Claims Officer  
Tower Hill Insurance Group, Inc.

Joel P. Curran  
Gainesville, Florida

Chief Underwriting Officer  
Tower Hill Insurance Group, Inc.

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

#### **Senior Officers**

<b>Name</b>	<b>Title</b>
William J. Shively	Chief Executive Officer
Phillip M. Thomasson	President
Donald C. Matz, Jr.	Chief Operating Officer and Secretary

The Company's Board appointed an internal committee in accordance with Section 607.0825, Florida Statutes. Following is the principal internal board committee and its members as of December 31, 2006:

#### **Audit Committee**

William J. Shively <sup>1</sup>  
Phillip M. Thomasson  
Donald C. Matz, Jr.  
<sup>1</sup> Chairman

The audit committee was comprised solely of management which was not considered independent in accordance with Section 624.424(8), Florida Statutes.

#### **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 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**

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

## **Surplus Debentures**

As of December 31, 2006, there were no outstanding debentures of the Company.

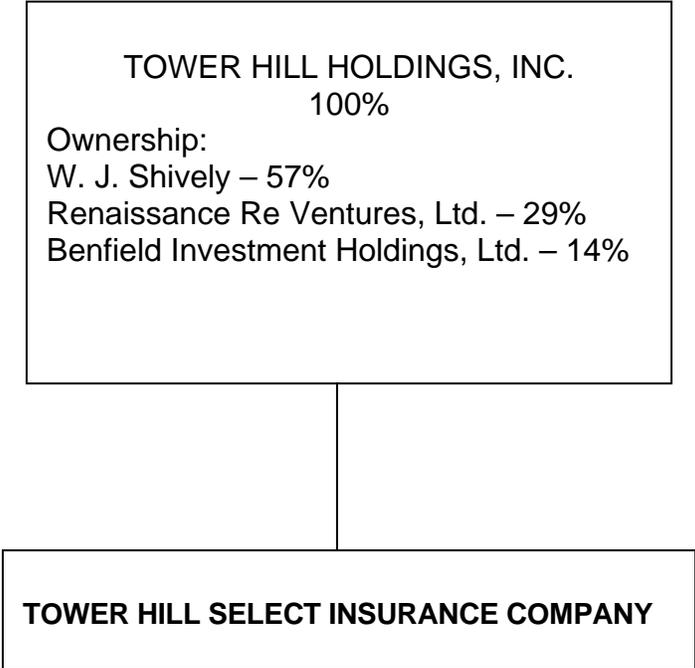
## **AFFILIATED COMPANIES**

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 September 30, 2006, 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.

**TOWER HILL SELECT INSURANCE COMPANY  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2006**



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. On December 31, 2006, the method of allocation between the Company and its parent was to be equal to the amount the Company would have paid had the Company filed an independent tax return.

### **Claims Services Agreement**

The claims services agreement was with Tower Hill Claims Service, Inc., an affiliated company. The agreement included the management, adjustment, payment request and other various claims administrative duties as necessary, other than those services administrated under the managing general agency agreement.

### **Management Agreement**

The management services agreement was with the Company's parent. The agreement included the coordination of the activities of the Company, development of corporate plans, legal counsel, executive management, internal auditing management, contract negotiations/approval and other such services as deemed necessary.

### **Managing General Agent Agreement**

The managing general agent (MGA) agreement was with Tower Hill Insurance Group, Inc., an affiliated company. The agreement services included the management and direct oversight of the production of business for the underwriting and policy administration functions. Additionally, the MGA facilitated the payment of claims and other various accounting, reporting and administrative functions.

## FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$3,100,000 with a deductible of \$50,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC Financial Condition Examiners Handbook.

The Company had no employees or physical assets requiring additional insurance coverages.

## PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

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

## 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	CD	<u>\$ 300,000</u>	<u>\$ 300,654</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 300,000</u>	<u>\$ 300,654</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 300,000</u>	<u>\$ 300,654</u>

## **INSURANCE PRODUCTS**

### **Territory**

The Company was licensed to transact insurance coverage in the State of Florida only.

### **Treatment of Policyholders**

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

The claims services company, Tower Hill Claims Services, Inc. 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 no risk during the examination period.

### **Ceded**

The Company ceded risk on both a quota share and excess of loss basis. The cash flow analysis performed on the quota share agreement indicated that there was a transfer of risk within the terms of the reinsurance contract. This agreement terminated on May 31, 2006.

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 Gainesville, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the year 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:

### **Custodial Agreement**

The Company had a custodial agreement with Wachovia Bank which contained all necessary elements required in Rule 69O-143.042(2), Florida Administrative Code.

### **Independent Auditor Agreement**

The Company had an independent auditor agreement for the year 2006 with KPMG LLP of Atlanta, Georgia.

## **Information Technology Report**

Tracy D. Gates, CISA, CPA, of Highland Clark, LLC, performed a computer systems evaluation on the Company. Results of the evaluation were noted in the information technology (IT) report provided to the Company. A summary of significant findings with recommendations were as follows:

1. The Company performed a disaster recovery test of their Border Gateway Protocol but not of other computer applications and hardware. Recommendation - Management should complete disaster recovery tests of all computer applications and hardware.
2. The Company had not developed and issued a formal policy on Security Responsibilities of users, management and security administration. Recommendation - The Company should develop and issue a formal policy on Security Responsibilities of users, management and security administration.
3. The Company had not yet completed the development of a comprehensive Business Continuity/Recovery Plan. Recommendation - The Company should complete the development of a comprehensive Business Continuity/Recovery Plan.

## **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."

**TOWER HILL SELECT INSURANCE COMPANY**  
**Assets**  
**DECEMBER 31, 2006**

	Per Company	Examination Adjustments	Per Examination
Cash:	\$43,813,350		\$43,813,350
Agents' Balances:			
Uncollected premium	14,347,899		14,347,899
Deferred premium			
Reinsurance recoverable	1,613,693		1,613,693
Interest and dividend			
income due & accrued	183,942		183,942
Current federal tax recoverable	280,000		280,000
Net deferred tax asset	1,360,000		1,360,000
Guarantee funds receivable	2,157,172		2,157,172
Aggregate write-in for other than invested assets	(6,700)		(6,700)
	<hr/>		
Totals	\$63,749,356	\$0	\$63,749,356
	<hr/> <hr/>		

**TOWER HILL SELECT INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2006**

	Per Company	Examination Adjustments	Per Examination
Losses	\$5,312,063		\$5,312,063
Loss adjustment expenses	242,143		242,143
Other expenses	50,550		50,550
Taxes, licenses and fees	1,417,728		1,417,728
Current federal income tax	351,988		351,988
Unearned premium	20,239,110		20,239,110
Ceded reinsurance premiums payable	19,499,981		19,499,981
Amounts withheld	20,186		20,186
Payable to parent, subsidiaries and affiliates	143,119		143,119
<b>Total Liabilities</b>	<b>\$47,276,868</b>	<b>\$0</b>	<b>\$47,276,868</b>
Common capital stock	\$100,000		\$100,000
Gross paid in and contributed surplus	20,900,000		20,900,000
Unassigned funds (surplus)	(4,527,512)		(4,527,512)
<b>Surplus as regards policyholders</b>	<b>\$16,472,488</b>		<b>\$16,472,488</b>
<b>Total liabilities, surplus and other funds</b>	<b>\$63,749,356</b>	<b>\$0</b>	<b>\$63,749,356</b>

**TOWER HILL SELECT INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2006**

<b>Underwriting Income</b>		
Premiums earned		\$25,748,898
	<b>Deductions:</b>	
Losses incurred		11,731,395
Loss expenses incurred		933,398
Other underwriting expenses incurred		20,542,137
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		<u>\$33,206,930</u>
Net underwriting gain or (loss)		(\$7,458,032)
<b>Investment Income</b>		
Net investment income earned		\$1,647,310
Net realized capital gains or (losses)		0
Net investment gain or (loss)		<u>\$1,647,310</u>
<b>Other Income</b>		
Total other income		\$0
Net income before dividends to policyholders and before federal & foreign income taxes		(\$5,810,722)
Net Income, after dividends to policyholders, but before federal & foreign income taxes		(\$5,810,722)
Federal & foreign income taxes		<u>(274,512)</u>
Net Income		(\$5,536,210)
<b>Capital and Surplus Account</b>		
Surplus as regards policyholders, December 31 prior year		\$14,019,212
Net Income		(\$5,536,210)
Change in net deferred income tax		1,695,600
Change in non-admitted assets		(753,114)
Change in provision for reinsurance		47,000
Surplus adjustments: Paid in		7,000,000
Examination Adjustment		0
Change in surplus as regards policyholders for the year		<u>\$2,453,276</u>
Surplus as regards policyholders, December 31 current year		<u><u>\$16,472,488</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Assets

#### Agent's Balances

\$14,347,899

The Agent's Balances of the Company were not being held in a fiduciary capacity in trust accounting, in accordance with Section 12(e) of Consent Order 76793-04-CO, Section 625.012(5)(a), Florida Statutes and the Company's General Agency Agreement.

The Agent's Balances of the Company were being held by a controlling person and not being remitted to the Company within 15 days of collection as required by Section 625.012(5)(a)1, Florida Statutes.

### Liabilities

#### Losses and Loss Adjustment Expenses

\$5,554,206

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, 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.

**Catastrophe (CAT) Reserve**\$0

The Company had not given consideration to conflagration or catastrophe hazards in its rates or rating plan, including surcharges and discounts, or established a reserve for that portion of the premium allocated to such hazard and shall maintain the premium in a catastrophe reserve, in accordance with Section 627.062(2)(b)(13)(d), Florida Statutes.

**Capital and Surplus**

The amount reported by the Company of \$16,472,488, exceeds the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

A Comparative analysis of changes in surplus is shown below.

**TOWER HILL SELECT INSURANCE COMPANY  
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	\$16,472,488
----------------------------------------------------------------------------	--------------

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS;			
No adjustments			
LIABILITIES;			
No adjustments			
Net Change in surplus			\$0
Surplus as Regards Policyholders December 31, 2006, Per Examination			\$16,472,488

## SUMMARY OF FINDINGS

### Compliance with previous directives

There were no significant adverse Findings contained in the Office's prior examination report as of December 31, 2005.

### 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:

### Management

The Company's audit committee was comprised solely of management. This was not considered independent. **We recommend that the Company comply with Section 624.424(8), Florida Statutes, as regards audit committee independence.**

### Agent's Balances

The MGA held the premiums collected rather than the Company depositing the money in a bank. Also, the MGA remitted the Agent's Balances within 45 days of collection. **We recommend the Company comply with Section 625.012(5)(a), Florida Statutes, and hold the premiums collected in a bank or other depository approved by the Office. The Statute requires the MGA to remit the Agent's Balance within 15 days of collection.**

## **CAT Reserve**

The Company has not given consideration to conflagration or catastrophe hazards in its rates or rating plan, including surcharges and discounts, or established a reserve for that portion of the premium allocated to such hazard and shall maintain the premium in a catastrophe reserve, in accordance with Section 627.062(2)(b)(13)(d), Florida Statutes. **We recommend that the Company give consideration to conflagration or catastrophe hazards in its rates or rating plan, including surcharges and discounts, and establish a reserve for that portion of the premium allocated to such hazard and maintain the premium in a catastrophe reserve, in accordance with Section 627.062(2)(b)(13)(d), Florida Statutes.**

## **Internal Controls**

The Company performed a failover test of their Border Gateway Protocol but not of other computer applications and hardware. Disaster recovery tests of all computer applications and hardware should be completed. **We recommend that the Company complete disaster recovery tests of all computer applications and hardware to comply with the IT report.**

The Company had not developed and issued a formal policy on Security Responsibilities of users, management and security administration. **We recommend that the Company develop and issue a formal policy on Security Responsibilities of users, management and security administration to comply with the IT report.**

The Company had not yet completed the development of a comprehensive Business Continuity/Recovery Plan. **We recommend that the Company complete the development of a comprehensive Business Continuity/Recovery Plan to comply with the IT report.**

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Tower Hill Select Insurance Company** 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 \$16,472,488, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Michael Hampton, CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor, John Berry, Financial Examiner/Analyst Supervisor, James Collins, Reinsurance/Financial Specialists and Joe Boor, FCAS, Office Actuary, participated in the examination. We also recognize Highland Clark, LLC's participation in the examination.

Respectfully submitted,

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Roger P. Kelley  
Financial Examiner/Analyst II  
Florida Office of Insurance Regulation