REPORT ON EXAMINATION

OF

FLORIDA SELECT INSURANCE COMPANY

SARASOTA, FLORIDA

AS OF

DECEMBER 31, 2002

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida
April 2, 2004

Kevin M. McCarty
Director
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 (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, 2002, of the financial condition and corporate affairs of:

FLORIDA SELECT INSURANCE COMPANY
1819 MAIN STREET, SUITE 700
SARASOTA, FL 34236

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, 2000 through December 31, 2002. This examination commenced with planning at the Office, on January 20, 2004 through January 23, 2004. The fieldwork commenced on January 26, 2004, and was concluded as of April 2, 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 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, 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, 2002. Transactions subsequent to year-end 2002 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.

Status of Adverse Findings from Prior Examination

The prior examination findings were as follows:

The Company did not maintain an audit committee as required by Section 624.424(8), FS.

Resolution: The Company appointed an audit committee at the February 16, 2000, board of director meeting and has maintained an audit committee thereafter.

The Company did not write insurance coverage in glass and industrial fire.

Resolution: The Company had such lines removed from its certificate of authority.

The Company's tax allocation agreement and expense sharing agreement referenced terms such as "reasonable time" and "equitable basis". The Company was directed to amend such agreements by March 31, 2001.

Resolution: The tax allocation agreement was replaced with a new agreement eliminating the ambiguous terms, as a result of the acquisition of the Company by Vesta Fire Insurance

Corporation. No evidence was provided by the Company that the expense sharing agreement was amended.

The Company did not maintain fidelity bond coverage in the amount recommended by the NAIC.

Resolution: The Company maintained the NAIC's recommended amount of fidelity bond coverage in 2002.

HISTORY

General

The Company was incorporated in Florida on May 29, 1996, and commenced business on August 16, 1996, as Florida Select Insurance Company. The Company was formed as part of the depopulation plan of the Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA). Under the terms of the FRPCJUA depopulation plan, a specified amount per policy assumed would be paid to the Company if certain criteria and conditions were complied with for a period of three years following the assumption date. During 2002, the Company received its final payment from the FRPCJUA.

The Company was the wholly owned subsidiary of Florida Select Insurance Holdings, Inc. (FSIH). FSIH was a subsidiary of Vesta Fire Insurance Corporation (VFI), which was ultimately owned by Vesta Insurance Group, Inc. (VIG).

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2002:

Fire	Allied Lines
Homeowners Multi Peril	Inland Marine
Earthquake	Other Liability
Burglary and Theft	Mobile Home Multi Peril

Mobile Home Physical Damage

The Company was authorized to write policies in the states of Florida, South Carolina, Texas and Virginia. In 2002, the Company did not write policies in Virginia or Texas.

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

Capital Stock

As of December 31, 2002, the Company's capitalization was as follows:

Number of authorized common capital shares	25,000
Number of shares issued and outstanding	25,000
Total common capital stock	$2,500,000
Par value per share	$100.00

Effective April 1, 2001, VFI acquired all the outstanding shares of FSIH.

Profitability of Company

The Company reported direct premiums of $74,712,557, which were 100% ceded to VFI. The Company reported net income after taxes of $2,963,195. This amount was an increase from a reported net income of $30,061 in 2001.

Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2002.

Management

The annual shareholder meeting for the election of directors was held in accordance with Section 607.1601 and 628.231, FS. Directors serving as of December 31, 2002, were:

Directors

Name and Location	Principal Occupation
Steven A. Korducki Minneapolis, MN	Director President, Florida Select Insurance Group
Ricardo A. Espino (1) Sarasota, FL	Director CFO of FSIH
Walter M. Lefler Sarasota, FL	Director VP and Chief Underwriting Officer, Florida Select Insurance Company President, Florida Select Insurance Agency
Hopson B. Nance Birmingham, AL	Director
John W. McMullough Birmingham, AL	Director

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

Senior Officers

Name	Title
Stephen A. Korducki	President
Ricardo A. Espino (1)	Treasurer
Mitchel J. Krouse (2)	Secretary

(1) Resigned effective July 2003.

(2) Resigned effective April 2004.

In December of 2000, the Company's board appointed an audit and investment committee in accordance with Section 607.0825, FS. Following are the principal internal board committees and their members as of December 31, 2002:

Audit Committee	**Investment Committee**
David Wasserman	David Wasserman
David Watkins	David Watkins
John Fitzpatrick	John Fitzpatrick
John G. Richards	John G. Richards
Stephen A. Korducki	Stephen A. Korducki

The Company stated that VIG created duties of the audit and investment committees in 2002. The Company did not provide any minutes by the board of directors that permitted VIG to authorize investments or take over the duties of the Company's audit committee, a violation of Section 625.304 and 607.1601(1), FS.

Conflict of Interest Procedure

The Company provided executed Conflict of Interest Statements from all the directors and officers except for two of the directors. This is in violation of Rule 69O-138.001(1), FAC.

Corporate Records

The recorded minutes of the shareholder and Board of Director's 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, with the exception of the assumption of the duties by the parent, as noted above.

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

Effective April 1, 2001, VFI, a wholly owned subsidiary of VIG, acquired all of the outstanding shares of FSIH, the parent of the Company. The Florida Select Insurance Agency, Inc., was sold by VFI to its affiliate, J. Gordon Gaines, also a wholly owned subsidiary of VIG, on September 30, 2001.

Surplus Debentures

The Company had no surplus debentures.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on January 14, 2003, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

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

Tax Allocation Agreement

The Company, along with its parent and various affiliated companies, filed a consolidated federal income tax return. The agreement, dated June 28, 1995, was between VIG and various corporations. The Company was added to the agreement by amendment on January 22, 2002. The parent and each of the subsidiaries of the affiliated group of companies were permitted to file a consolidated federal income tax return pursuant to the terms of Section 1504 of the Internal Revenue Code of 1986.

The Company was not following the repayment schedule contained in their tax allocation agreement, in violation of Rule 69O-143.047, FAC. The agreement called for each subsidiary to make periodic payments of estimated tax to the parent no later than the dates on which the payments of estimated tax would have been paid by the subsidiary. The tax payment was not made to the parent by the Company; instead, Florida Select Insurance Agency, Inc. (FSIA) made the payment on behalf of the Company.

Cost Sharing Agreement

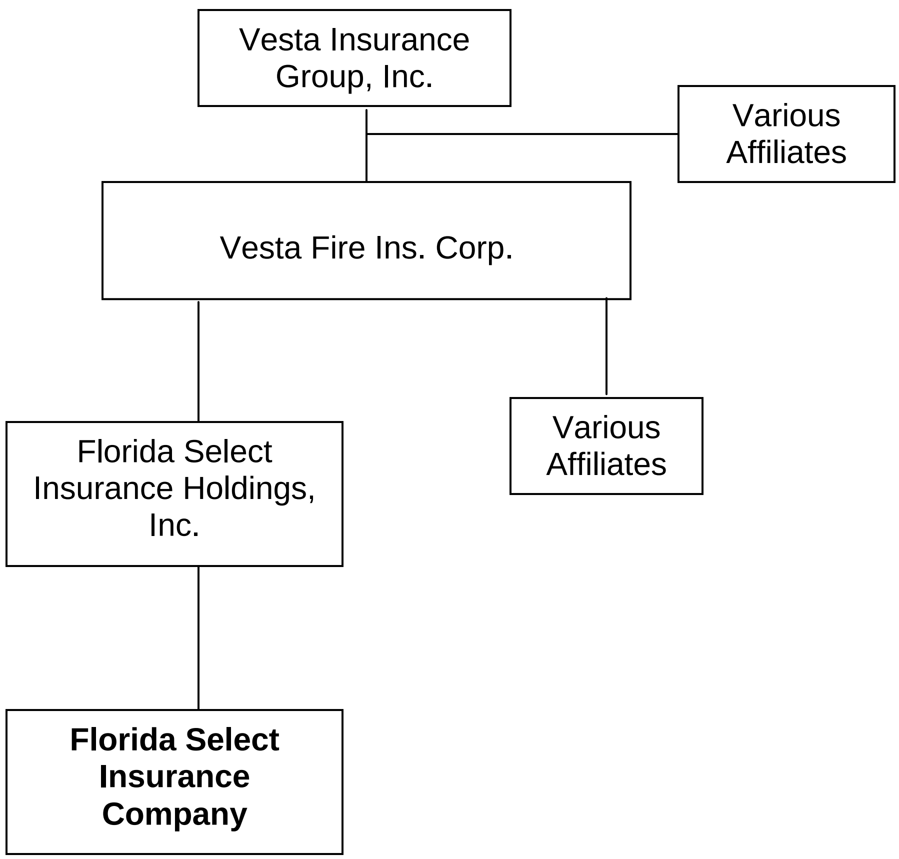
The Company maintained an expense sharing agreement, dated May 29, 1996, between the Company, FSIA and FSIH. The companies shared certain expenses to reduce the overall operating and administrative expenses of each party, subject to the terms and conditions of this agreement.

MGA Agreement

The Company entered into a managing general agency agreement with FSIA who provided underwriting, production, reinsurance placement, and marketing services for the Company as its managing general agent. The Company maintained agency agreements as a co-party to the agreements with FSIA.

An organizational chart as of December 31, 2002, reflecting the holding company system is shown below. Schedule Y of the Company's 2002 annual statement provided a list of all related companies of the holding company group, in compliance with Rule 69O-137.001(4), FAC. The Company did not list all income tax amounts resulting from inter-company tax sharing arrangements on Schedule Y, Part 2, in violation of Rule 69O-137.001(4)(a)(1), FAC.

FLORIDA SELECT INSURANCE COMPANY
ORGANIZATIONAL CHART
DECEMBER 31, 2002



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company did not have any employees.

STATUTORY DEPOSITS

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

State	Description	Par Value	Market Value
FL	Cook County Bond 5.875% 12/01/13	$ 350,000	$ 401,817
TOTAL FLORIDA DEPOSITS		$ 350,000	$ 401,817
SC	USTNTS, 7.5%, 2/15/05	$150,000	$168,199
		$150,000	$168,199
VA	USTNTS, 7.5%, 2/15/05	$550,000	$616,730
		$550,000	$616,730
TOTAL DEPOSITS		$1,050,000	$1,186,746

Territory and Plan of Operation

The Company was authorized to transact insurance in Florida, in accordance with Section 624.401(2), FS. The Company held certificates of authority to write business in Florida, South Carolina, Virginia and Texas.

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 agreement reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines. The reinsurance agreement provided for reports of premiums and losses, as required in SSAP No. 62, Paragraph (8)(d). The Company was in compliance with SSAP No. 62, paragraph 9, in regard to timing risk and also the receipt and payment of cash.

Concurrent with VFI's acquisition of FSIH, the Company commuted a 50% quota share reinsurance agreement with a third party. The Company paid $3 million to commute the reinsurance treaty effective January 1, 2001.

The Company had mandatory participation in the Florida Hurricane Catastrophe Fund (FHCF). The Company participated in the National Flood Insurance Program.

Assumed

The Company assumed $50,576,498 in premiums from Texas Select Insurance Company, an affiliate.

Ceded

The Company maintained a 100% quota share agreement with an affiliate, VFI. The Company ceded 100% of written and assumed premiums and losses to VFI.
The reinsurance contract was reviewed by the Company's appointed actuary and was utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years 2000, 2001 and 2002, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-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, except where noted in this report.

The Company maintained its principal operational offices in Sarasota, Florida. The examination was conducted at the office of CSC, the Company's policy servicing company.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with Southtrust Asset Management Company of Florida. The agreement was in compliance with Rule 69O-143.042(1), FAC.

Asset Management Agreement

The Company maintained an asset management agreement with Conning Asset Management Company to perform investment advisory and portfolio management services.

Claim Management Agreement

The Company maintained a claims servicing agreement with Risk Enterprise Management Limited to perform claims services.

Policy Servicing Agreement

The Company maintained a total policy management services agreement with Policy Management Systems Corporation (now known as CSC).

Independent Auditor Agreement

The Company maintained a contract with an external CPA to perform the annual audit, in compliance with Section 624.424(8), FS.

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, 2002, 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."

FLORIDA SELECT INSURANCE COMPANY
Analysis of Assets

DECEMBER 31, 2002

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	$11,227,289		$11,227,289
Preferred Stock	4,175,000		4,175,000
Cash:			
On deposit	759,945		759,945
Short term investments	9,157,960		9,157,960
Agents' Balances:			
Due in course of collection	1,282,459		1,282,459
Booked but deferred	3,556,732		3,556,732
Reinsurance Recoverable	30,501		30,501
FIT recoverable	0		0
Interest & dividend income due & accrued	222,871		222,871
Receivable from parent, subsidiary & affiliates	1,237,336		1,237,336
Aggregate write-ins for other than invested assets	2,500		2,500
Totals	$31,652,593	$0	$31,652,593

FLORIDA SELECT INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2002

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	$0		$0
Loss adjustment expenses	0		0
Commissions payable, contingent commission and other similar charges	1,207,287		1,207,287
Other expenses	919,452		919,452
Taxes, licenses and fees	1,089,566		1,089,566
Federal and foreign income taxes	1,372,010		1,372,010
Advance premiums	2,961,712		2,961,712
Ceded reinsurance premiums payable	3,630,295		3,630,295
Payable to parent, subsidiaries and affiliates	1,360,066		1,360,066
Aggregate write-ins for liabilities	1,235,676		1,235,676
Total Liabilities	$13,776,064		$13,776,064
Common capital stock	2,500,000		2,500,000
Gross paid in and contributed surplus	16,575,875		16,575,875
Unassigned funds (surplus)	(1,199,346)		(1,199,346)
Surplus as regards policyholders	17,876,529		17,876,529
Total liabilities, capital and surplus	$31,652,593	$0	$31,652,593

FLORIDA SELECT INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2002

Premiums earned	$2,559,934
DEDUCTIONS:	
Losses incurred	0
Loss expenses incurred	0
Other underwriting expenses incurred	2,540,289
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	$2,540,289
Net underwriting gain or (loss)	$19,645
Investment Income	
Net investment income earned	$848,911
Net realized capital gains or (losses)	(376,152)
Net investment gain or (loss)	$472,759
Other Income	
Net gain or (loss) from agents' or premium balances charged off	($193,414)
Finance and service charges not included in premiums	187,255
Aggregate write-ins for miscellaneous income	0
Total other income	($6,159)
Net income before dividends to policyholders and before federal & foreign income taxes	$486,246
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	$486,246
Federal & foreign income taxes	(2,476,949)
Net Income	$2,963,195
Capital and Surplus Account	
Surplus as regards policyholders, December 31, 2001	$14,085,358
Gains and (Losses) in Surplus	
Net Income	$2,963,195
Net unrealized capital gains or losses	85,550
Change in net deferred income tax	(157,666)
Change in non-admiited assets	343,595
Surplus changes: Paid in	556,498
Cumulative effect of changes in accounting principles	0
Examination Adjustment	0
Change in surplus as regards policyholders for the year	$3,791,172
Surplus as regards policyholders, December 31, 2002	$ 17,876,530

COMMENTS ON FINANCIAL STATEMENTS

Assets

Bonds $11,227,289

The Company did not submit one of their investments to the NAIC Securities Valuation Office (SVO), in violation of Section 625.141(2), FS.

Cash $759,945

The Company did not reconcile the cash accounts on a current basis, in violation of Rule 69O-137.001(2), FAC. Adjusted balances were reported on a one-month delay, because the Company was required to report to the parent within five (5) days of the close of the year.

Agents' Balances $4,839,191

The Company did not provide documentation which allocated the totals in the general ledger to Premiums and agents balances in course of collection and Agents' balances and installments booked but deferred and not yet due. Subsequent event: On June 28, 2004, the Company provided a summary allocation.

The Company was maintaining contra asset accounts in agents' balances recorded as "A/R offset – advance premiums", rather than recording such offset of advanced premium billings as unearned premiums.

The Company was maintaining a $14,831 balance within Agents' balances recorded as "A/R Balances adjustment", which included balances dated July 31, 1998 through September 30,

2002. These balances were over ninety days old and should have been non-admitted per SSAP No. 6, Paragraph 9.

Other Assets Non-admitted $0

The Company reported an account titled "Agt/Premium balances charged off" on this line item rather than on the line for Agents' balances, column 2.

Aggregate Write-ins for Other Than Invested Assets $2,500

The Company incorrectly reported a receivable from an affiliate, Texas Select Insurance Company, on this line item, rather than on the line item for Receivable from parent, subsidiaries or affiliates.

Liabilities

Losses and Loss Adjustment Expenses $0

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, 2002, 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 rendered an opinion which agreed with the outside actuarial firm.

Other Expenses $919,452

The Company reported an accrual on the intangible taxes line item rather than on the line item for taxes, licenses and fees.

The Company reported an accrual for a balance due on the Policy fees payable intercompany on this line item rather than on the line item for payable to parent, subsidiaries and affiliates.

Commissions Payable $1,207,287

The Company reported an amount payable on the "Unclaimed Property – JUA AGT C" line item rather than on the line item for Aggregate write-ins for liabilities.

Advance Premiums $2,961,712

The Company reported an amount on the line item for policy premium received in advance and placed the amount into a suspense account due to the policy number not being identifiable at the time of receipt. The amount should have been placed on the line item for Remittances and items not allocated.

Payable to Parent, Subsidiaries and Affiliates $1,360,066

The Company reported a reinsurance transaction and federal income taxes payable on this line item. Amounts owed due to intercompany tax sharing agreements and amounts related to reinsurance transactions should be excluded from this line item.

Surplus $17,876,529

No reclassification adjustments were made to Surplus as reported on the annual statement due to the immateriality of the dollar amounts of those adjustments.

FLORIDA SELECT INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2002

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, 2002, Annual Statement				$17,876,529
	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
ASSETS:				
No adjustments made.				
LIABILITIES:				
No adjustments made.				
Net Change in Surplus:				0
Surplus as Regards Policyholders December 31, 2002, Per Examination				$17,876,529

SUMMARY OF FINDINGS

Previous examination findings and corrective action

The Company's expense sharing agreement contained the term equitable basis. The Company was directed to amend the agreement to define this term and have provided no such amendment to the Office. **The Company is directed to comply with the directive in the 1999 examination report and provide documentation of compliance to the Office within 90 days after this report is issued.**

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, 2002.

General

The Company did not disclose all payments to its parent, under their tax allocation agreement on Schedule Y, Part 2 of the annual statement. **The Company is directed to disclose such in all future annual statement filings.**

The Company did not maintain conflict of interest statements from two directors. **The Company is directed to provide the missing conflict of interest statements to the Office within 90 days after the report is issued.**

The Company allowed the duties of the audit and investment committee to be performed by its parent, without a record of the authorization noted in the board minutes. **The Company is directed to comply with Section 625.304, FS and Section 607.1601(1), FS. The Company is to provide documentation of compliance to the Office within 90 days after the report is issued.**

The Company did not record the review of the prior examination report in the board of director's minutes. **It is recommended that the board of directors review this examination report at the next meeting of the board after this examination report has been issued, and record the review in the Company minutes.**

Management Agreements

The Company did not pay estimated and final tax payments on schedule according to the terms of their tax allocation agreement. Additionally, the payments were being made by FSIA on behalf of the Company. **The Company is directed to comply with the terms of the tax allocation agreement in all future tax years.**

Bonds

The Company did not submit all of their investments to the SVO for valuation. **The Company is directed to insure that all current and future investments are valued by the SVO.**

Cash

The Company did not maintain all of their cash balances on a current adjusted general ledger basis. **The Company is directed to comply with Rule 69O-137.001(2), FAC. The Company is to provide documentation of compliance to the Office within 90 days after the report is issued.**

Agents Balances'

The Company did not provide documentation which allocated premiums and agents' balances to the line items 10.1 and 10.2, on page 2 of the annual statement; however, on June 28, 2004, the Company provided a summary allocation. **The Company is directed to maintain documentation for such allocation for all future annual and quarterly statement filings.**

The Company maintained contra asset accounts in agents' balances rather than setting such offset to advanced premium billings up as unearned premiums.

The Company maintained a $14,831 balance within Agents' balances which contained items greater than ninety (90) days old. **The Company is directed to non-admit such over 90 day balances in all future annual and quarterly statements.**

Other Assets Non-admitted

The Company reported a balance for "Agent/Premium balances charged off" on this line item rather than on line 10.1, column 2.

Aggregate Write-ins for Other Than Invested Assets

The Company incorrectly reported a receivable from an affiliate on this line item rather than on the line item for Receivable from parent, subsidiaries or affiliates.

Other Expenses

The Company incorrectly reported an accrual for intangible taxes on this line item rather than on the line item for Taxes, licenses and fees.

The Company incorrectly reported an accrual for Policy fees payable intercompany on this line item rather than on the line item for Payable to parent, subsidiaries and affiliates.

Commissions Payable

The Company incorrectly reported an amount for "Unclaimed property JUA AGT C" on this line item rather than on the line item for Aggregate write-ins for liabilities.

Advance Premiums

The Company incorrectly reported an amount for Advance premiums received for policy numbers yet to be determined rather than on the line item for Remittances and items not allocated.

Payable to Parent, Subsidiaries and Affiliates

The Company incorrectly reported a reinsurance transaction and Federal income taxes payable on this line item rather than on the line item for which they apply.

Subsequent Event: On March 31, 2003, A.M. Best downgraded its rating of the Company and VFI from B+ to B.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Florida Select Insurance Company** as of December 31, 2002, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was $17,876,529, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Mary James, CFE, Financial Examiner/Analyst Supervisor, Sri Ramanujam, Actuary, March Fisher, Senior Actuarial Analyst, Owen Anderson, Financial Examiner/Analyst, Joel Bengo, Financial Examiner/Analyst and Jerry Golden, Financial Examiner/Analyst participated in the examination.

Respectfully submitted,

____
Miriam Bleakley
Financial Examiner/Analyst II
Florida Office of Insurance Regulation