REPORT ON TARGET EXAMINATION

OF

AEQUICAP INSURANCE COMPANY

FORT LAUDERDALE, FLORIDA

AS OF

DECEMBER 31, 2007

BY THE

OFFICE OF INSURANCE REGULATION

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February 20, 2009

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 a target examination as of December 31, 2007 of:

AEQUICAP INSURANCE COMPANY
3000 WEST CYPRUS CREEK ROAD
FORT LAUDERDALE, FL 33309

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

SCOPE OF EXAMINATION

This examination was a target (or “limited scope”) examination as of December 31, 2007, of assets and liabilities pursuant to Consent Order 96722-08-CO and other items directed by the Office of Insurance Regulation. The following lists the items reviewed under the target examination.

Assets and Liabilities:

Commercial mortgage loans on real estate - $2,025,000

Other invested assets:

Meritas LLC - “B” units - $3,000,000

Meritas LLC – “A” units – $1,623,412

Sterling Laureate - Executive Fund - $875,000

Receivables from parent, subsidiaries and affiliates - $3,316,685 (excluding $8,090,190 contributed surplus).

Pledged assets, as disclosed in Note 20(c) to the financial statement

Loss and loss adjustment expense reserves

Transactions subsequent to year-end 2007 affecting the items above

Other:

Premiums and commission transactions involving Gulf Coast Transportation, Inc.

Loss control practices performed by the Company and application of related credits for premium tax purposes

The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2005. The fieldwork commenced on August 11, 2008, and was concluded as of February 13, 2009.

This target statutory financial examination was 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.

EXAMINATION REVIEW

Assets and Liabilities

Commercial mortgage loan on real estate - $2,025,000

The Company had one mortgage loan at year-end 2007, a commercial mortgage loan of $2,025,000. The interest was prepaid to October 29, 2009 and no principal payments were due until January 1, 2010.

The mortgage loan of $2,025,000 was collateralized by a property referred to as Loxahatchee Groves which had been appraised for $2,880,000. The appraisal was dated April 17, 2007, six months before the investment was made. An additional property referred to as Parkland was subject to a first mortgage of $500,000 owned by American National Bank. The $218,000 equity in excess of the first mortgage amount was represented as additional security to the commercial loan.

The title insurance policy providing coverage on the property collateralizing the Company's commercial mortgage loan investment has AequiCap Inc. as the insured instead of the Company.

Other invested assets:

Meritas LLC - "B" units - $3,000,000

The 27.723 Meritas LLC "B" units were exchanged on February 28, 2008, for "A" units as part of a capital contribution. As the exchange occurred prior to the examination, the review of this investment consisted of obtaining the valuation of the "A" units which were reported as having a value of $5,700,000.

Meritas LLC – "A" units – $1,623,412

Meritas, LLC is the owner of a number of private schools both in Florida and abroad. Mr. Morgaman was Chairman of both Companies as of the date of the exam and the former CEO of Meritas, which shows common management.

The latest valuation of the Meritas LLC was performed May 24, 2007 by BMO Capital Markets. There was not a current valuation of Mertias LLC at year-end 2007. As of the February 28, 2008 capital contribution, the Company had $10,113,602 invested in Meritas LLC.

Subsequent event: The holdings in Meritas LLC were liquidated on April 9, 2009.

Sterling Laureate - Executive Fund - $875,000

The sterling laureate executive fund was not re-titled into the Company's name. However, it is noted that this investment was sold on August 27, 2008 for

$1,050,000. Receipt of the proceeds, which were traced through the Company's bank account, supported the year-end valuation of the investment.

The recorded minutes of the Investment Committee or Board of Directors did not adequately document the authorization of investments as required by Section 625.304, Florida Statutes.

Receivables from parent, subsidiaries and affiliates - $3,316,685 (excluding $8,090,190 contributed surplus).

Eighty-three percent (83%) of the $3,316,685 receivable was due from the Company's MGA, AequiCap Program Administrators, representing payroll advances and other transactions associated with business relationship. The receivable of $3,316,685 was aged and reviewed for subsequent receipt. Over 99% of the balance was verified as collected, with all but approximately 1.3% of the balance received during the first quarter of 2008.

The following related parties were identified in addition to the companies reported in Schedule Y of the Annual Statement:

- Mr. Morgaman, Company Chairman, owned 76% of the Company and had a 50% interest in Gulf Coast Transportation, Inc.
- Mr. Morgaman, Company Chairman, was also the Chairman of Meritas, LLC representing common management. The Company reported investments in Meritas LLC of $4,623,412 at year-end 2007. The investment in Meritas LLC increased in February, 2008, to $10,113,602 through a capital contribution of $5,490,190 of a debenture and Class A Units.

Loss and loss adjustment expense reserves

The targeted scope for loss and loss adjustment reserves was confined to a test of closed commercial automobile liability claims in the period August 1, 2007, through July 31, 2008, to ascertain how the closed claims compared to the established reserves at December 31, 2006, (if applicable) and December 31, 2007.

Our testing revealed that a number of smaller property damage claims were under reserved. The initial claim reserve for property damage coverage was usually $100, while the ultimate payout was well over $1,000. The Company maintained that these property damage reserves were in total insignificant and that, in any case, any significant shortfalls would be covered by the IBNR reserves.

Our testing of the bodily injury claims also indicated the Company ultimately was under reserved. The total number of bodily injury reserves tested were 47 out of a total open file count of 2,618. The Company stated that they responded quickly with respect to increasing reserves where legal correspondence had been received or legal action threatened an assertion.

Subsequent event: The Company was party to Consent Order 96722-08-CO dated August 22, 2008. Topics addressed in the Consent Order included claims reserving issues, and as of the date of this report the Company was in compliance with the terms relating to claims reserves.

Pledged assets

The Company's Notes to Financials of the 2007 Annual Statement included under Note 20(C)(1&2) pledged assets of $3,662,937. The Company has two bank accounts that were represented as collateral accounts, which totaled restricted assets of $3,797,333. The restricted assets were sufficient to cover the obligations reported by the Company as being backed by these collateral accounts.

Transactions subsequent to year-end 2007

The Company received a capital contribution of $8,090,190 on February 28, 2008, which consisted of the following:

Meritas Class A	$	5,700,000
Meritas Class B		(3,000,000)
Meritas Debenture		2,790,190
Equipment Trust Certificate		2,600,000
	$	8,090,190

The Florida Office of Insurance Regulation and the Company agreed to a Consent Order, #96722-08-CO, which addressed certain assets, liabilities, and financial reporting requirements. In particular, it was noted that the Company complied with section 4 (a), regarding the divestiture of Equipment Trust and Cry Baby Broadway, Ltd investments totaling $3,819,366, infusing cash in their place.

Other

Premiums and commission transactions involving Gulf Coast Transportation, Inc. (Gulf Coast).

A limited underwriting and rating review was performed on policies issued to Gulf Coast, along with a sample review of several other taxi and truck fleet commercial liability policies. The review consisted of a sample of 15 including Gulf Coast and 14 other unrelated policies, which revealed the following:

1. In all 15 cases, files were not properly documented to support rate modifications, and in 10 cases renewal premiums showed changes in rate modifications, but no justification for the change. These findings are expanded below under a. and b., respectively.

   a. The Company was required to maintain documentation which supports the rate modification. Appropriate documentation includes loss control reports, inspection reports, financial analyses, photographs, and safety plans.

   b. The modification shall remain in effect for all the renewals of that policy or for any replacement policy. If the insurer changes the modification upon renewal or replacement of that policy, the insurer shall maintain appropriate documentation of the revised modification and justify the change in the modification.

2. Of the 14 other unrelated policies sampled, there were two policies that had small balances owed by the insured after the policy had expired, but considered immaterial with respect to the total premium (Approximately $606 of $75k and $492 of $25k). Additionally, there was one policy with Gulf Coast, a related party as it is under common ownership by Mr. Morgaman, for which the premium wasn't paid until almost 9 months after expiration. There wasn't any payment made on this policy (Approximately 486k) until almost 6 months after the effective date. Approximately 71% of the premium wasn't paid until after the policy period expired. Although the premium payments did not comply with policy provisions, there was no evidence in the policy file of a notice of cancellation being issued by the Company.

A review of the commission checks payable to the agent of Gulf Coast revealed that, several, generally smaller, commission checks payable to the agent had been held for several months. In the instance involving the commissions on of the Gulf Coast policy, the Company had held these checks for the completion of a premium audit. A sample of commission checks payable to other brokers during this period did not indicate that the Company was holding commission checks as a standard practice.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2007, 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."

AEQUICAP INSURANCE COMPANY
Assets

December 31, 2007

	Per Company	Examination Adjustments	Per Examination
Bonds	$15,296,209	-	$15,296,209
Stocks:			
Common	6,377,862		6,377,862
Mortgage loans on real estate:	2,025,000		2,025,000
Real Estate:			
Properties			
occupied by Company	5,544,508		5,544,508
Cash	8,184,141		8,184,141
Other invested assets	7,451,778		7,451,778
Investment income due and accrued:	168,544		168,544
Agents' Balances:			
Uncollected premium	6,297,594	-	6,297,594
Deferred premium	12,310,953		12,310,953
Reinsurance recoverable	1,337,004		1,337,004
Current federal taxes reocverable	689,386		689,386
Net deferred tax asset	1,784,654		1,784,654
EDP Equipment	494,699	-	494,699
Receivable from parents, subsidiaries			
and affiliates	11,406,874		11,406,874
Aggregate write-ins for			
other than invested assets	93,830	-	93,830
Totals	$79,463,036	-	$79,463,036

AEQUICAP INSURANCE COMPANY
Liabilities, Surplus and Other Funds

December 31, 2007

	Per Company	Examination Adjustments	Per Examination
Losses	$42,877,219		$42,877,219
Reinsurance payable on paid losses and loss expenses	3,939,844		3,939,844
Loss adjustment expenses	3,613,719		3,613,719
Other expenses	498,147	-	498,147
Taxes, licenses and fees	432,290		432,290
Unearned premiums	4,515,730		4,515,730
Ceded reinsurance premiums payable	4,850,960		4,850,960
Funds held under reinsurance treaties	190,107		190,107
Amounts withheld or retained by company	140,720		140,720
Provision for reinsurance	46,307		46,307
Aggregate write-ins for laibilities	955,818		955,818
Total Liabilities	62,060,861	-	62,060,861
Aggregate write-ins for special surplus funds	250,000		250,000
Common capital stock	2,350,000		2,350,000
Gross paid in and contributed surplus	39,930,346		39,930,346
Unassigned funds (surplus)	(25,128,171)		(25,128,171)
Surplus as regards policyholders	17,402,175	-	17,402,175
Total liabilities, surplus and other funds	$79,463,036	-	$79,463,036

AEQUICAP INSURANCE COMPANY
Statement of Income

December 31, 2007

Underwriting Income	
Premiums earned	$45,518,887
Deductions:	
Losses incurred	29,853,998
Loss expenses incurred	12,326,028
Other underwriting expenses incurred	13,739,572
Aggregate write-ins for underwriting deductions	(250,000)
Total underwriting deductions	55,669,598
Net underwriting gain or (loss)	(10,150,711)
Investment Income	
Net investment income earned	269,584
Net realized capital gains or (losses)	265,061
Net investment gain or (loss)	534,645
Other Income	
Aggregate write-ins for miscellaneous income	1,066
Total other income	1,066
Net income (loss) before dividends to policyholders and before federal & foreign income taxes	(9,615,000)
Dividends to policyholders	110,000
Net Income (Loss) after dividends to policyholders, but before federal & foreign income taxes	(9,725,000)
Federal & foreign income taxes	-
Net Income (Loss)	($9,725,000)
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	$20,162,689
Net Income (Loss)	(9,725,000)
Net unrealized capital gains or losses	199,520
Change in non-admitted assets	226,398
Change in net deferred income tax	(1,542,421)
Change in provision for reinsurance	(9,201)
Surplus adjustments: Paid in	8,090,190
Examination Adjustment	
Change in surplus as regards policyholders for the year	($2,760,514)
Surplus as regards policyholders, December 31 current year	$17,402,175

COMMENTS ON FINANCIAL STATEMENTS

Capital and Surplus

The amount reported by the Company of $17,402,175 was not changed as a result of examination.

A comparative analysis of changes in surplus is shown in the follow schedule:

AEQUICAP INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

December 31, 2007

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, 2007 per Annual Statement				$17,402,175
	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
ASSETS:				
		$0		
LIABILITIES:				
No adjustments				
Net Change in Surplus:				0
Surplus as Regards Policyholders December 31, 2007, Per Examination				$17,402,175

SUMMARY OF FINDINGS

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, 2007.

The recorded minutes of the Investment Committee or Board of Directors did not adequately document the authorization of investments as required by Section 625.304, Florida Statutes. **We recommend that the Company ensure its corporate records document that all investments have been authorized by the Board of Directors.**

Commercial mortgage loans on real estate

The title insurance policy providing coverage on the property collateralizing the Company's commercial mortgage loan investment has AequiCap Inc. as the insured instead of the Company. **We recommend that the Company ensure proper title insurance coverage on the property collateralizing its commercial mortgage loan investment by being listed as the insured on the policy.**

Sterling Laureate - Executive Fund

The sterling laureate executive fund was not re-titled into the Company's name. **We recommend that the Company ensure that all invested assets are titled in the Company name.**

Pledged assets

Financial Note 20(C)(1&2) of the Company's 2007 Annual Statement reported the incorrect amount of pledged assets. **We recommend that the Company comply with the NAIC**

Annual Statement Instructions and properly report the total of restricted assets in the Notes to Financial Statements.

Premiums and commission transactions involving Gulf Coast Transportation, Inc. (Gulf Coast)

In the 14 cases for policies of insureds not related to the company or its management, files were not properly documented to support rate modifications, and in 10 cases renewal premiums showed changes in rate modifications, but no justification for the change. **We recommend that the Company comply with Rule 69O-170.004, Florida Administrative Code by notating its files indicating support for debits/credits to the rating. Additionally, the Company should be consistent on issuing policy credits from year to year.**

There was one policy with Gulf Coast, a related party as it is under common ownership by Mr. Morgaman, that was ultimately paid almost 9 months after expiration. **We recommend that the Company comply with the terms of the policy with all insureds, specifically with the provisions involving premium payment.**

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **AequiCap Insurance Company** as of December 31, 2007, consistent with the insurance laws of the State of Florida.

In addition to the undersigned, David Schleit, CPA, CFE, Senior Insurance Examiner, Victor Negron, AIE, Market Conduct Supervisor, and Todd Fatzinger, CFE, Managing Partner, all of Examination Resources, LLC, participated in the examination.

Respectfully submitted,

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Kethessa Carpenter, CPA
Financial Examiner/Analyst Supervisor