REPORT ON EXAMINATION

OF

FIRST PROTECTIVE INSURANCE COMPANY

LAKE MARY, FLORIDA

AS OF

DECEMBER 31, 2004

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

October 12, 2005

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 (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, 2004, of the financial condition and corporate affairs of:

FIRST PROTECTIVE INSURANCE COMPANY
200 Colonial Center Parkway, Suite 100
LAKE MARY, FLORIDA 32746

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, 2002 through December 31, 2004. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2001. This examination commenced, with planning at the Office, on March 21, 2005. The fieldwork commenced on March 23, 2005 and was concluded as of October 12, 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 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 (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, 2004. Transactions subsequent to year-end 2004 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

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

Unearned Premiums

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, 2001, along with resulting action taken by the Company in connection therewith.

Management

The Company did not maintain an audit committee

Finding: The Company did not have an audit committee at December 31, 2004; but did establish an audit committee on May 19, 2005.

HISTORY

General

The Company was incorporated on March 16, 1998, under the laws of the State of Florida, as a stock property and casualty insurer. The Company commenced business on April 30, 1998, with the name of First Protective Insurance Company.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2004:

Fire	Allied Lines
Homeowners multi Peril	Other Liability
Mobile Home Multi Peril	Mobile Home Physical Damage

The Articles of Incorporation and the Bylaws were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2004, the Company's capitalization was as follows:

Number of authorized common capital shares	500,000
Number of shares issued and outstanding	100,000
Total common capital stock	$100,000
Par value per share	$1.00

Control of the Company was maintained by its prior parent, Homeowners Holding Company (HHC). Consent Order #68545-03-CO, dated June 12, 2003, approved the merger of HHC into PWC Financial, Inc., (PWC). PWC was the surviving corporation. The Company was in violation of the consent order because the Company did not cancel the stock issued to HHC. HHC remained the sole shareholder of FPIC at year-end although they ceased to exist on August 1, 2003. On May 10, 2005, the Company cancelled the stock issued to HHC and reissued the stock to PWC.

Profitability of Company

The following table shows the profitability trend (in dollars) of the Company for the period of examination.

	2004	2003	2002
Premiums Earned	14,887,100	7,563,254	10,723,724
Net Underwriting Gain/(Loss)	(2,413,666)	(485,013)	(2,172,012)
Net Income	(2,221,059)	(305,206)	(430,487)
Total Assets	16,456,569	12,670,169	17,357,971
Total Liabilities	12,235,769	5,839,852	11,967,192
Surplus As Regards Policyholders	4,220,800	6,830,317	5,390,779

Dividends to Stockholders

In accordance with Section 628.371, FS, the Company did not declare or pay dividends to its stockholders.

Management

There was no written documentation that the Company held an annual shareholder meeting for the election of directors, in violation with Sections 607.1601 and 628.231, FS.

The following were reported as directors as of December 31, 2004:

Directors

Name and Location	Principal Occupation
Leman Miles Porter Lake Mary, Florida	President First Protective Insurance Company
Lanier Miles Porter Maitland, Florida	Chief Executive Officer First Protective Insurance Company
Dwayne Richard Williams Lake Mary, Florida	Chief Financial Officer First Protective Insurance Company
Harold Mack Humphrey Lake Mary, Florida	Vice President First Protective Insurance Company
Willis Thomas King, Jr. Summit, New Jersey	Chairman of the Board PWC Financial, Inc.
Emily Roberts McDonald Summit, New Jersey	Director First Protective Insurance Company
John Francis Cosgrove Miami, Florida	Attorney First Protective Insurance Company

The Board of Directors, in violation of the Company's bylaws, did not annually appoint the Company's officers.

The following senior officers were reported in the Company's holding company registration statement:

Senior Officers

Name	Title
Leman Miles Porter	President & Secretary
Lanier Miles Porter	Chief Executive Officer
Harold Mack Humphrey	Vice President
Dwayne Richard Williams	Treasurer & CFO

The Company did not maintain an audit committee on December 31, 2004, as required by Section 624.424(8), FS. On May 19, 2005, the Board of Directors appointed an audit committee comprised of four of its directors actively involved in the daily operations of the

Company. Section 624.424(8)(c), FS, requires that the audit committee be comprised solely of members who are free from any relationship that, in the opinion of its Board of Directors, would interfere with the exercise of independent judgment as a committee member.

Conflict of Interest Procedure

The Company adopted a policy statement requiring disclosure of conflicts of interest, in accordance with Section 607.0832, FS.; however, this disclosure was not made on an annual basis.

Corporate Records

The recorded minutes of the 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 in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

There was no documentation in the minutes reviewed that the Company's directors reviewed the previous examination report.

The Company had four directors as of December 31, 2002, in violation of Section 628.231(1) FS. , which requires five or more. The Company has subsequently maintained the required number of directors.

The Company did not appoint a CPA firm, as of December 31, 2002, to audit and render an opinion of the Company's financial statements, in violation with Section 624.424(8), FS. The Company has subsequently appointed the CPA firm annually.

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

On January 1, 2004, the Company assumed a book of business from Argus Fire and Casualty Insurance Company through an assumption agreement.

Surplus Debentures

The Company issued two surplus debentures to its parent, PWC in the amounts of $1,000,000 issued on August 1, 2003 and $1,500,000 issued on December 31, 2003.

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 13, 2004, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

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, 2004, the method of allocation between the Company and its parent was not provided. The agreement was not properly executed or approved by the Office. The Company failed to disclose that the federal income tax recoverable was due from their parent, in violation of Section 69O-138.001, FAC.

Management Agreements

The Company contracted policy services to Frontline Insurance Managers, Inc. (Frontline), which subcontracted them to INSpire Insurance Solutions, Inc. (INSpire) by an agreement dated January 1, 1998. The Company's managing general agency (MGA) agreement with Frontline stated that Frontline would perform claims servicing and assign any of its obligations or duties under the MGA agreement, subject to the conditions and limitations set forth in the contract with subcontractors, with whom Frontline elects to contract. INSpire designed, constructed and implemented the software systems to support the services fee of 5% of gross direct written premium. The fee was subject to a minimum charge of $41.67 per policy averaged quarterly. One-fourth of the MGA fee of $25 per policy was paid to INSpire. Policy administration fees were subject to a minimum of $50,000 per month. Installment and non-sufficient fund fees were retained by INSpire, although none of the fees were assessed.

The Company entered into an agreement on April 30, 1998, with its parent, HHC, to handle the management and accounting of the Company. HHC duties included: investment management, financial management, accounting and tax services, legal advice, corporate management services, human resource services, corporate expense oversight, benefit plan management, actuarial services, regulatory liaison services, marketing assistance and information systems. There is a duplication of duties outsourced in the management agreement and in the MGA agreement. There is a duplication of duties outsourced in the management agreement and the MGA agreement.

MGA Agreement

The Company entered into an agreement to contract exclusively with Frontline for agency services on April 30, 1998. Frontline was to provide comprehensive management and administration of the Company's insurance business. The management and administration included underwriting, reinsurance, claims processing, loss prevention and analysis, premium collection, regulatory liaison, policy advisor and consultant, accounting, books and records, retention of accountants and actuaries, and marketing and agent relations.

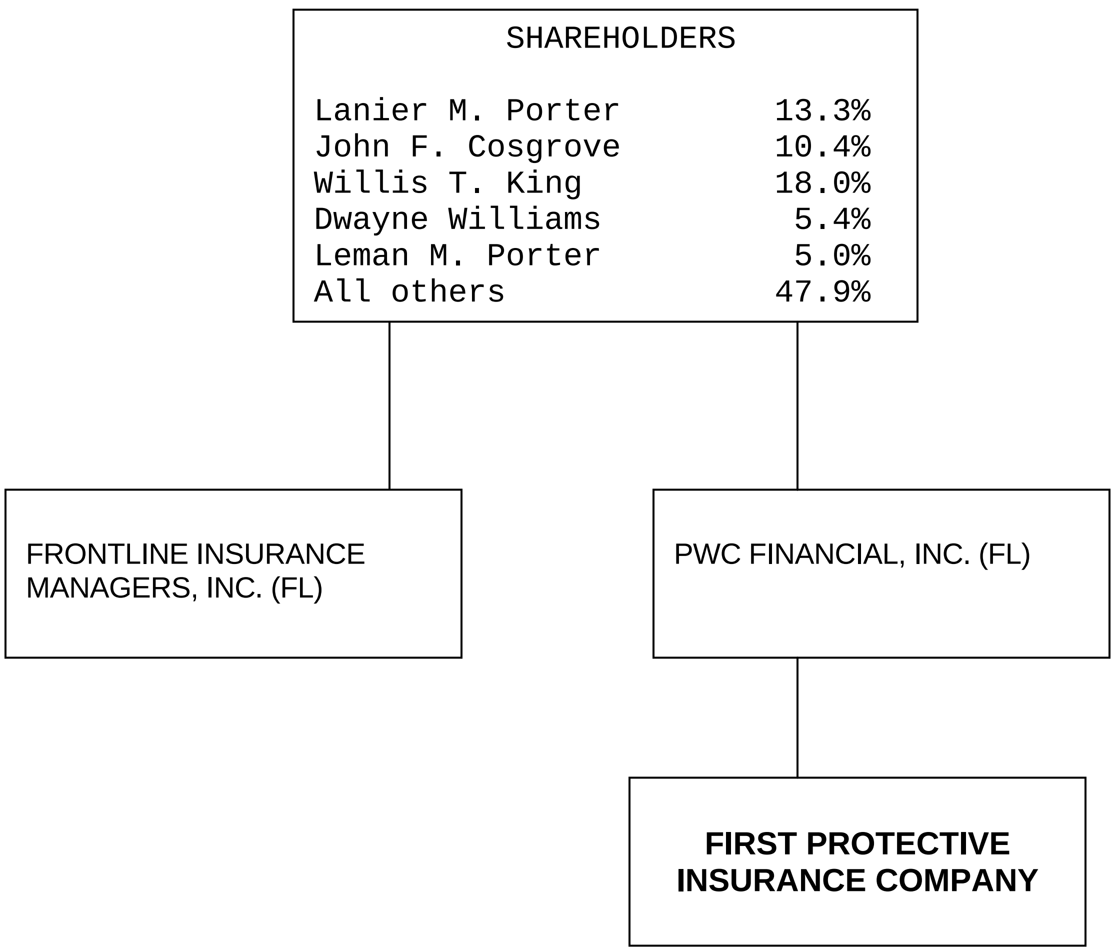
Frontline paid expenses and received reimbursement for all or an allocated portion of the expenses. The expenses included the following: employment expenses of personnel employed by Frontline to render the services and related expenses, rent, telephone, utilities, office furniture, equipment, machinery and other office expenses, miscellaneous administrative and overhead expenses, professional advisors and consultants engaged or retained, taxes payable in respect of the income, operations and properties of Frontline, and any costs, fines, or penalties imposed on or paid by Frontline because of its actual or alleged conduct or operations.

Frontline deducted and retained compensation of 10% of net written premiums collected for all business originated or produced and services rendered, negotiated, or retained by Frontline. Pursuant to the agreement, Frontline was also entitled to receive 15.5% of incurred losses for claims administration services and to receive reimbursement of actual legal expenses incurred in connection with claims against the Company under policies written by the Company and subject to this agreement. Frontline also charged and retained a per policy fee not to exceed $25.

A simplified organizational chart as of December 31, 2004, reflecting the holding company system, is shown below. Schedule Y of the Company's 2004 annual statement provided a list of all related companies of the holding company group.

FIRST PROTECTIVE INSURANCE COMPANY, INC.
ORGANIZATIONAL CHART

DECEMBER 31, 2004



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to $25,000 with no deductible. This amount did not adequately cover the suggested minimum amount of coverage for the Company as recommended by the NAIC in the NAIC's Financial Condition Examiners Handbook.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company offered a 401k plan, healthcare, dental, group life, and disability insurance for their employees.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS:

State	Description	Par Value	Market Value
FL	CASH	$1,000,000	$1,000,000
TOTAL SPECIAL DEPOSITS		$1,000,000	$1,000,000

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

The Company was authorized to transact insurance in the State of Florida only, in accordance with Section 624.401(2) F.S.

The Company was not following the underwriting guidelines on file for their homeowners' product, which was accepted by the office for use on August 24, 1998. The Company used a different set of underwriting guidelines since January 2005. These different guidelines were not filed with the Office.

Treatment of Policyholders

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

The Company maintained a claims procedure manual that included procedures for handling claims.

REINSURANCE

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

The Company reported $8,741,000 in dispute on Schedule F, part 6, which was explained as a misinterpretation of the NAIC Annual Statement Instructions.

The Company reported Lease security deposits as Other amounts receivable under reinsurance contracts. These amounts were misclassified and were non-admitted as provided in Section 625.031(7) FS.

Assumed

The Company assumed a book of business from Argus Fire and Casualty Insurance Company through an assumption agreement.

Ceded

The Company ceded risk on a 50 percent quota share basis to Transatlantic Reinsurance Company. The Company ceded on an excess of loss basis to several London reinsurers, with a retention of $1.5 million and coverage of up to $70 million per catastrophe. The Florida Hurricane Catastrophe Fund provided an additional $67.3 million of catastrophe coverage, based on a 90% participation.

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

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years 2002, 2003 and 2004, 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; however, the accounting records were not in order, were not accurate, and were not complete. Supporting detail did not exist for many summary ledger balances.

Significant and material deficiencies existed in the three largest cycles for the Company; claims, premiums and reinsurance, resulting in extensive delays in attempting to provide supporting documentation, which in many cases did not exist or was not provided to the Office examiners.

Internal accounting and administrative controls were weak in most areas and non-existent in other areas. There was under-staffing of critical areas and significant data issues resulted from bringing in-house the services formerly contracted out to service entities. It is yet to be determined whether bringing those services in-house will be beneficial in the long run given the significant and material accounting problems already created by doing so without the proper controls and staffing in place to undertake such action.

Schedule P was inaccurate and did not reconcile to supporting detailed loss runs which, in turn, did not reconcile to supporting claim files.

The maintenance of the Waterstreet and AS400 written premium detail along with the AS400 written premium accrual were sampled and traced without exception to premium files. However, the remaining written premium adjustments totaling $1.9 million or 6.4% of the total reported written premium was not supported by detail. Therefore, the accuracy of the reported written premium was not determined.

The Amounts recoverable from reinsurers, which totaled to more than 2 ½ times the amount of the Company's reported Surplus as regards policyholders, was not detailed by the Company any more specifically than identifying reinsurers from which the amounts were due. For such a material amount relative to the surplus size of the Company, not to be supported by detailed claim paid documentation evidencing the claims paid and now recoverable from the reinsurers, highlights the significant and material weaknesses in the internal accounting and administrative controls at the Company.

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

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company did not have a custodial agreement as of December 31, 2004. Charles Schwab held the Company's securities at year-end. Charles Schwab was not a qualified custodian per Rule 69O-143.041(2), FAC. Subsequent to year-end the Company had moved their securities to a new custodian but did not provide the Office with the name, address and executed custodial agreement, despite numerous requests of the Company.

Independent Auditor Agreement

The Company had an independent auditor agreement with Thomas Howell Ferguson as of December 31, 2004.

Risk-Based Capital

The Company reported its risk-based capital at the Company Action level.

Information Technology (IT) Evaluation

Tracy Gates, Highland Park, LLC, performed a computer systems evaluation on the Company. A summary of significant findings with recommendations are as follows:

Backup Provisions

Backup tapes containing data files and programs were stored on-site in the computer room. In the event of a fire or other physical disaster, the entire history of data on the tapes and adjacent computers could be destroyed.

Logical and Physical Access

The Specialty Insurance Services (SIS) application security settings allow for incompatible duties between initiation and authorization of financial transactions. For example, users in Finance have Underwriting and Claims module access. Other users have both Underwriting and Claims entry module access. Both the vendor and IT support personnel have access to virtually all functions in the system.

Logical and Physical Security

The Company does not have an acceptable Use Policy. Without such a policy, the Company can be held liable for unlawful or offensive employee actions perpetrated with company-owned computers. The policy should be signed by each employee.

Contingency Planning – Business Recovery of Operations

The Company has not developed a business contingency plan. Failure to document critical business functions and their required resources could subject the Company to excessive costs, litigation, or fines stemming from claims processing errors or delays after a physical disaster. Additionally, all source documents and tape backup media are retained on-site, exposing the Company to an entire loss of information in the event of a physical disaster.

Contingency Planning – Disaster Recovery of IT Operations

IT management has not developed a Disaster Recovery Plan (DRP) to guide system restoration in the event of a disaster. A DRP is necessary to coordinate and address the dependencies between critical operations and information systems. Failure to plan for an organized recovery of computer systems and network connectivity could increase the cost or ultimately prevent the Company from operating after a disaster.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2004, 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."

FIRST PROTECTIVE INSURANCE COMPANY, INC.
Assets

DECEMBER 31, 2004

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	$2,854,984		$2,854,984
Cash:			
On deposit	(4,046,678)		(4,046,678)
Short-term investments	2,224,711		2,224,711
Interest and dividend income due & accrued	59,243		59,243
Agents' Balances:			
Uncollected premium	414,167	$62,647	351,520
Reinsurance:			
Recoverable	10,378,101		10,378,101
Funds held by reinsured co.	1,348,995		1,348,995
Other amounts receivable	1,121,362	21,362	1,100,000
Federal income tax recoverable	17,993		17,993
Net deferred tax asset	492,603		492,603
Receivable from PSA	1,588,284	1,588,284	0
Aggregate write-in for other than invested assets	2,804		2,804
Totals	$16,456,569	$1,672,293	$14,784,276

FIRST PROTECTIVE INSURANCE COMPANY, INC.
Liabilities, Surplus and Other Funds

DECEMBER 31, 2004

Liabilities	**Per Company**	**Examination Adjustments**	**Per Examination**
Losses and LAE	4,909,827	4,660,000	9,569,827
Commissions payable	561,734		561,734
Other expenses	237,617		237,617
Taxes, licenses, and fees	303,794		303,794
Unearned premium	4,882,559		4,882,559
Advance Premiums	1,086,559		1,086,559
Aggregate write-ins for liabilities	253,679		253,679
Total Liabilities	$12,235,769	4,660,000	16,895,769
Common capital stock	100,000		100,000
Surplus notes	2,500,000		2,500,000
Gross paid in and contributed surplus	4,900,000		4,900,000
Unassigned funds (surplus)	(3,279,200)	6,332,293	(9,611,493)
Surplus as regards policyholders	4,220,800	6,332,293	(2,111,493)
Total liabilities, capital and surplus	$16,456,569	$1,672,293	$14,784,276

FIRST PROTECTIVE INSURANCE COMPANY, INC.
Statement of Income

DECEMBER 31, 2004

Underwriting Income	
Premiums earned	$14,887,100
DEDUCTIONS:	
Losses incurred	9,445,140
Loss expenses incurred	2,611,812
Other underwriting expenses incurred	5,261,814
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	$17,318,766
Net underwriting gain or (loss)	($2,431,666)
Investment Income	
Net investment income earned	$192,613
Net realized capital gains or (losses)	0
Net investment gain or (loss)	$192,613
Other Income	
Total other income	$0
Net income before dividends to policyholders and before federal & foreign income taxes	($2,239,052)
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	($2,239,052)
Federal & foreign income taxes	(17,993)
Net Income	($2,221,059)
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	$6,830,317
Gains and (Losses) in Surplus	
Net Income	($2,221,059)
Net unrealized capital gains or losses	0
Change in net deferred income tax	913,988
Change in non-admitted assets	(1,384,546)
Change in provision for reinsurance	82,100
Examination Adjustment	(6,332,293)
Change in surplus as regards policyholders for the year	(8,941,810)
Surplus as regards policyholders, December 31 current year	($2,111,493)

COMMENTS ON FINANCIAL STATEMENTS

Uncollected premiums
and agents' balances in the course of collection **$351,520**

The above amount is $62,647 less than the amount reported by the Company. Rule 69O-138.024, FAC requires that this receivable be supported by detailed records on a policy level basis that are aged based on the effective date of the policy. The Company did not maintain an aging of this receivable. The $62,647 non-admitted by this examination represented the aggregate premiums due on policies with effective dates prior to October 1, 2004 and not collected by the Company by December 31, 2004.

Other amounts receivable under reinsurance contracts **$1,100,000**

The above amount is $21,362 less than the amount reported by the Company. The Company had included their office lease deposits into this general ledger account. The lease deposit is a prepaid expense, which is a non-admitted asset pursuant to Section 625.031(7), FS.

Receivables from parent, subsidiaries and affiliates (PSA) **$0**

The above amount is $1,588,284 less than that reported by the Company. Prepayments of fees to Frontline make up the entire $1,588,284. These amounts were not evidenced by secured loans. These amounts were earned by Frontline as premiums were written and collected. Therefore, these amounts were prepayments to Frontline and are non-admitted assets pursuant to Section 625.031(7), FS. SSAP 25 provides for the admittance of loans or advances to an affiliate; however, certain items must be present for these amounts to be considered loans, which are not present in this situation. Loans are evidenced by loan documents and are required to be secured pursuant to Section 625.012(2), FS, neither of which are present in this situation. An advance is the same as a prepayment and Section 625.031(7) FS specifically identifies prepayments as non-admitted assets, contradicting and overruling the language in SSAP 25.

Losses and Loss Adjustment Expenses $\underline{\$9,569,827}$

The above amount is $4,660,000 more than that reported by the Company. 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, 2004, 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 contracted with Kay Kufera, Veris Consulting, an independent actuary and Roger C. Sullivan, Jr., Insurance Consulting Company, LLC, an independent claims specialist. The Office's independent actuary determined that reserves were deficient by $4,660,000 and that Schedule P of the annual statement was not accurate. The Company's independent CPA tested paid losses from the cash payments system to supporting detail without exception but did not reconcile Schedule P to the detailed supporting documentation. The Company's independent CPA relied upon the work of the Company's independent actuary and reconciled Schedule P to the Company's independent actuary's report.

Kay Kufera, Veris Consulting, performed a review of the reserves for unpaid losses and loss adjustment expenses. A summary of significant findings are as follows:

For both a gross and net of reinsurance basis, the indicated amounts were those estimated to be a full and sufficient reserve for future loss and loss expense liabilities, assuming there were no reinsurance collectibility issues. The indicated amounts were much higher than the amount of reserves reported by the Company and the amounts carried by the Company at December 31, 2004 were significantly inadequate on both a direct and assumed basis and on a net basis.

Schedule P did not match to any reports of claims files, for any year. While it comes close to matching for the 2004 year, there are still unexplained "adjustments" used in the Company's Schedule P reconciliation. An attempt was made to reconcile Schedule P with the Company's claim files. The reconciliation could not be completed due to many discrepancies. The amounts used for combined lines and combined loss and allocated loss adjustment expense fluctuated inexplicably between reports. The exhibit was sent to the Company's independent actuary for comment, but no response was received. The Fire/Allied Lines Schedule P has been completed erroneously since the inception of the Company.

The catastrophe data provided had several problems. For example, there were claims shown in the paid file but not in reserve file and vice versa, and many claims were listed twice in file. Also, two claims were categorized as Hurricane Charley in the paid file and Hurricane Frances in the reserve file.

Of the following claims reviewed:

61 claims listed in reserve file but not in paid file
19 claims listed twice in reserve file (not included in above total)
53 claims listed in paid file but not in reserve file
20 claims listed twice in paid file

At June 30, 2005, the following reserve amounts existed on closed files for Jeanne: $45,826 reserves for business assumed from Argus Fire and Casualty Insurance Company, and $83,451 for the Company.

As of June 30, 2005, significant reserves were held for hurricane claim files designated as “closed” by the Company.

A significant comment made regarding the estimated ultimate amount for the 2004 catastrophes in the opining actuary’s report was this: in his analysis, the estimated ultimates using a paid development approach were significantly less for three of the hurricanes than those calculated using other approaches and were, in fact, less than the current incurred amounts for Frances and Jeanne at year-end 2004. Rather than removing this estimate from the average or giving it a lesser weight, the actuary chose to give this estimate more credence than the other estimates. The Office disagrees with this approach. The Office was concerned about the way that the ultimate catastrophe amount estimated was selected by the opining actuary at year-end. It was difficult to ascertain the number of catastrophe claims made because different number of claims exist in various data files. The Company had a significant increase in incurred catastrophe claims for 2004 for the period between March 31, 2005 and June 30, 2005. This amount went from $116,000,000 to $132,000,000, an increase of almost 14%. The catastrophe losses were allocated incorrectly to Schedule P line of business at year-end 2004.

Roger C. Sullivan, Jr., Insurance Consulting Company, LLC, performed a review of 143 open and closed homeowners claims on the Company. A summary of significant findings are as follows:

A review of open claim reserves as of August 19, 2005 were not generally reflective of case values and were not consistent with generally observed industry practice. The analysis of 38 open claim suffixes resulted in an estimate of the gross case indemnity reserve total of $1,003,129. The Company's stated outstanding indemnity case reserve total equaled $298,425. Company reserves were lower than the independent calculations by $704,704 or 236.1%. A variance of plus or minus 10% may normally occur between estimators in valuing open claims. This variance is not within the normal limits generally observed in the industry.

A review of open claim expense reserves as of August 19, 2005 were not generally reflective of case values and were not consistent with generally observed industry practice. The analysis of 38 open claim suffixes on which legal, expert, and independent adjuster expenses appeared warranted resulted in an estimated reserve total of $307,250. The Company's stated estimated expense reserves were $208,778. Company reserves were lower than the independent calculations by $98,472 or 47.2%. Again, a variance of plus or minus 10% may normally occur between estimators in valuing open claims. This variance is not within the normal limits generally observed. There was no consistency between the reserves stated in the adjusters' file activity notes and reports and the loss run information provided. The hard copy claims files did not contain claim reserve histories or documentation of current reserves. When a reserve notation was noted, it frequently did not agree with the loss runs provided. This practice was not consistent with generally observed industry practices. There was no indemnity or expense payment history in the claims files. In order to confirm payment amount totals it was necessary to add copies of cancelled checks. Frequently, the loss data information did not agree with check and invoice copies. Missing check copies and file information were noted in a number of the files. These practices are not consistent with generally observed industry practices.

No explanation for payment delay was contained in the file in 37 closed claims where the independent adjusters' reports and supporting documentation for payment were presented prior to December 31, 2004 and paid after January 1, 2005. There were 34 storm loss claims where the independent adjusters reports were received before December 31, 2004 but payments were not made until after January 1, 2005. In some instances, payments were made 60 days or more from the date of the report. This practice is not consistent with generally observed industry practices. A total of 86 of the claims in the selected sample were storm loss claims reflected as open in the December 31, 2004 loss run provided by the Company. At that time, these claims were 90 to 120 days old and payment had not been made. Payment delays were attributable to slow reporting on the part of Specialty Claims and slow processing by the Company. This practice is not consistent with generally observed industry practices. Correspondence from the Company to Specialty Claims prompting timely handling or seeking initial report information did not exist. Fifty of the independent adjusters reports were received two months after the date of assignment. This practice is not consistent with generally observed industry practices.

Reserve adjustments were made on closed files to align the reserves to payments that had already taken place. This practice is not consistent with generally observed industry practices. There were 9 instances that offsetting reserves to payments were not entered resulting in a negative balance on the loss runs. This practice is not consistent with generally observed industry practices. In the review sample, 9 claim files could not be located. None of the hard copy claim material was stamped with the date received. Many of the independent adjusters reports from Specialty Claims were undated. This practice is not consistent with generally observed industry practices. The adjuster file activity notes in many files were stale or incomplete, which made it difficult to determine the adjuster's exposure evaluation and any proposed activity to close the claim. There was no follow up diary on the part of inside adjusters, supervisors or managers noted in the claims files. This practice is not consistent with generally observed industry practices. The indemnity and expense case reserves on the open claims files reviewed were inadequate to meet current exposures. The Company's claim reserving and claims handling practices associated with the reserving process were inconsistent with general industry standards and practices.

Advanced premiums **$1,086,559**

The above amount is the same as that reported by the Company. However, an adjustment was made by the Company to recognize $856,017 as fully earned in the premium clearing account. The Company could not provide any policy level detail evidencing what polices amounted to the $856,017. The independent auditor for the Company performed additional testing to determine that this adjustment was reasonable.

FIRST PROTECTIVE INSURANCE COMPANY, INC.
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS

DECEMBER 31, 2004

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, 2004, Annual Statement				$4,220,800
	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
ASSETS:				
Uncollected premiums & agents' balances	$414,167	$351,520	($62,647)	
Other amounts receivable under reinsurance contracts	$1,121,362	$1,100,000	($21,362)	
Receivables from parent, subsidiaries & affiliates	$1,588,284	$0	($1,588,284)	
LIABILITIES:				
Losses and LAE	$4,909,827	$9,569,827	($4,660,000)	
Net Change in Surplus:				($6,332,293)
Surplus as Regards Policyholders December 31, 2004, Per Examination				($2,111,493)

SUMMARY OF FINDINGS

Compliance with previous directives

The Company complied with the findings in the 2001 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, 2004.

General

The Company established an audit committee on May 19, 2005 comprised of four of its directors actively involved in the daily operations. Section 624.424(8)(c), FS, requires that the audit committee be comprised solely of members who are free from any relationship that, in the opinion of its Board of Directors, would interfere with the exercise of independent judgment as a committee member. **It is recommended that the Company's Board of Directors evaluate and determine whether the audit committee composition complies with Section 624.424(8)(c), FS, and provide a copy of the minutes documenting the determination to the Office within 90 days of the issuance of this report.**

The Company did not maintain written minutes documenting the annual shareholders meeting. **It is recommended that the Company comply with Sections 607.1601 and 628.231, FS., during all future shareholders meetings.**

The Company did not disclose conflicts of interests on an annual basis. **It is recommended that in all future years, the Company disclose conflicts of interest on an annual basis pursuant to Section 607.0832, FS.**

The Board of Directors did not annually appoint the Company officers as required by the Company bylaws. **It is recommended that the Board of Directors in all future years, comply with the bylaws of the Company and appoint the officers.**

There was no documentation in the Board minutes that the prior examination report was reviewed. **It is recommended that the Company's Board of Directors review all future Office examination reports.**

The Company did not maintain the suggested amount of fidelity bond coverage as recommended by the NAIC. **It is recommended that the Company obtain adequate fidelity bond coverage and provide a copy of such to the Office within 90 days of the issuance of this report.**

The Company did not have a custodial agreement with Charles Schwab, who held their securities at year-end. The Company indicated they transferred their securities to a new custodian but did not provide the examiner with the name, address and executed custodial agreement. **It is recommended that the Company insure that their securities are held by a qualified custodian, enter into a custodial agreement and provide a copy of the custodial agreement to the Office within 90 days of the issuance of this report.**

The Company's tax allocation agreement did not provide for the method of allocation between the Company and the parent and was not properly executed or approved by the Office. The Company failed to disclose in the annual statement that the federal income tax recoverable was due from their parent. **It is recommended that the Company amend the tax allocation agreement and provide a copy to the Office within 90 days of the issuance of this report. It is further recommended that the Company disclose in future annual statements that the federal income tax recoverable is due from the parent.**

The Company's management agreement and MGA agreement outsourced duplicative duties. **It is recommended that the Company amend the management agreements and the MGA agreement to eliminate the duplicative duties and provide a copy of the amended agreements to the Office for approval within 90 days of the issuance of this report.**

The Company's underwriting guidelines for their homeowners' product, which were on file and accepted for use on August 24, 1998, were not being used since January 2005. **It is recommended that the Company follow the guidelines that have been filed with the Office until new underwriting guidelines are filed with the Office.**

The Company reported $8,741,000 in dispute on Schedule F, Part 6, which the Company explained as a misinterpretation of the NAIC annual statement instructions. **It is recommended that the Company properly complete the annual statement in all future years**.

The Information Technology (IT) evaluation noted several significant areas of concern. Backup file provisions need to be improved for data files and computer programs. Logical and physical access review should be performed for all functions in the computer system. An acceptable Use Policy should be published and signed by each employee. The Company should develop and document a business contingency plan and a disaster recovery plan. **It is recommended that the Company address the specific findings in the IT evaluation and provide documentation of corrective action to the Office within 90 days of the issuance of this report.**

The claims review noted several significant areas of concern as regards deficiencies in the claims practices and condition of the claims files. The open claim reserves were not reflective of case values and not consistent with general observed industry practice. The sampled case reserves independently calculated were $704,704 greater than that calculated by the Company. The open claim expense reserves were not reflective of case values and not consistent with general observed industry practice. The sampled Company reserves were lower than an independent calculation by $98,472. There was no consistency between the reserves stated in the adjuster's file activity notes and reports and loss runs. The hard copy claims files did not contain claim reserve histories or current reserve documentation. Indemnity or expense payment history did not exist in the claims files, and loss date information was not consistent. Payment documentation for closed claims was inconsistent. Correspondence from the Company to Specialty Claims did not exist regarding initial report information. Reserve adjustments were made on closed files to align the reserves to payments already made. Nine instances of offsetting reserves to payments not entered resulted in a negative balance on the loss runs. Nine claim files could not be located. None of the claim copy hard copies were stamped with the date received. Adjuster file activity notes in many files were stale or incomplete. No follow-up diary of an inside adjuster, supervisor or manager were noted in the claim files. The indemnity and expense case reserves on the open claim files reviewed were inadequate to meet current exposures. There were significant delays in the payment of claims. **It is recommended that the Company address the specific findings from the claims review and provide documentation of corrective action to the Office within 90 days of the issuance of this report.**

The Office's independent actuarial review noted several areas of concern as regards Schedule P and the Company actuary's methodology**.** The amounts carried by the Company were significantly inadequate on both a direct and assumed basis and on a net basis. Schedule P did not match to any claim files, for any year. Adjustments by the Company remain unexplained. Amounts used for combined lines and combined loss and allocated LAE fluctuated between reports. The Fire/Allied Lines Schedule P has been in error since the inception of the Company. Hurricane catastrophe data provided had several problems. Significant reserves were held for hurricane claim files designated as "closed" by the Company. Catastrophe losses were allocated incorrectly in Schedule P. Different number of claims exist in various data files, which made it difficult to determine the number of catastrophe claims made. The office's independent actuary disagrees with the estimated ultimate catastrophe amount estimation approach by the Company's actuary. **It is recommended that the Company address the specific findings from the actuarial Review and provide documentation of corrective action to the Office within 90 days of the issuance of this report.**

The Company's accounting records were not in order, were not accurate, not complete and supporting detail did not exist for many summary ledger balances. **It is recommended that the Company address this deficiency and provide evidence of**

the corrective action taken to eliminate this deficiency within 90 days of the issuance of this report.

Financial

The Company's agents' balances aging schedule did not exist. **It is recommended that the Company comply with Rule 69O-138.024(2), FAC and provide documentation to the Office evidencing the maintenance of an aging schedule within 90 days after the issuance of this report.**

Prepayments of fees to Frontline and lease security deposits are not admitted assets. **It is recommended the Company non-admit prepaid items in all future filings of annual and quarterly statements with the Office.**

The Company made a journal adjustment of $856,017 to Advanced premiums without supporting detail. **It is recommended that the Company maintain supporting documentation for all future journal adjustments.**

The Office's independent actuary concluded there was a deficiency of $4,660,000 in the loss and loss adjustment expense reserves. **It is recommended that the Company increase the loss and loss adjustment expense reserves to account for this deficiency in the next and future annual and quarterly statements filed with the Office.**

SUBSEQUENT EVENTS

Based upon the information and representations provided by the Company, the Office approved the request of the Company to commute the reinsurance treaties with ACE Tempest Re for a final payment to the Company of $3,150,000, as part of the resolution of an arbitration between ACE Tempest Re and the Company.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **First Protective Insurance Company** as of December 31, 2004, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was ($2,111,493) which was not in compliance with Section 624.408, FS and places the Company in an insolvent financial position. It is recommended that the Company immediately cure the surplus deficiency.

In addition to the undersigned, Rose Cady, Financial Examiner/Analyst, James Collins, Financial Examiner/Analyst, Samita Lamsal, Financial Examiner/Analyst, Roger C. Sullivan, Jr., AIC, ARM, Claims Consultant, Insurance Consulting Company, LLC, Kay Kufera, FCAS, MAAA, Veris Consulting, LLC, and Tracy Gates, CISA, CPA, Highland Clark, LLC, participated in the examination.

Respectfully submitted,

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Mary M. James, CFE, CPM
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation