

**REPORT ON EXAMINATION**  
**OF**  
**GUARANTEE INSURANCE COMPANY**  
**FORT LAUDERDALE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2010**

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

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Tallahassee, Florida

July 9, 2011

Kevin M. McCarty  
Commissioner  
Office of Insurance Regulation  
State of Florida  
Tallahassee, Florida 32399-0326

Joseph Torti III  
Chairman, NAIC Financial Condition (E) Committee  
Superintendent  
State of Rhode Island  
Department of Business Regulation, Division of Insurance  
1511 Pontiac Avenue, Building 69-2  
Cranston, Rhode Island 02920

Dear Sirs:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination of December 31, 2010, of the financial condition and corporate affairs of:

**GUARANTEE INSURANCE COMPANY  
401 E. LAS OLAS BLVD, SUITE 1650  
FORT LAUDERDALE, FLORIDA 33301**

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, 2007, through December 31, 2010. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2006, and subsequently, a limited scope examination was performed by representatives of the Office as of December 31, 2007. This examination commenced with planning at the Office on February 21, 2011, to February 24, 2011. The fieldwork commenced on February 28, 2011, and concluded as of July 9, 2011.

This examination was a multi-state financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

## **SUMMARY OF SIGNIFICANT FINDINGS**

### **Current Exam Findings**

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during this examination.

### **Affiliated Agreements**

The Investigative Services Agreement with Patriot Recovery, Inc. was not in compliance with SSAP No. 96 in that it did not contain provisions for a timely settlement of accounts involved nor did it contain a specific due date for those amounts.

The Company did not maintain written agreements with certain affiliated persons, entities and/or related parties as required by paragraph 15 of Florida Consent Order 88129-06, filed December 29, 2006. The affiliated parties lacking written agreements consisted of: Patriot National Insurance Group, Patriot General Agency, and Del Pizzo & Associates.

### **Prior Exam Findings**

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2007, along with resulting action taken by the Company in connection therewith. It should be noted that while this is a four-year examination dating back

to the end of the last full-scope examination performed as of December 31, 2006, the limited scope examination as of December 31, 2007 reviewed all of the findings of the 2006 full-scope examination most of which were cleared. This review of prior examination findings is limited to only those outstanding examination findings from the limited scope examination performed as of December 31, 2007, which includes findings in the full-scope examination as of December 31, 2006.

### **Aggregate Write-ins for Assets**

During the 2006 full-scope examination, the amounts reported by the Company were increased due to unreported deductible recoverable and the use of deposit accounting due to a reinsurance agreement that did not transfer risk and was decreased by the incorrect amount reported for an affiliated promissory note.

During the 2007 limited scope examination, the amount reported by the Company was not adjusted. The examination concluded that except for an immaterial \$300,000 balance reported in Suspense Account – Paid Losses, the balance of aggregate write-ins for assets was properly stated at December 31, 2007 and considered the Company to be in compliance with Consent Order 93640-07-CO.

Additionally, the 2007 limited scope examination found through a review of the CPA audit work that the Company had advanced Patriot Risk Services \$300,000 during 2007 through a series of cash transfers beginning in March 2007. The limited scope examination indicated concern as to the admissibility of this asset as of December 31 2007.

**Resolution:** The amount reported for aggregate write-ins for assets contained only a balance for deductible recoveries which were tested during the review of reserves and no exceptions were noted. The Company correctly reported their Annual Statement account balances in accordance with SSAP No. 25; the Company was in compliance with Rule 69O-143.047, Florida Administrative Code.

### **Aggregate Write-Ins for Liabilities**

During the 2006 full-scope examination, the amounts reported by the Company for unearned ceding commissions were increased due to calculation errors.

During the 2007 limited scope examination, the aggregate write-ins for liabilities at December 31, 2007 consisted of the unearned ceding commission for the Company's treaty business and alternative market business. The limited scope examination tested calculations of the alternative market business unearned ceding commission resulting in a \$17,133 difference which was immaterial to the Company's overall financial position. Except for the immaterial \$17,133 balance reported in unearned ceding commissions, the balance of aggregate write-ins for liabilities was generally correct in total at December 31, 2007 and the Company was determined to be in compliance with Consent Order 93640-07-CO.



Additionally, the 2007 limited scope examination found differences within individual alternative market cells that resulted from the ceding commission rates used in the test calculations differing from the rates used by the Company; noting this could indicate errors in the individual cells' funds withheld balances.

**Resolution:** The Company's alternative market reinsurance program for the current examination period was reviewed and no material errors or incorrect rates were found.

### **Payables to Parent, Subsidiaries and Affiliates**

During the 2007 limited scope examination, it was reported that the Company had a number of service agreements with affiliated companies. The Company represented that the inter-company accounts were being used when one company paid expenses for other companies since some bills were processed for the consolidated group. The accounts were then settled monthly within thirty (30) days of the end of the month. The Company also represented that accounting for certain service agreements did not go through the inter-company accounts but were set up on Patriot's books as receivables and on the Company's books as expenses and liability accruals. Additionally, the examiner asked the Company to demonstrate where the offsetting liabilities were recorded in the Company's general ledger. The Company responded "the offsetting liabilities are all in individual case LAE reserves which may include other non-intercompany LAE expense costs as well." Based on this response, the examiner was unable to verify if the intercompany liabilities discussed above had been accrued by the Company at December 31, 2007.

**Resolution:** No material reporting errors or indications of funds advanced were found. The Great Plains general ledger system had been enhanced to include a module for tracking and reporting inter-company transactions. The Company correctly reported their Annual Statement account balances in accordance with SSAP No. 25 and the Company was in compliance with Rule 69O-143.047, Florida Administrative Code.

### **Unearned Premium**

During the 2006 full-scope examination, the amount reported by the Company was increased due to errors in calculation which resulted in an overstatement that was due to reserve credit taken for reinsurance with no risk transfer.

During the 2007 limited scope examination, the CPA audit work papers were obtained and reviewed that included a copy of the Company's Calendar Earned / Unearned (CEU) Report as of December 31, 2007. Using ACL, the unearned premiums were summarized by type of business (treaty and alternative market), noting that the total unearned premium for the types of business agreed to the corresponding balances in the Company's December 31, 2007 general ledger. The examination proposed no adjustment to the unearned premium for either treaty or alternative market business general ledger accounts as of December 31, 2007.

In the course of using ACL software to review unearned premiums, five policies were found with negative unearned premium totaling \$10,097 for treaty business. The Company researched the issue and reported the problems were due to clerical input errors and endorsement transactions. The Company represented that they would work with the application developers to correct any software coding that might alleviate future problems.

**Resolution:** The Company's unearned premium detail was reviewed for the current examination period and no material errors or negative unearned premiums were found. The substantive review of the account detail substantiated that corrective controls were put into place.

### **Reinsurance Risk Transfer**

During the 2006 full-scope examination, an adequate analysis of risk transfer was not identified in the documents provided for the examination in five reinsurance agreements. Additionally, the Company was improperly including reinsurance transactions in the net amounts receivable from Pinnacle Actuarial Services (PAS) and was unable to provide supporting documentation for some transactions to clearly identify proper classification.

During the 2007 limited scope examination, the risk transfer analysis performed by PAS and the in-house computations performed by the Company were reviewed. Independent analysis and calculations regarding the risk transfer analysis concurred with PAS's and the Company's conclusions as to the adequacy of risk transfer for the contracts reviewed but identified the following areas of concern and related recommendations:

- PAS used a discount rate for the discounting of the payout of losses that was off by one duration. When this error was corrected, the revised analysis indicated that the 10/10 guideline test had been achieved for one reinsurance agreement that had previously failed this test. The error did not have a material impact on the other reinsurance agreements tested. We recommend that the Company review all risk transfer calculation assumptions to ensure that assumption errors do not have a material impact on the Company's conclusions regarding risk transfer in the future.

- In performing the 10/10 risk transfer analysis, PAS assumed lognormal distribution of losses and assumed a mean loss ratio of 60%. The Office was concerned that the assumed 60% mean loss and ALAE ratio was unreasonably low. A review of the U.S. Property and Casualty Insurance Industry Experience for Workers Compensation Insurance as published in Best's Aggregates and Averages indicated a combined U.S. Industry experience mean loss and ALAE ratio of approximately 81% for the 2004, 2005 and 2006 periods. Since the Company is a relatively young company with limited loss experience that writes, by the Company's own admission, a riskier clientele, it appeared appropriate to assume that the ultimate losses would not be more favorable than industry experience. We recommended that the Company continue to monitor loss ratios and consider future results on the Company's risk transfer.
- The Company performed in-house risk transfer testing for five quota share reinsurance agreements with effective dates in 2007 and six reinsurance agreements effective prior to 2006. The test calculations for these agreements were reviewed and it was concluded that these calculations were relatively simplistic and utilized only one simulation.

**Resolution:** It was discovered that prior Company and examination risk transfer analysis and findings were not based on the Company's Redomestication Consent Order 88129-06, which required risk transfer of a 10% chance of a 25% loss (10/25) instead of a 10% chance of a 10% loss (10/10).

Subsequent Event: The issue has been resolved by amended Consent Order #88129-06 which changed the required risk transfer to 10/10.

### **Cash and Short Term Investments**

During the 2006 full-scope examination, the Company reported \$781,000, which represented receivables for securities, as cash and short term investments and also reported \$500 under cash, which represented an error by the Company.

During the 2007 limited scoped examination, the CPA investment work papers plus bank and investment account statements and confirmations were reviewed. It was noted that the errors identified by the 2006 Examination Report were not present; however, one exception was identified in the reporting of \$5,645,834 held in a Class 1 money market account. The Company included the balance in cash on Schedule E of the 2007 Annual Statement when the funds should have been reported as a short-term investment on Schedule DA. Except for the reporting error regarding the money market account discussed above, the Company was determined to be in compliance with Consent Order 93640-07-CO with regard to cash and short-term investment balances.

**Resolution:** The Company's cash and short-term investment accounts for the current examination period were reviewed and no material errors or misclassifications of assets were found. The Company correctly reported their Annual Statement account balances in accordance with SSAP No. 2, the NAIC Annual Statement Filing Instructions and NAIC SVO Manual.

### **Current Federal Income Tax Recoverable**

During the 2006 full-scope examination, the amounts reported by the Company were decreased due to an understatement in income tax provision.

During the 2007 limited scope examination, an adjustment to current federal income taxes recoverable/payable of \$93,903 was reflected in the examination financial statements and the following errors or irregularities were identified:

- In June 2007, the Company made an \$850,000 federal estimated income tax payment. In September and October, the Company was reimbursed \$400,000 from SunCoast Holdings and \$32,373 from Patriot Risk Service, respectively. These transactions were reflected in the current income tax reconciliation discussed above and indicated that the Company advanced funds on behalf of other members of the affiliated tax group in violation of terms of the Tax Allocation Agreement.
- Based on the results of the procedures, the Company was not in compliance with Consent Order 93640-07-CO, in regard to Current Federal Income Tax Recoverable.

**Resolution:** The Company's federal income tax transactions for the current examination period was reviewed and no material errors or indications of funds advanced were found. The Company correctly reported their Annual Statement account balances in accordance with SSAP No. 10, SSAP No. 25, and the NAIC Annual Statement Filing Instructions. The Company was in compliance with Consent Order 93640-07-CO.

### **Other Expenses**

During the 2006 full-scope examination, the amount reported by the Company was decreased due to reclassification to the appropriate annual statement lines. We recommended that the Company correctly report other expenses balances on all future annual and quarterly statement filings as required by SSAP No. 35 and the NAIC annual statement instructions.

The 2007 limited scope examination made the following adjustments, summarized below, to the examination financial statement:

- The Company failed to accrue \$125,100 in 2007 bonuses which were paid out in March 2008.
- The Company over-accrued salaries by \$29,826.
- During 2007, the payment of \$64,284 for reinsurance segregated cell license fees were processed through a liability account and not properly expensed.
- After making the \$64,284 adjustment discussed above, the balance in an account titled Accrued Management Fee was \$94,033. This liability represented management fees due Patriot Risk Services, an affiliate. The examination tested this liability balance for reasonableness and reclassified this balance to amounts payable to parent subsidiaries and affiliates on the examination balances sheet.
- The Company included \$100,000 in accrued expenses of examination fees. The examination reclassified this liability to taxes, licenses and fees in accordance with the annual statement instructions.

Although the sum of the adjustments identified above was immaterial to the Company's overall financial position, the Company was not in compliance with Consent Order 93640-07-CO in regard to Other Expenses Payable due to the Company's failure to properly account for and report liability balances.

**Resolution:** The Company's other expense transactions for the current examination period were reviewed and no material reporting errors or misclassifications were found. The Company correctly reported their Annual Statement account balances in accordance with SSAP No. 35 and the NAIC

Annual Statement Filing Instructions. The Company was in compliance with Consent Order 93640-07-CO.

### **Taxes, Licenses & Fees**

During the 2006 full-scope examination, the amount reported by the Company was increased due to under accrued liabilities.

During the 2007 limited scope examination, it was noted that the Company accrued \$100,000 for examination expenses at December 31, 2007. This liability was included as Other Expenses on Page 3, Line 5 of the 2007 Annual Statement. This classification was not in accordance with the annual statement instructions which require examination fees to be included in taxes, licenses and fees in the annual statement. We reclassified this liability to taxes, licenses and fees in the examination balance sheet.

In October 2007, the Company paid \$202,189 to the State of Florida for the Florida corporate/franchise tax for the tax year 2006. An adjustment for \$163,954 to reduce state tax expense and establish a receivable from parent was reflected in the examination financial statements. The examination non-admitted this receivable balance. The payment of \$202,189 for the 2006 Florida corporate/franchise tax included funds advanced by the Company on behalf of other members of the affiliated tax group in violation of the terms of the Tax Allocation Agreement.

Based on the results of these procedures, the Company was not in compliance with Consent Order 93640-07-CO.



**Resolution:** The Company's premium tax, corporate/franchise tax, guaranty fund assessment and state examination expense transactions for the current examination period were reviewed and no material reporting errors or misclassifications were found. The Company correctly reported their Annual Statement account balances in accordance with SSAP No. 5, SSAP No. 35, SSAP No. 53 and the NAIC Annual Statement Filing Instructions. The Company was in compliance with Consent Order 93640-07-CO.

## **SUBSEQUENT EVENTS**

The Company is now held under the Patriot National Insurance Group, Inc. (PNIG) holding structure due to recent restructuring. Patriot Risk Management, Inc. (PRMI) entered into negotiations with MCMC, LLC in early 2011 to be sold and the transaction was completed June 24, 2011 resulting in PRMI and all its affiliate subsidiaries being acquired by MCMC, LLC.

## **HISTORY**

### **General**

The Company is a stock property and casualty insurance company wholly owned by PNIG, an insurance holding company. When PNIG purchased the Company in 2003, it had not written business since 1987. In late 2010, the holding company structure was reorganized, removing PRMI and its related service affiliates to a separate organization structure.

The Company was party to Consent Order 88129-06 regarding the application for redomestication to the State of Florida. The Company failed to comply with the following provisions of this consent order:

- The Company did not maintain written contracts with certain affiliated persons, entities and/or related parties as required by paragraph 15 of the Consent Order. The affiliated

persons, entities and/or related parties lacking written agreements consisted of: PNIG, Patriot General Agency, and Del Pizzo & Associates.

- The Company did not maintain its ceding reinsurance risk transfer requirements as required by paragraph 22 of the consent order.

Subsequent Event: Following discussions between the Office and Company Management regarding risk transfer issues, Consent Order 88129-06 was modified regarding paragraph 22 to reflect that the Company will not enter into any reinsurance agreement that has less than a ten percent (10%) chance of a ten percent (10%) loss to the reinsurer based on the present value of all cash flows between the Company and assuming companies under reasonably possible outcomes, pursuant to SSAP No. 62. The Company also consented to file documentation evidencing compliance with this paragraph on an annual basis with the Annual Financial Statement.

Further amendment included a new paragraph inserted after paragraph 22 indicating that the Company agrees to file with the Office, documentation evidencing that the Company is appropriately setting reserves for Losses and Loss Adjustment Expenses that consider under all possible eventual costs underlying the liabilities, the likelihood that losses will exceed either that total allowable collateral presently in each account or the attachment of any aggregate excess of stop loss program sold, and the expected average cost, beyond the collateral or the attachment point. A full reserve will be calculated by a qualified actuary and included in all future loss reserve and actuarial reports and reflected in future actuarial opinions.

The Company was party to Consent Order 93640-07-CO regarding the limited scope examination as of December 31, 2007. The Company failed to comply with the following provisions of this consent order:

- The Company did not maintain adequate loss and loss adjustment expense as required by paragraph 5 (e) (vii) of the Consent Order and Section 625.101, Florida Statutes, at closer to the mid range rather than at the low end of the range of reasonable estimates.

Subsequent Event: As of the June 30, 2011, Quarterly Statement, the Company strengthened accident years 2010 and prior by recording \$6,694,000 on Part 3, Loss and Loss Adjustment Expense Reserves (line 5, column 15). Accordingly, the proposed examination adjustment is currently reflected on the company's records.

The Company was party to Consent Order #08-1466 with the State of South Carolina, filed March 15, 2010, regarding the writing of new business in the State of South Carolina. The Company complied with the provisions of this consent order:

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2010:

#### Workers' Compensation

The Articles of Incorporation and the Bylaws were amended and/or restated during the period covered by this examination. The Articles of Incorporation were amended and restated as required for the Company's redomestication to Florida and to adopt Article 14 related to participating policies. This provision allows the Company to issue any or all of its policies with or without

participation in profits, savings, or unabsorbed portions of premiums. The Bylaws were restated as required for the Company's redomestication to Florida.

### **Dividends to Stockholders**

There were no dividends declared or paid to its stockholders during the examination period.

### **Capital Stock and Capital Contributions**

As of December 31, 2010, the Company's capitalization was as follows:

Number of authorized common capital shares	36,001.2
Number of shares issued and outstanding	36,001.2
Total common capital stock	\$3,600,120.00
Par value per share	\$100.00

Control of the Company was maintained by its parent, PNIG, who owned 100% of the stock issued by the Company. PNIG in turn was 95.5% owned by Steven Mariano, an individual, and 4.5% owned by other investors and individuals. The parent contributed \$117,343,628 in cash to the Company as of December 31, 2010.

### **Surplus Debentures**

The Company had surplus notes totaling \$851,000 with three different entities as of December 31, 2010. The surplus notes are as follows:

<b>Note Holder</b>	<b>Date Issued</b>	<b>Principal Balance</b>	<b>Interest Rate</b>	<b>Maturity</b>
Essex	7/12/2004	\$62,000	3%	Not specified
Westwind	8/13/2004	\$500,000	3%	Not specified
SPC 104 Caledonian Re	9/30/2004	\$218,000	3%	Not specified
SPC 104 Caledonian Re	9/30/2004	\$71,000	3%	Not specified

## **Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales Through Reinsurance**

On November 29, 2010, PRMI completed a structural corporate reorganization. The transaction did not change either the ultimate controlling shareholders or the ownership percentages of the ultimate controlling shareholders and no unaffiliated parties acquired any direct or indirect interest in the Company. Furthermore, the structural change did not result in any changes in the business operations or management of any of the entities involved. The reorganization divided PRMI into two separate holding company entities: PRMI and PNIG.

Stockholders in PRMI continue to hold their PRMI stock and received shares in PNIG reflecting their identical percentage ownership in PRMI. As a result of the structural reorganization, PNIG is now the immediate and ultimate parent company of the Company. The shareholders of PNIG, following the reorganization, are the same shareholders of PRMI, with the exact same ownership percentages.

To further the structural corporate reorganizational transaction, PRMI's Board of Directors determined that it would be in the best interest of PRMI and its stockholders to memorialize the separation of the insurance underwriting business from PRMI in a Separation Agreement which sets forth the arrangements between PRMI, PNIG and Patriot Underwriters, Inc. concerning the separation of the Insurance Underwriting Business as defined in the Separation Agreement to mean the business conducted by the Insurance Company subsidiaries.

### **CORPORATE RECORDS**

The recorded minutes of the shareholder, Board of Directors (Board), and certain internal committees were reviewed for the period under examination. The recorded minutes of the Board

adequately documented its meetings and approval of Company transactions and events, including the authorization of investments as required by Section 625.304, Florida Statutes.

### **Conflict of Interest**

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 690-138.001, Florida Administrative Code.

## **MANAGEMENT AND CONTROL**

### **Management**

The annual shareholder meeting for the election of directors was held in accordance with Section 628.231, Florida Statutes. Directors serving as of December 31, 2010, were:

#### **Directors**

<b>Name and Location</b>	<b>Principal Occupation</b>
Steven Michael Mariano Miami, Florida	Chairman and CEO Guarantee Insurance Company
Michael John Sluka Ft. Lauderdale, Florida	Treasurer and CFO Guarantee Insurance Company
Theodore George Bryant Weston, Florida	Secretary, SVP and General Counsel Guarantee Insurance Company
Michael William Grandstaff Plantation, Florida	Treasurer, CFO and SVP Patriot Risk Management Inc.
John Richard Del Pizzo Newton Square, Pennsylvania	President, Secretary and Treasurer Del Pizzo & Associates
Charles Kevin Schuver Weston, Florida	President and CUO Guarantee Insurance Company

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

### Senior Officers

Name	Title
Steven Michael Mariano	Chief Executive Officer
Charles Kevin Schuver	President and Chief Underwriting Officer
Theodore George Bryant	Secretary, SVP and General Counsel
Michael John Sluka	Treasurer and Chief Financial Officer

The Company's Board appointed several internal committees. Following were the principal internal board committees and their members as of December 31, 2010:

#### Audit Committee

Steven M. Mariano <sup>1</sup>  
Timothy J. Tompkins <sup>2</sup>  
John R. Del Pizzo

#### Investment Committee

Handled at the parent company level

<sup>1</sup> Chairman

<sup>2</sup> Resigned 9/30/2010, replaced by Ernst Csiszar on 1/18/2011

### Affiliated Companies

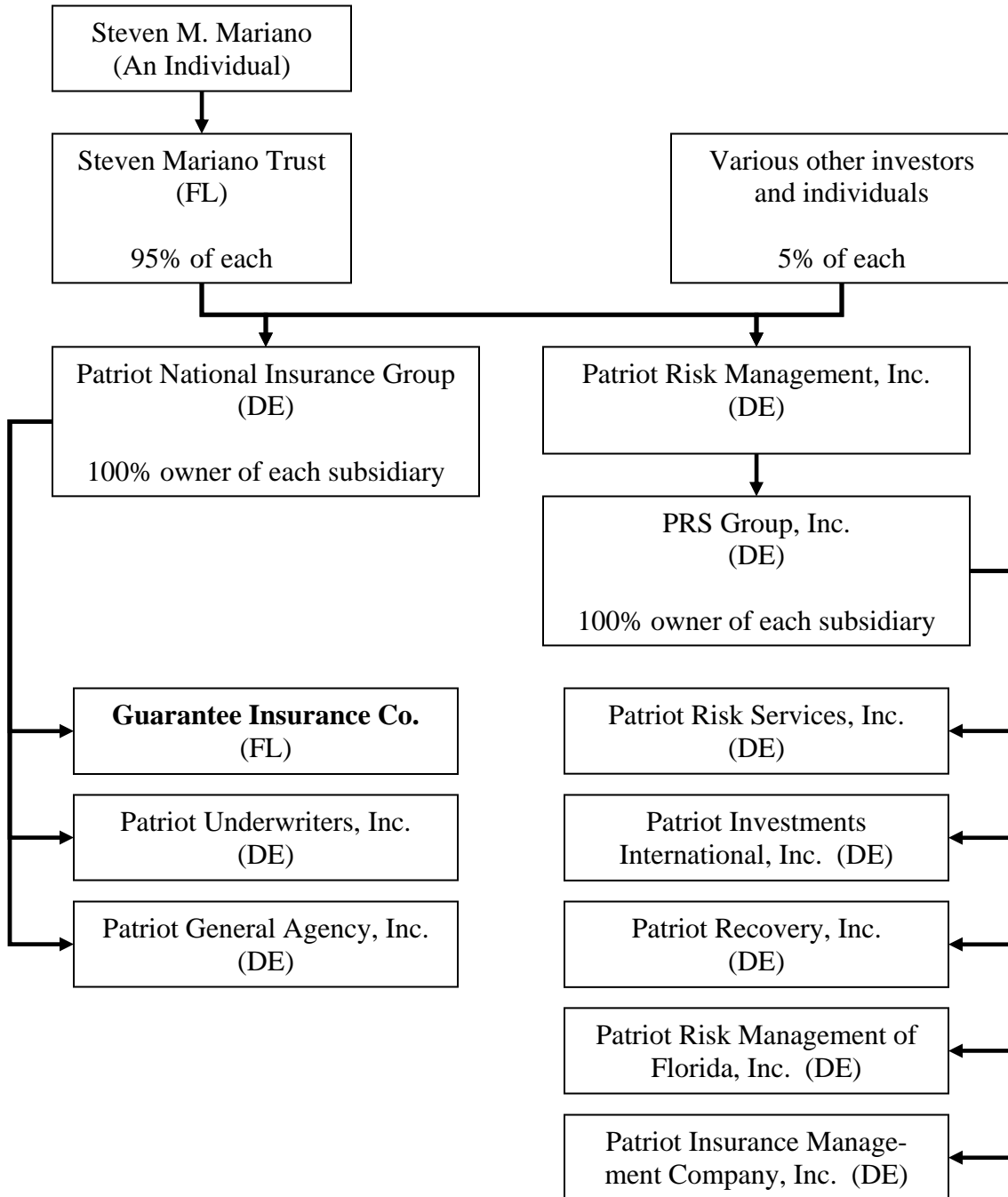
The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on February 25, 2011, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

An organizational chart as of December 31, 2010, reflecting the holding company system, is shown on the following page. Schedule Y of the Company's 2010 annual statement provided a list of all related companies of the holding company group.

# GUARANTEE INSURANCE COMPANY

## ORGANIZATIONAL CHART

DECEMBER 31, 2010





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

### **Tax Allocation Agreement**

The Company, along with its parent, PNIG, and affiliates, filed a consolidated federal income tax return. On December 31, 2010, the method of allocation between the Company and PNIG was on a separate-entity basis. Each member of the group recorded an inter-company income tax receivable or payable with PNIG. Within ninety (90) days of the remittance by PNIG of any income tax payment to the taxing authorities, all inter-company tax receivables/payables were settled.

### **Expense Reimbursement Agreements**

The Company entered into an Expense Reimbursement Agreement with PRMI on January 1, 2006. The agreement was amended June 11, 2008, to accommodate the name change of PRMI to PRS Group, Inc. The agreement allocated business expenses based upon the scope of work and responsibilities performed, such as shared office space, employees, administrative and other expenses for the benefit of the appropriate company. Under the terms of the agreement, each party would settle its cash obligations to the other party on a monthly or more frequent basis.

The Company entered into an Expense Reimbursement Agreement with Patriot Underwriters, Inc. on April 1, 2009. The agreement allocated business expenses based upon the scope of work and responsibilities performed, such as shared office space, employees, administrative and other expenses for the benefit of the appropriate company. Under the terms of the agreement, each party would settle its cash obligations to the other party on a monthly or more frequent basis.

## **Producer Agreements**

The Company entered into a Producer Agreement with an affiliate, Tarheel Insurance Management Company, on January 1, 2004, to provide certain marketing and program administration services. The agreement was amended June 11, 2008, to accommodate the name change of Tarheel Insurance Management Company to Patriot Insurance Management Company, Inc. and additionally to change applicable law from South Carolina to Florida as a result of the Company's redomestication. The agreement continues in force indefinitely, unless otherwise terminated within the guidelines of the agreement. The marketing fee paid by the Company each month was equal to 2.0% of written premium on new and renewed business. Fees incurred under this agreement during 2010 amounted to \$3,329,782.

The Company entered into a Producer Agreement with an affiliate, Patriot Risk Services, Inc., on January 1, 2006, to provide certain marketing and program administration services. The agreement was amended June 11, 2008, to change applicable law from South Carolina to Florida as a result of the Company's redomestication. The agreement continues in force indefinitely, unless otherwise terminated within the guidelines of the agreement. The marketing fee paid by the Company each month was equal to 2.0% of written premium on new and renewed business. Fees incurred under this agreement during 2010 amounted to \$1,993,113.

The Company entered into a Producer Agreement with an affiliate, Patriot Underwriters, Inc., on October 12, 2009, to provide certain marketing and program administration services. The agreement continues in force indefinitely, unless otherwise terminated within the guidelines of the agreement. The marketing fee paid by the Company each month was equal to 2.0% of written premium on new and renewed business. No fees were incurred under this agreement during 2010.

### **Management Services Agreement**

The Company entered into a Management Services Agreement with its parent, Suncoast Holdings, Inc., on January 1, 2004, to provide certain management services. The agreement was amended June 11, 2008, to accommodate the name change of Suncoast Holdings, Inc. to Patriot Risk Management, Inc. and additionally to change applicable law from South Carolina to Florida as a result of the Company's redomestication. On July 1, 2011, this agreement was further modified to reflect the reorganization and name change of the parent, PNIG. The agreement continues in force indefinitely, unless otherwise terminated within the guidelines of the agreement. The management fees were paid monthly by the Company as set forth in the agreement, which included benefits administration, human resource management, strategic planning services and investment portfolio management. Fees incurred under this agreement during 2010 amounted to \$1,349,593.

### **Managed Care Services Agreement**

The Company entered into a Managed Care Services Agreement with its affiliate, Patriot Risk Services, Inc., on January 1, 2006. The agreement was amended June 11, 2008 to change applicable law from South Carolina to Florida as a result of the Company's redomestication and additionally, the definition of On-Site Case Management Services was slightly altered. The agreement continues in force indefinitely, unless otherwise terminated within the guidelines of the agreement. Under the terms of the agreement, Patriot Risk Services, Inc. provided certain managed care services on claims arising out of the policies to the Company, and paid a fee for services within 30 days of receipt of the monthly invoices. A description of services and fees were explained on Schedule 1 of the agreement. Fees incurred under this agreement during 2010 amounted to \$2,816,883.

### **Reinsurance Brokerage Agreement**

The Company entered into a Reinsurance Brokerage Agreement with its affiliate, Patriot Re on January 1, 2006. Under the terms of the agreement, Patriot Re was appointed as broker of record regarding all or part of its ceded reinsurance program and was authorized to solicit, negotiate and procure reinsurance on the Company's behalf, but without the authority to accept, bind or manage reinsurance. Patriot Re remitted all monies due to the Company within 30 days of receipt. All monies collected by Patriot Re were held in a fiduciary capacity by Patriot Re in a bank that was a qualified United States financial institution as defined in the applicable laws of each state in which the Company was a licensed insurer. This agreement was terminated on August 17, 2010. No fees were incurred under this agreement during 2010.

### **Subrogation Services Agreement**

The Company entered into a Subrogation Services Agreement with its affiliate, Patriot Recovery, Inc. on January 1, 2009. Under the terms of agreement, Patriot Recovery, Inc. was granted authority to review assigned claims files for potential subrogation and to pursue and settle subrogation cases on behalf of the Company. Fees incurred under this agreement during 2010 amounted to \$13,788.

### **Investigation Services Agreement**

The Company entered into an Investigation Services Agreement with its affiliate, Patriot Recovery, Inc. on January 1, 2009. Under the terms of the agreement, Patriot Recovery, Inc. was to review assigned files or matters which required specialized investigatory services. Upon review of this Agreement, the examination found that it is not in compliance with SSAP No. 96 in that it does not contain provisions for a timely settlement of accounts involved nor does it contain a specific

due date for those amounts. Fees incurred under this agreement during 2010 amounted to \$128,149.

### **Affiliated and Related Party Transactions without Agreements**

During the review of the Company's affiliated and related party transactions, it was found that the Company transacted with certain affiliated and/or related parties where no written contract was in place. The affiliated persons, entities and/or related parties lacking written agreements consisted of: PNIG, Patriot General Agency, and Del Pizzo & Associates. The Company did not maintain written contracts with certain affiliated persons, entities and/or related parties as required by paragraph 15 of Consent Order 88129-06, SSAP No. 96 and SSAP No. 25.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained fidelity bond coverage up to \$1,000,000 with a deductible of \$25,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained Directors and Officers (D&O) liability, Business Package, Workers Compensation, Foreign Package, Fiduciary liability, Crime, Employment Practices liability, Professional liability and Agents Errors and Omissions liability insurance coverage during the period of this examination.

### **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

Employees of the Company were covered by a qualified, defined-contribution plan sponsored by the Company. Employees could contribute up to allowable limits set by regulation and the Company could make voluntary contributions. The Company's contribution for 2010 was \$0.

## TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance in the following states, districts and territories:

Alabama	Maryland	Ohio
Arkansas	Massachusetts	Oklahoma
California	Michigan	Oregon
Colorado	Minnesota	Pennsylvania
Delaware	Mississippi	South Carolina
District of Columbia	Missouri	South Dakota
Florida	Montana	Tennessee
Georgia	Nebraska	Texas
Hawaii	Nevada	Vermont
Idaho	New Hampshire	Virginia
Indiana	New Jersey	Washington
Kentucky	New Mexico	West Virginia
Louisiana	New York	Wisconsin
Maine	North Carolina	

### Treatment of Policyholders

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

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) (i) 3a, Florida Statutes.

## COMPANY GROWTH

Gross written premiums increased during the first two years of the examination period and then decreased to a growth rate of 15% for year ending 2010. The Company shifted its focus over the past few years to concentrate more on Alternative Markets (risk-sharing) and away from traditional Workers' Compensation markets.

While the Company showed strength in its claims handling and closing practices, they had issues surrounding capitalization, the collection of reinsurance receivables and deductible recoverables, and recent loss development.

### **Profitability of Company**

The following table shows the profitability trend (in dollars) of the Company for the period of examination, as reported in the filed annual statements.

	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>
Premiums Earned	52,479,750	35,707,368	49,920,489	23,815,030
Net Underwriting Gain/(Loss)	1,967,117	(1,243,366)	1,937,055	(379,117)
Net Income	115,219	(3,871,501)	1,565,620	(172,765)
Total Assets	164,083,428	149,264,858	130,806,666	108,548,875
Total Liabilities	138,883,638	132,062,166	112,513,933	93,735,995
Surplus As Regards Policyholders	25,199,790	17,202,692	18,292,736	14,812,880

### **LOSS EXPERIENCE**

At year end 2010, the one-year net loss development was unfavorable at \$12,569,000 and the two-year net loss development was unfavorable at \$9,362,000.

## REINSURANCE

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines except as noted in this report.

### **Assumed**

The Company's original assumed risk, placed in 1987 and prior years, was in run-off from operations prior to the September 11, 2003, acquisition of the Company. The business included assumed and retroceded reinsurance. Many of the reinsurers were either insolvent, troubled companies or had commuted contracts. The claims administration for the run-off business for the reinsurance pool, GRE Reinsurance of American Corporation, was performed by Cambridge Integrated Services Group in Cranbury, New Jersey. The claims administration for the run-off for the Excess and Casualty Reinsurance Association Pool was performed by the pool manager, Excess & Treaty Management Corporation.

The Company assumed a portion of the risk on business produced by Patriot Underwriters, Inc., an affiliate, for Ullico Casualty Company. This arrangement allowed the Company, through Patriot Underwriters, to utilize Ullico to front business in states where the Company was not yet licensed. The Company's assumed risk was determined on a policy-by-policy basis and amounted to written premiums of \$46.8 million and \$16.7 million for 2010 and 2009 respectively. The Company also assumed certain business in connection with its participation in the National Council on Compensation Insurance, Inc. National Workers' Compensation Insurance Pool for 2010 and 2009.



## **Ceded**

The Company had two major segments in its ceded reinsurance program. The first and original program was for traditional business that insured through ordinary risk transfer and the second program, developed over the past six to seven years, was for alternative risk business that insures in a more limited manner through the concept of risk sharing.

### Traditional Business

The first layer of reinsurance for the traditional business was a \$250,000 excess of \$750,000 excess of loss agreement with a single authorized reinsurer. Both the traditional and the alternative risk business were covered by four additional layers of excess of loss reinsurance as follows:

- \$4 million excess \$1 million per occurrence reinsurance with eight reinsurers of which six were authorized (77.5% of reinsurance layer pool), two were unauthorized (22.5% of reinsurance layer pool) and all are A rated or better;
- \$5 million excess \$5 million per occurrence reinsurance with eight reinsurers, all of which were authorized (100% of reinsurance layer pool) and are A rated;
- \$10 million excess \$10 million per occurrence reinsurance with ten reinsurers, eight of which were authorized (70% of reinsurance layer pool), two of which were unauthorized (30% of reinsurance layer pool) and all are A rated or better;
- \$30 million excess \$20 million per occurrence reinsurance with ten reinsurers; eight of which were authorized (75% of reinsurance layer pool), two of which were unauthorized (25% of reinsurance layer pool) and all are A rated or better.

### Alternative Market Business

The alternative market involved captive arrangements whereby the insured shared risk with the reinsurer and the Company wrote the business on its paper and reinsured most of the risk. Of the fifty-seven captive reinsurers, all but six were organized as protected cell companies set up under three reinsurers (Caledonian, Ancora Re and Green Oaks Investors). Under the Cayman Island Companies Law (2004 Revision), these captives are defined as Segregated Portfolio Companies (SPCs) and the Company utilized that nomenclature to identify this sub-set of captive reinsurers. Each captive served as a 90% quota-share reinsurer, assuming risk originating on the Company's paper for a specific insured. The Company ceded 90% of the written premium, less the ceding commission, for 90% of the first \$1 million loss in any one occurrence. The Company's retention per occurrence was \$100,000. Each captive also had a corresponding aggregate excess of loss reinsurance agreement with the Company whereby losses exceeding a certain percentage would then retrocede back to the Company. Reinsurance collateral for the regular captives and SPCs consisted of funds withheld, ceded premiums payable, letters of credit and other financial instruments acceptable to the Company.

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

### **Risk Transfer Analysis**

An analysis of the Company's risk transfer was performed by the examination actuary, Mr. Dennis R. Henry, FCAS, MAAA of The Actuarial Advantage, Inc. In order to evaluate the Company's risk transfer testing and documentation as of December 31, 2010, Mr. Henry obtained and reviewed Company work papers that included reinsurance agreements, detailed loss data and detailed premium data along with summaries of risk transfer testing results and

various other reports prepared by the Company's consulting actuary, Mr. Derek W. Freihaut, FCAS, MAA of Pinnacle Actuarial Resources, Inc. (Pinnacle). To assess the reasonableness of Pinnacle's analyses, Mr. Henry performed Independent calculations for five representative contracts and compared his results to Pinnacle's. The differences found in recalculating the five sample contracts were minor and within an acceptable tolerance.

Mr. Henry prepared and implemented his full-scale, risk transfer testing by selecting low and high loss development factors (LDFs) based on NCCI data, obtaining interest rates for US Treasuries for 2009 and 2010, creating a database of reinsurance parameters derived from ground up Company loss and premium data and then performed simulations at the claim level involving approximately 10,000 iterations. Mr. Henry's review and analysis of the Company's risk transfer testing and documentation as of December 31, 2010 concluded the following:

- The risk transfer testing produced reasonable results;
- The Company's excess of loss contracts met risk transfer based on the terms of the contracts;
- All Alternative Market contracts tested passed the 10-10 risk transfer threshold; however, the following eight contracts did not pass the 10-25 threshold mandated in the Florida Consent Order #88129-06:

- Caledonian Reinsurance SPC 116
- Caledonian Reinsurance SPC 135
- Caledonian Reinsurance SPC 142
- Caledonian Reinsurance SPC 144
- Caledonian Reinsurance SPC 163
- Green Oaks Investors
- Green Oaks SPC 102
- Ancora Re

- The Company's retrocession of assumed Ullico business met risk transfer based on the terms of the contract.

## **Collateral for Unauthorized Reinsurance**

### Traditional Business

On Schedule F, Part 5, Column 10, the Company recorded \$548,000 and \$760,000 for Other Allowed Offsets for Trenwick America and Scottish and York respectively. These reinsurers were initially reported as authorized, but later reclassified as unauthorized. The column 10 amount represented the difference between the recoverable and the collateral held to effect this treatment. An exam adjustment of \$1,308,000 was made to increase the provision for reinsurance.

Subsequent Event: As of December 31, 2011, The Company did not report any amounts in Schedule F, Part 5, Other Allowed Offset Items (now on Column 13 for the 2011 Annual Statement) for reinsurers Trenwick America or Scottish and York.

### Alternative Market Business

On Schedule F, Part 5, Column 10, the Company recorded \$5,150,000 and \$4,097,000 for Other Allowed Offset Items for the segregated portfolio companies Ancora Re and Green Oaks Investors, respectively. This treatment was discussed with the Company on June 13, 2011, and additional information was provided by the Company on June 15, 2011. Per the Company's explanation, the amounts represented unearned ceding commission calculated at the ceding commission rate times the ceded unearned premium balances for these two reinsurers. The Company asserted this was an acceptable form of collateral since the ceding commission represented funds that will remain under the control of the Company. While these two

reinsurers represent the largest balances, the Company indicated that this treatment was applied to other reinsurers as well. The net effect was to reduce the provision for reinsurance liability. In statutory accounting, insurance companies must recognize the full policy acquisition expense of a policy at inception, but must accrue earned premium over the life of the policy. However, for reinsured business, this impact is mitigated by allowing the insurer to recover their acquisition expense in the form of ceding commission, often recognized as a contra-expense with a credit balance. Thus, ceding commission serves to increase surplus by reducing expenses and increasing net income. The Company's decision to recognize an unearned component of ceding commission as collateral means those dollars were benefiting surplus twice; first as a reduction in acquisition expense, second as a reduction in the provision for reinsurance liability. Recognizing ceded unearned commission as collateral is a violation of Section 624.610(4), Florida Statutes. An examination adjustment of \$3,768,000 was made to increase the provision for reinsurance.

Subsequent Event: As December 31, 2011, The Company did not report any amounts in Schedule F, Part 5, Other Allowed Offset Items (now on Column 13 for the 2011 Annual Statement) for reinsurers Ancora Re and Green Oaks Investors.

## **ACCOUNTS AND RECORDS**

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

An independent CPA audited the Company's statutory basis financial statements annually for the years 2007, 2008, 2009 and 2010, in accordance with Section 624.424(8), Florida Statutes.

Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Company and non-affiliates had the following agreements:

### **Custodial Agreement**

The Company maintained custodial agreements with The Bank of New York Trust Company entered into on July 27, 2006. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

### **Independent Auditor Agreement**

The Company contracted with an external, independent CPA firm to perform the annual audit of its financial statements as required by Rule 69O-132.002 (7) (c), Florida Administrative Code.

### **Information Technology Report**

Highland Clark, LLC performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology Report provided to the Company.

## STATUTORY DEPOSITS

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

STATE	Description	Par Value	Market Value
FL	USTNTS, 4.625%, 07/31/12	\$ 1,400,000	\$ 1,492,204
FL	USTBDS, 3.125%, 04/30/13	40,000	42,263
FL	MN State Bond, 5.0%, 08/01/16	75,000	87,272
FL	NY State Bond, 4.5%, 06/15/13	<u>700,000</u>	<u>746,011</u>
TOTAL FLORIDA DEPOSITS		\$ 2,215,000	\$ 2,367,750
CA	USTBDS, 3.125%, 04/30/13	\$ 28,000	\$ 29,584
DE	USTBDS, 3.125%, 04/30/13	96,000	101,431
DE	USTNTS, 3.375%, 06/30/13	40,000	42,597
DE	CT State Bond, 5.5%, 12/15/14	400,000	460,076
DE	CT State Bond, 5.0%, 06/01/15	350,000	397,946
DE	GA State Bond, 5.5%, 07/01/12	248,000	266,193
DE	NC State Bond, 5.0%, 05/01/16	110,000	120,156
GA	NC State Bond, 5.0%, 05/01/16	85,000	92,848
IN	USTNTS, 3.375%, 06/30/13	100,000	106,493
MA	USTNTS, 3.375%, 06/30/13	100,000	106,493
MT	USTNTS, 3.375%, 06/30/13	25,000	26,623
NV	Merck & Co Inc, 4.0%, 06/30/15	300,000	321,870
NM	USTBDS, 3.125%, 04/30/13	105,000	110,940
NC	NC State Bond, 5.0%, 05/01/16	300,000	327,699
SC	GA State Bond, 5.5%, 07/01/12	300,000	322,008
TN	MI State Hwys, 5.25%, 02/01/15	120,000	126,070
TX	GA State Bond, 5.5%, 07/01/12	102,000	109,483
VA	USTBDS, 3.125%, 04/30/13	510,000	538,851
OT	MN State Bond, 5.0%, 08/01/16	185,000	215,272
OT	Williamson Co Bd, 5.0%, 05/01/12	100,000	105,954
OT	MI State Hwys, 5.25%, 02/01/15	70,000	73,541
OT	IL Reg Trans Auth, 5.5%, 06/01/12	200,000	212,750
OT	VA Beach Dev Auth, 5.0%, 07/15/12	<u>150,000</u>	<u>159,476</u>
TOTAL OTHER DEPOSITS		<u>\$ 4,024,000</u>	<u>\$ 4,374,354</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 6,239,000</u>	<u>\$ 6,742,104</u>

## **FINANCIAL STATEMENTS PER EXAMINATION**

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



**GUARANTEE INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2010**

	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Bonds	\$30,176,465		\$30,176,465
Stocks:			
Common	6,433		6,433
Real Estate:			
Properties			
held for the production of income	143,998		143,998
Cash and Short-Term Investments	25,447,124		25,447,124
Interest and dividend			
income due & accrued	220,731		220,731
Agents' Balances:			
Uncollected premium	5,933,856		5,933,856
Deferred premium	82,865,402		82,865,402
Reinsurance:			
Recoverable	3,625,059		3,625,059
Funds held or deposited	2,332,283		2,332,283
Other amounts receivable	1,658,564		1,658,564
Current federal and foreign income			
taxes recoverable	857,380		857,380
Net Deferred Tax Asset	2,784,482		2,784,482
EDP Equipment	213,129		213,129
Receivable from parents, subsidiaries			
and affiliates	4,070,785		4,070,785
Healthcare receivables	258,438		258,438
Aggregate write-in for			
other than invested assets	3,489,299		3,489,299
	<hr/>		
Totals	\$164,083,428	\$0	\$164,083,428
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**GUARANTEE INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2010**

	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Losses	\$28,480,691	\$2,768,392	\$31,249,083
Reinsurance payable on paid losses & lae	1,165,000		1,165,000
Loss adjustment expenses	9,969,675	969,077	10,938,752
Commissions payable	1,585,250		1,585,250
Other expenses	1,761,994		1,761,994
Taxes, licenses and fees	9,631,559		9,631,559
 Unearned premiums	 26,375,892		 26,375,892
 Ceded reinsurance premiums payable	 32,232,000		 32,232,000
Funds held under reinsurance treaties	13,551,000		13,551,000
Amounts withheld	8,397,236		8,397,236
 Provision for reinsurance	 2,157,242	 \$5,076,000	 7,233,242
 Aggregate write-ins for liabilities	 3,576,100		 3,576,100
 Total Liabilities	 \$138,883,638	 \$8,813,469	 \$147,697,107
 Common capital stock	 \$3,600,120		 \$3,600,120
 Surplus notes	 851,000		 851,000
Gross paid in and contributed surplus	117,343,628		117,343,628
Unassigned funds (surplus)	(96,594,958)	(8,813,469)	(105,408,427)
 Surplus as regards policyholders	 \$25,199,790	 (\$8,813,469)	 \$16,386,321
 Total liabilities, surplus and other funds	 \$164,083,428	 \$0	 \$164,083,428

**GUARANTEE INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2010**

**Underwriting Income**

Premiums earned		\$52,479,750
	<b>Deductions:</b>	
Losses incurred		28,580,433
Loss expenses incurred		11,316,932
Other underwriting expenses incurred		10,615,268
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$50,512,633
Net underwriting gain or (loss)		\$1,967,117

**Investment Income**

Net investment income earned		\$798,063
Net realized capital gains or (losses)		1,434,514
Net investment gain or (loss)		\$2,232,577

**Other Income**

Net gain or (loss) from agents' or premium balances charged off		(\$3,055,323)
Finance and service charges not included in premiums		0
Aggregate write-ins for miscellaneous income		9,392
Total other income		(\$3,045,931)
Net income before dividends to policyholders and before federal & foreign income taxes		\$1,153,796
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$1,153,763
Federal & foreign income taxes		1,038,544
Net Income		\$115,219

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year		\$17,202,693
Net Income		\$115,219
Change in deferred income tax		727,745
Change in non-admitted assets		(535,974)
Change in provision for reinsurance		26,107
Change in surplus notes		(336,000)
Surplus adjustments: Paid in		8,000,000
Examination Adjustment		(8,813,469)
Change in surplus as regards policyholders for the year		(\$816,372)
Surplus as regards policyholders, December 31 current year		\$16,386,321

A comparative analysis of changes in surplus is shown below.

**GUARANTEE INSURANCE COMPANY**  
**Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2010**

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, 2010, per Annual Statement	\$25,199,790
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
<b>ASSETS:</b>			
No Adjustment			
<b>LIABILITIES:</b>			
Losses	\$28,480,691	\$31,249,083	(\$2,768,392)
Loss Adjustment Exp.	\$9,969,675	\$10,938,752	(\$969,077)
Prov. for Reinsurance	\$2,157,242	\$7,233,242	(\$5,076,000)
 Net Change in Surplus:			 (8,813,469)
 Surplus as Regards Policyholders December 31, 2010, Per Examination			 \$16,386,321

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

#### Losses and Loss Adjustment Expenses \$ 42,187,835

An outside actuarial firm appointed by the Board, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2010, 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 engaged an independent actuarial firm, The Actuarial Advantage, Inc., to review the Loss and Loss Adjustment Expense Reserves carried in the Company's balance sheet as of December 31, 2010 and found the reserves were reported \$3,737,469 below the mid-point of their calculated range of reasonableness. Loss and LAE reserves were increased \$3,737,469 to strengthen reserves up to the mid-point of the exam actuary's range.

#### Provision for Reinsurance \$ 7,233,242

The amount reported by the Company of \$2,157,242, was increased by \$5,079,000 due to improper amounts recorded for collateral held as Other Allowed Offset Items in Schedule F, Part 5, Column 10, representing both traditional and SPC captive reinsurers.

#### Capital and Surplus \$ 16,386,321

The amount reported by the Company of \$25,199,790, was decreased by \$8,813,469 to \$16,386,321 due to the adjustments above for reserves and reinsurance. Surplus As Regards Policyholders exceeded the examination adjusted minimum of \$11,750,760 required by Section 624.408, Florida Statutes.

## **SUMMARY OF RECOMMENDATIONS**

### **Affiliated Agreements**

We recommend that the Company amend their Investigation Services Agreement with Patriot Recovery, Inc. to contain language that specifies Company settlements and specific dates due to comply with SSAP No. 96.

We recommend that the Company have written agreements covering relationships/transactions with all related parties and these agreements must comply with paragraph 15 of Florida Consent Order 88129-06, SSAP No. 96 and SSAP No. 25.

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Guarantee Insurance Company** as of December 31, 2010, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$16,386,321, which exceeded the examination adjusted minimum of \$11,750,760 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Steven R. Sigler, CFE, AES, Examiner-In-Charge, John Coleman, CFE, Participating Examiner, Sheri Kenney, CFE, Participating Examiner, Brad Hazelwood, Participating Examiner and Tracy Gates, CPA, CISA, IT Manager, Participating Examiner of Highland Clark, LLC; Dennis Henry, FCAS MAAA, consulting actuary of Actuarial Resources, participated in the examination. Jonathan Frisard, CPA, Financial Examiner/Analyst Supervisor Bradley Stevenson, Financial Examiner/Analyst II, and Kethessa Carpenter, Financial Examiner/Analyst Supervisor of the Office also participated in the examination.

Respectfully submitted,

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Mary James, CFE, CPM  
Chief Examiner  
Florida Office of Insurance Regulation