

REPORT ON LIMITED SCOPE EXAMINATION
OF
COMPANION PROPERTY & CASUALTY
INSURANCE COMPANY
COLUMBIA, SOUTH CAROLINA

OF THE

**Loss and Loss Expenses, Large Deductible
Collateral Reserves and Reinsurance
As of September 30, 2010**

BY THE
OFFICE OF INSURANCE REGULATION

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TALLAHASSEE, FLORIDA

March 28, 2011

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, Rule 69O-138.005, Florida Administrative Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted a limited scope examination of the private passenger personal injury protection Loss and Defense and Cost Containment Expense Reserves as of September 30, 2010, of:

**COMPANION PROPERTY & CASUALTY INSURANCE COMPANY
51 CLEMSON ROAD
COLUMBIA, SOUTH CAROLINA 29229**

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

SCOPE OF EXAMINATION

This was a limited scope examination of the Company to the extent and in the manner directed by the Florida Office of Insurance Regulation (Office). To the extent applicable, the limited scope examination was conducted in accordance with the guidance of the National Association of Insurance Commissioners (NAIC) Financial Condition Examiner's Handbook, the NAIC Accounting Practices and Procedures Manual and the Florida Administrative Code. The limited scope examination differed in many respects from that of a full-scope examination or an audit performed in accordance with generally accepted auditing standards.

The field work commenced on December 16, 2010, and concluded as of March, 28, 2011. The limited scope examination included material events occurring subsequent to September 30, 2010, and noted during the course of the examination as they related to the foregoing areas within the limited scope of the examination.

This examination covered the Company's reporting of worker's compensation loss and loss adjustment expenses, accounting for collateral on large deductible worker's compensation policies, and the quota-share reinsurance programs as of September 30, 2010. The examination was conducted by Highland Clark, LLC.

HISTORY

General

The Company was incorporated in South Carolina on February 13, 1984, and commenced business on July 1, 1984, as Companion Property and Casualty Insurance Company. The Company was founded by its current president as a wholly owned subsidiary of Blue Cross and Blue Shield of South Carolina (BCBSSC). The Company formed a subsidiary company, Companion Commercial Insurance Company (CCIC), in 1997 to write a second tier workers' compensation line of business. The Company assumes 100% of the business written by CCIC.

The Company was licensed in all states, except New York, for which a current application was pending. The Company's top three states for written premium were Pennsylvania (\$28.7 million), Florida (\$25.3 million) and South Carolina (\$25.0 million). The Company was also licensed as a servicing carrier in Georgia, Mississippi, North Carolina, New Jersey, South Carolina, Tennessee, Virginia and the District of Columbia. The servicing carrier business included contracts to administer a portion of workers' compensation assigned risk plans.

Florida Workers Compensation and Other Liability Business

In 2006, the Company entered the Florida worker's compensation and other liability market through a series of agreements executed with Dallas National Insurance Company (DNIC). The Coverage Agreement, Third Party Administrator (TPA) Agreement, Pledge Agreement, Guarantee and Indemnity Agreement established the arrangement between the Company and DNIC entities to allow DNIC to: underwrite the business for AMS Staff Leasing (AMS) on the Company's paper, service AMS claims as a TPA, and reinsure the AMS business back from the Company through a 100% quota-share reinsurance agreement.

The following table shows worker's compensation and other liability premiums written and ceded country-wide under all fronting arrangements and specifically to DNIC. Increased cession percentages leveled off in 2009 as the parent company assumed a portion of the worker's compensation business.

The following table shows Florida business ceded to DNIC through December 31, 2010. Cession percentages remained the same from 2009 to 2010, as there have been no changes to the treaties. DNIC is an unauthorized reinsurer in Florida. The Company, therefore, was in violation of Sections 624.404(4)(a) and (b), Florida Statutes, which prohibits companies from ceding more than fifty percent of their Florida portfolio, or any one line of business, to an unauthorized reinsurer.

December 31, 2010 Florida Business			
Line of Business	Direct Written Premium	Total Premium Ceded to DNIC	% of Direct Written Premium Ceded to DNIC
Homeowners Multiple Peril	\$ 6,966,296	-	-
Inland Marine	10,270,639	-	-
Workers' Compensation	9,556,469	\$ 8,889,438	93.02%
Other Liability-Occurrence	1,106,525	1,106,525	100.00%
Private Passenger Auto No-Fault (personal protection)	18,911	-	-
Other Private Passenger Auto Liability	93,116	-	-
Other Commercial Auto Liability	7	-	-
Private Passenger Auto Physical Damage	290,740	-	-
Commercial Auto Physical Damage	393	-	-
Surety	1,014,393	-	-
Total	\$ 29,317,489	\$ 9,995,963	34.10%

LOSS AND LOSS ADJUSTMENT EXPENSES

The TPA agreement from March of 2006 listed DNIC as the TPA. Follow-up with the Company indicates that Aspen Administrators, Inc. (Aspen) was the TPA. Aspen is an affiliate of the DNIC through common ownership. AMS, the primary Florida policyholder, is also an affiliate of DNIC through common ownership. Highpoint Underwriters (Highpoint) performs the underwriting on the Florida business as contracted in the Coverage Agreement. Highpoint is also an affiliate of DNIC through common ownership. DNIC is also the 100% quota-share reinsurer for the Florida workers compensation and other liability business. DNIC's affiliation with AMS, through common ownership and direct control over the claims processing, weakened the Company's ability to provide proper oversight and control of various functions, including claims handling and reporting.

In determining the source and disposition of losses and loss adjustment expenses (LAE) for the worker's compensation and other liability business ceded to DNIC, the examination evaluated the supporting agreements and general ledger transactions for the recording of written premium, underwriting commissions, fronting fees and ceding commissions. It was determined that losses and LAE within the \$1 million dollar deductible amount were being paid by DNIC/Aspen acting as TPA for the Company, with DNIC seeking reimbursement from AMS. Since virtually all of the loss expenses fell below the \$1 million dollar threshold, the Company only reported an immaterial amount of paid losses for the Florida worker's compensation business. The examination inspected collateral analysis reports prepared for the Company by their consulting actuary (Milliman, Inc.). The most recent full-year analysis available, dated December 31, 2009, indicated that AMS had deductible paid losses and loss adjustment expenses totaling \$16.4 million dollars. However, these deductible losses were not recorded in the Company's general

ledger or claims operating account, but rather settled in aggregate through a large deductible collateral account maintained by the Company. Furthermore, the Company allowed DNIC to file its NCCI statistical reports on this loss experience. Failure to maintain proper accounting records and statistical reporting of large deductible claims is a violation of Rule 69O-189.006 (2), Florida Administrative Code.

LARGE DEDUCTIBLE COLLATERAL

Insurance companies are required by statute to pay the first dollar of loss on large deductible worker's compensation policies and then seek reimbursement from the policyholder. This results in many companies requiring some form of collateral to mitigate their credit risk. The Company required that AMS provide cash collateral, recorded in a contract-liability account. Each quarter, the balance of this account would be adjusted with deposits or remittances based on actuarially determined values.

The examination evaluated the funding of this account, the actuarial analysis performed by the consulting actuary, and the ongoing disposition of balances by the Company. The Company was diligent in obtaining the up-front collateral and making adjustments as required by the collateral analysis reports provided. The examination actuary also evaluated the methods and assumptions utilized by Milliman, Inc. to establish the collateral reserves. However, when evaluating the disposition of the collateral balances, the examination found that the Company does not maintain the funds in a truly segregated fashion. Rather, the balance of the collateral bank account is transferred into a short-term investment account. For this reason, as of September 30, 2010, the collateral bank account balance did not reflect the required funds

based on the actuarial determination. The cash collateral are fiduciary funds belonging to the policyholder and should not be co-mingled with other Company funds.

REINSURANCE

The Company had two quota-share reinsurance agreements with DNIC covering their worker's compensation and other liability lines respectively. Both of these agreements established cession rates of 100% with 0% ceding commission, which created a fronting arrangement, in violation of Section 624.404(4)(b), Florida Statutes. With regards to Florida business, the statute prohibits companies from ceding more than fifty percent of their total lines of business, any one line of business, or any one agent's business, to an unauthorized reinsurer.

As indicated above in the section captioned "Florida Workers Compensation and Other Liability Business", the Company had various other agreements with DNIC. To evaluate compliance with Statements of Statutory Accounting Principles (SSAP) #62, it was necessary for the examination to obtain an understanding of these agreements, their related financial transactions and their potential impact to the reinsurance arrangement with DNIC.

Of significant relevance was the Pledge and Guarantee Agreement, which in part, "assigns, transfers, pledges and delivers to the Company, as secured party, a first priority lien and security interest in all of the issued and outstanding equity interest of DNIC and AMS, together with all earnings thereon, all additions thereto". The examination also noted that DNIC does not report these pledges on their filed annual statements to Texas.

The Coverage Agreement indicated fees paid by DNIC to the Company were 6% of gross written premium, while the TPA Agreement indicated fees paid by the Company to DNIC for claim handling were 8% of the gross earned premium on any policies for which DNIC handled claims.

The existence of the Coverage, TPA and Pledge Agreements constitute side arrangements that call into question the validity of the reinsurance agreement between the Company and DNIC. Particularly, the Coverage Agreement contains verbiage that establishes components of the reinsurance arrangement, retention, layers, retrocession, and fees paid to the Company. The TPA Agreement outlines percentage-based service fees payable to DNIC that effectively reduce its potential liability for assumed losses. Lastly, the Pledge Agreement, with benefits accruing to the Company, creates an environment that precludes any reasonable expectation of arms-length negotiations with DNIC going forward.

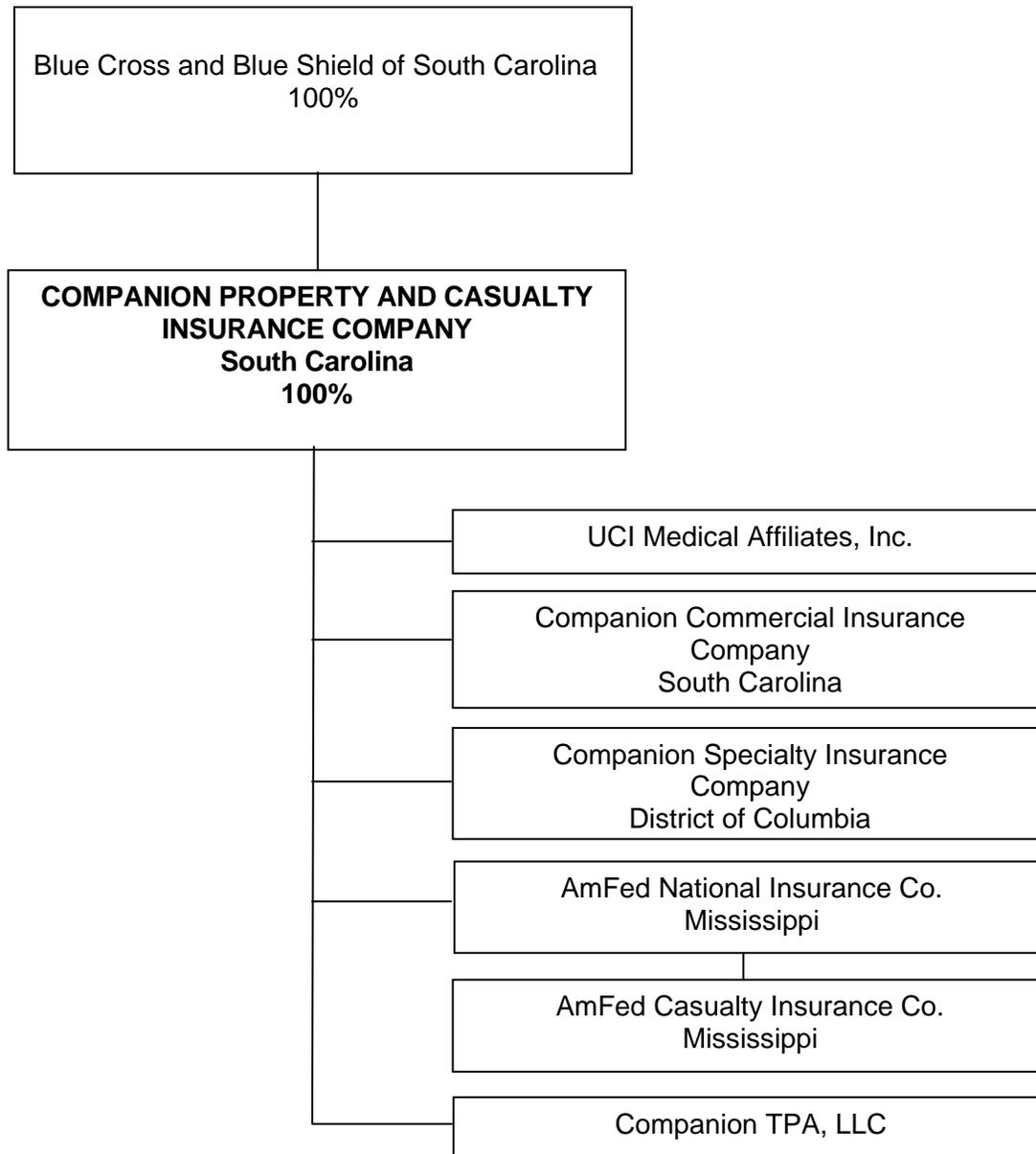
Subsequent Event

The Office and The Company subsequently entered into a Consent Order (Case No.: 107977-09-CO) filed March 18, 2011. The Consent Order addresses certain issues including but not limited to compliance with Rule 69O-189.006, Florida Administrative Code, Section 624.404(4)(a), Florida Statutes and submission of a Florida Business Plan to the Office which details the methods by which the Company will maintain proper controls and oversight over its book of business in Florida. The Company will also retain operational control over its underwriting and claims handling procedures for the Florida business. Further, the Consent Order requires written approval of the Office prior to any material deviation from the Florida Business Plan.

A simplified organizational chart as of September 30, 2010, reflecting the holding company system, is shown below. Schedule Y of the Company's 2009 annual statement provided a list of all related companies of the holding company group.

**COMPANION PROPERTY AND CASUALTY INSURANCE COMPANY
ORGANIZATIONAL CHART**

SEPTEMBER 30, 2010



FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of September 30, 2010, 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."

COMPANION PROPERTY AND CASUALTY INSURANCE COMPANY
Assets

SEPTEMBER 30, 2010

	Per Company	Examination Adjustments	Per Examination
Bonds	\$ 262,887,937	\$ -	\$ 262,887,937
Stocks:			
Common	59,666,675	-	59,666,675
Cash and S/T investments	82,826,336	-	82,826,336
Other Invested Assets	16,928,441	-	16,928,441
Investment Income			
Due and Accrued	2,680,603	-	2,680,603
Premiums and considerations:			
Uncollected Premiums	34,271,652	-	34,271,652
Deferred Premiums	39,201,921	-	39,201,921
Reinsurance Recoverable	4,447,836	-	4,447,836
Taxes:			
Net Deferred Tax Asset	7,647,431	-	7,647,431
Guaranty Funds Receivable or on Deposit	3,345,770	-	3,345,770
Electronic Data Processing Equipment and Software	76,777	-	76,777
Receivable from Parent, Subsidiary and Affiliates	8,940,053	-	8,940,053
Aggregate Write-In for Other than Invested Assets	13,690,386	-	13,690,386
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Total	\$ 536,611,818	\$ -	\$ 536,611,818
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COMPANION PROPERTY AND CASUALTY INSURANCE COMPANY
Liabilities, Surplus and Other Funds

SEPTEMBER 30, 2010

	Per Company	Examination Adjustments	Per Examination
Losses	\$ 111,234,841	\$ -	\$ 111,234,841
Reinsurance Payable on Paid Losses and LAE	6,922,269	-	6,922,269
Loss adjustment expenses	35,319,109	-	35,319,109
Commissions payable	3,331,934	-	3,331,934
Other expenses	5,752,366	-	5,752,366
Taxes, licenses and fees	9,016,737	-	9,016,737
Current Federal and Foreign Income Taxes	1,921,000	-	1,921,000
Unearned premiums	87,612,497	-	87,612,497
Advance premiums	256,560	-	256,560
Ceded reinsurance premiums payable	5,093,242	-	5,093,242
Funds Held by Company Under Reinsurance Treaties	16,961,320	-	16,961,320
Provision for reinsurance Payable to Parent, Subsidiary and Affiliate	76,711	-	76,711
Aggregate Write-Ins for Liabilities	31,862,780	-	31,862,780
			-
Total liabilities	\$ 329,540,005		\$ 329,540,005
Common Stock	\$ 4,200,000	\$ -	\$ 4,200,000
Gross Paid In and Contributed Surplus	122,369,422	-	122,369,422
Unassigned funds (surplus)	80,502,391	-	80,502,391
			-
Surplus as regards policyholders	\$ 207,071,813		\$ 207,071,813
Totals	\$ 536,611,818	\$ -	\$ 536,611,818

COMPANION PROPERTY AND CASUALTY INSURANCE COMPANY
Statement of Income

SEPTEMBER 30, 2010

UNDERWRITING INCOME

Premiums earned	\$	90,737,291
DEDUCTIONS		
Losses incurred	\$	41,362,607
Loss adjustment expenses incurred		13,092,295
Other underwriting expenses incurred		37,047,289
Total underwriting deductions	<u>\$</u>	<u>91,502,191</u>
Net underwriting gain (loss)	\$	(764,900)

INVESTMENT INCOME

Net investment income earned	\$	5,114,344
Net realized capital gains		(60,456)
Total investment income (loss)	<u>\$</u>	<u>5,053,888</u>

OTHER INCOME

Net gain (loss) from agents' or premium balances charged off	\$	(922,581)
Finance and service charges not included in premiums		195,223
Aggregate write-ins for miscellaneous income		946,638
Total other income (loss)	<u>\$</u>	<u>219,280</u>
Net income before dividends to policyholders	\$	4,508,268
Dividends to policyholders		147,353
Net income after dividends to policyholders	<u>\$</u>	<u>4,360,915</u>
Federal and foreign income taxes incurred		2,202,607
Net income	<u><u>\$</u></u>	<u><u>2,158,308</u></u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders December 31 prior year	\$	<u>199,665,831</u>
Net income	\$	2,158,308
Change in unrealized capital gains or (losses)		6,341,690
Change in non-admitted assets		(1,017,307)
Change in provision for reinsurance		(76,711)
Change in Surplus as regards policyholders	<u>\$</u>	<u>7,405,980</u>
Rounding adjustment	\$	2
Surplus as regards policyholders September 30 current year	<u><u>\$</u></u>	<u><u>207,071,813</u></u>

A comparative analysis of changes in surplus is shown below.

**COMPANION PROPERTY AND CASUALTY INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS
SEPTEMBER 30, 2010**

Surplus as regards policyholders September 30, 2010 per Quarterly Statement			\$ 207,071,813
	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS: No Adjustment			
LIABILITIES: No Adjustment			
Net Change in Surplus:			\$ -
Surplus as regards policyholders September 30, 2010 per Examination			<u>\$ 207,071,813</u>

SUMMARY OF FINDINGS

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 limited scope examination as of September 30, 2010.

Loss and Loss Adjustment Expenses

The Company was not paying first-dollar losses on the large deductible worker's compensation policies or maintaining control over claims handling, accounting and statistical reporting as required by Rule 69O-189.006, Florida Administrative Code. **We recommend that the Company properly account for deductible paid losses and loss adjustment expense to evidence compliance with Rule 69O-189.006, Florida Administrative Code, regarding payment and required statistical reporting of first-dollar losses.**

The Company was utilizing a TPA that was affiliated with the policyholder and reinsurer. **We recommend that the Company discontinue use of TPAs affiliated with or under the control of its policyholders or reinsurers.**

Large Deductible Collateral

The Company was co-mingling worker's compensation large deductible collateral funds with other Company funds. **We recommend that the Company establish a trust account for large deductible collateral, to be used only for settlement of paid losses. The trust account balance should not be reported on the balance sheet but rather disclosed in the notes to the financial statements.**

Reinsurance

The Company's 100% quota share reinsurance agreements with DNIC created an illegal fronting arrangement under Section 624.404(4)(b), Florida Statutes. **We recommend that the Company re-negotiate the DNIC quota share reinsurance agreement to be in compliance with Section 624.404(4)(b), Florida Statutes.**

The Company had executed a pledge agreement with DNIC, giving the Company first lien on the securities and earnings of DNIC. **We recommend that the Company establish independence from DNIC by terminating any pledge or other agreements that encumber the securities or earnings of DNIC companies.**

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Companion Property and Casualty Insurance Company** as of September 30, 2010, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$207,071,813, which exceeded the minimum of \$32,954,000, required by Section 624.408, Florida Statutes.

In addition to the undersigned, Tracy D. Gates, CISA, CPA (North Carolina), Examiner in Charge, Julie Geilear, CFE, Worker's Compensation Specialist, Brad Hazelwood, Participating Examiner and Dennis Henry, FCAS, MAAA, Actuary, participated in the examination. We also recognize the participation of Highland Clark, LLC and The Actuarial Advantage, Inc. in the examination.

Respectfully submitted,

Kethessa Carpenter, CPA
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation