

REPORT ON EXAMINATION
OF
SOUTHERN GROUP INDEMNITY, INC.
MIAMI, FLORIDA

AS OF
DECEMBER 31, 2002

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida
March 16, 2004

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (FS), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2002, of the financial condition and corporate affairs of:

**SOUTHERN GROUP INDEMNITY, INC.
1769 NW 79TH AVENUE
MIAMI, FLORIDA 33126**

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

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2000 through December 31, 2002. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 1999. This examination commenced with planning at the Office on December 15, 2003 to December 19, 2003. The fieldwork commenced on December 22, 2003, and was concluded as of March 12, 2004. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

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

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2002. Transactions subsequent to year-end 2002 were reviewed where relevant and deemed significant to the Company's financial condition.

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

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 1999, along with resulting action taken by the Company in connection therewith.

Management

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

Resolution: The Company established an audit committee on May 6, 2000 in accordance with the above Statute.

Accounts & Records

Schedule Y, Part 2 of the Company's 1999 annual statement was incorrectly filed.

Resolution: The Company properly completed all subsequent filings of Schedule Y.

Custodial Agreement

The Company had custodial agreements with Union Planters Bank and PaineWebber, which were not in compliance with Rule 69O -143.042, FAC.

Resolution: The Company entered into compliant custodial agreements with Union Planters Bank and PaineWebber; however, PaineWebber is not a qualified custodian per Rule 69O -143.041, FAC.

HISTORY

General

The Company was incorporated in Florida on September 28, 1990 and commenced business on October 31, 1990, as Southern Group Indemnity, Inc.

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

Fire
Homeowners Multi Peril
Private Passenger Auto Physical Damage
Private Passenger Auto Liability
Commercial Automobile Liability
Commercial Auto Physical Damage

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

Capital Stock

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

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

Control of the Company was maintained by its parent, Club Marketing and Sales, Inc., who owned 100 percent of the stock issued by the Company, who in turn was 100 percent owned by ten unrelated shareholders.

Profitability of Company

The Company reported underwriting losses of \$833,907, \$1,121,125, and \$769,240 for the years ending December 31, 2000, 2001, and 2002, respectively. For each of those years the Company reported net investment gains of \$835,510, \$829,985, and \$719,613, respectively. As stated in the Company's 2003 annual statement, the underwriting loss was \$655,476 with a net investment gain of \$713,817.

Dividends to Stockholders

No dividends were declared or paid during the examination period.

Management

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

Directors

Name and Location	Principal Occupation
Mario Vives Miami, Florida	Director/President Club Marketing and Sales, Inc.
Donald Carlin Miami, Florida	Director Southern Group Indemnity, Inc.
Thomas A. Green Miami, Florida	Director/President/Secretary Southern Group Indemnity, Inc.
Jose Mon Miami, Florida	Director Southern Group Indemnity, Inc.
Caridad N. Eawaz Miami, Florida	Director/Treasurer Southern Group Indemnity, Inc.
Bryan W. Deutsch Miami, Florida	Vice President Southern Group Indemnity, Inc.

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

Senior Officers

Name	Title
Thomas A. Green	President/Secretary
Bryan W. Deutsch	Senior Vice President
Caridad N. Eawaz	Treasurer

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. The following are the principal internal board committees and their members as of December 31, 2002:

Executive Committee

Donald Carlin¹
Mario Vives
Thomas A. Green

Audit Committee

Donald Carlin¹
Mario Vives
Thomas A. Green

Investment Committee

Mario Vives¹
Thomas A. Green

¹ Chairman

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, FS. No exceptions were noted during this examination period.

Corporate Records

The recorded minutes of the shareholder, Board of Directors, and Executive and Investment Committee meetings were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

There was documentation in the minutes that the Company's directors reviewed the previous examination report.

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

The company had no acquisitions, mergers, disposals, dissolutions, purchase or sales through reinsurance.

Surplus Debentures

The Company had no surplus debentures as of December 31, 2002. Two previous surplus notes payable to the parent in the amount of \$500,000 and \$3,000,000 were converted to additional paid in capital in 2001.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on September 8, 2003 as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

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

Tax Allocation Agreement

The Company, along with its parent and affiliates, filed a consolidated federal income tax return. On December 31, 2002, the method of allocation between the Company and its parent was that the income tax benefit, if any, shall be allocated in proportion to the contribution to the income tax by the respective companies.

Cost Sharing Agreement

The Company was the owner of the telephone system used by its affiliates. By agreement with the Company, affiliates residing within the building paid their share, either by charges that were identifiable and/or by a proportionate share based on a percentage or flat charge specified in the agreement.

Reimbursement Agreement

The Company purchased from time to time various supplies that were used by its affiliates residing in the building. The Company was reimbursed based on the supplies consumed by the other parties.

Claims Service Agreement

The Company and its affiliate, Statewide Adjusters, Inc., were parties to an agreement whereby Statewide Adjusters, Inc. provided full claims handling for all reported losses with the Company's automobile line of business.

Business Lease Agreement

The Company leased office space to its affiliates.

Data Processing Equipment and Software Lease Agreement

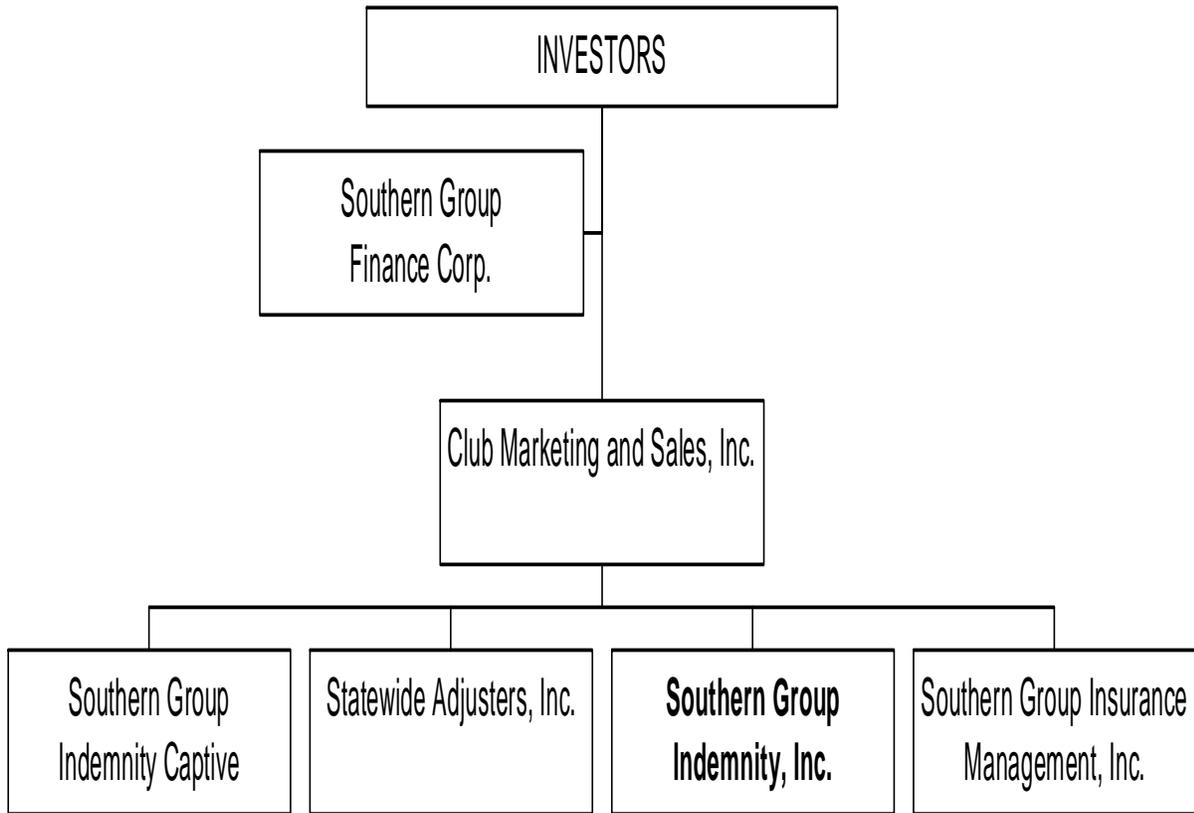
The Company leased certain data processing equipment and software to its affiliates.

MGA Agreement

The Company and its affiliate, Southern Group Insurance Management, Inc. (SGIM), were parties to an agreement whereby SGIM acted as the Company's managing general agent (MGA) for its private passenger automobile liability and physical damage insurance lines.

A simplified organizational chart as of December 31, 2002, reflecting the holding company system, is shown below. Schedule Y of the Company's 2002 annual statement provided a list of all related companies of the holding company group.

**SOUTHERN GROUP INDEMNITY, INC.
ORGANIZATIONAL CHART
DECEMBER 31, 2002**



FIDELITY BOND AND OTHER INSURANCE

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

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company sponsored life and disability, dental and major medical insurance coverage for its eligible employees. There were no pension or profit sharing plans available.

STATUTORY DEPOSITS

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

State	Description	Par Value	Market Value
FL	Cash	\$ 300,000	\$ 300,000
FL	CD, .91%, 10/03/04	300,000	300,000
FL	CD, .91%, 05/01/04	150,000	150,000
FL	CD, 1.10%, 10/23/04	<u>250,000</u>	<u>250,000</u>
Total Special Deposits		<u>\$1,000,000</u>	<u>\$1,000,000</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company had a market conduct examination as of December 31, 2002. This examination was conducted by the Office to determine the accuracy of premium computation, policy construction,

claims handling procedures, and the use of filed rates and forms. The exceptions noted in the issued report did not affect the solvency of the Company.

Territory and Plan of Operation

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

Treatment of Policyholders

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS. The Company maintained a detailed claims procedure manual that included how the adjuster should proceed and finalize as well as copies of the applicable Florida Statutes relating to claims adjusters or claim handling procedures.

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.

Assumed

The Company did not assume risk during the years under examination.

Ceded

The Company ceded risk to other U.S. authorized reinsurers on all property and casualty lines of insurance on a quota share with varying participation percentages, excess of loss, and stop loss basis.

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

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years 2000, 2001 and 2002, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 690-137.002, FAC.

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

The Company did not maintain an aging of premiums receivable per policy as required by Rule 69O-138.024, FAC.

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

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company did not have a custodial agreement with Ameritrade; and both Ameritrade and PaineWebber are not qualified custodians per Rule 69O-143.041, FAC.

MGA Agreement

The Company had an agreement with Apex Managers, Inc. (Apex), whereby Apex acted as an agent for the homeowner lines of business.

Independent Auditor Agreement

The Company had an independent auditor agreement with Infante and Company, Inc.

Risk-Based Capital

The Company reported its risk-based capital at an adequate level.

Information Technology

An evaluation performed by an Information Technology (IT) Specialist noted the following:

The size of the Company's IT staff did not permit an organizational structure that in every case assures appropriate separation of duties and cross checks. Written formal procedures and documentation were needed to mitigate this risk. A lack of documentation created an unacceptable risk and reliance on a part-time consultant and code level research for software modification and analysis. Additionally, a continuity plan and risk profile assessment had not been developed.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2002, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

SOUTHERN GROUP INDEMNITY, INC.
Assets

DECEMBER 31, 2002

Classification	Per Company	Examination Adjustments	Per Examination
Stocks:			
Common	25,411		25,411
Mortgage loans on real estate	198,721		198,721
Real Estate:			
Properties			
occupied by Company	741,452		741,452
Cash:			
On hand	100		100
On deposit	6,797,532		6,797,532
Agents' Balances:			
Uncollected premium	425,321		425,321
Deferred premium	(58,203)		(58,203)
Reinsurance Recoverable	557,267		557,267
EDP Equipment	52,796		52,796
Interest and dividend			
income due & accrued	36,766		36,766
Receivable from PSA	215,363		215,363
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Totals	\$8,992,526	\$0	\$8,992,526
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SOUTHERN GROUP INDEMNITY, INC.
Liabilities, Surplus and Other Funds

DECEMBER 31, 2002

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$2,491,000	\$450,000	\$2,941,000
Loss adjustment expenses	387,041		387,041
Commissions payable, contingent commissions	490,000		490,000
Taxes, licenses and fees	982		982
Unearned premium	1,295,810		1,295,810
Ceded reinsurance premiums payable	269,771		269,771
Drafts outstanding	726,890		726,890
Total Liabilities	\$5,661,494	\$450,000	\$6,111,494
Common capital stock	500,000		500,000
Gross paid in and contributed surplus	5,648,000		5,648,000
Unassigned funds (surplus)	(2,816,968)	450,000	(3,266,968)
Surplus as regards policyholders	3,331,032	450,000	2,881,032
Total liabilities, capital and surplus	\$8,992,526	\$0	\$8,992,526

SOUTHERN GROUP INDEMNITY, INC.
Statement of Income

DECEMBER 31, 2002

Underwriting Income

Premiums earned	\$6,560,457
DEDUCTIONS:	
Losses incurred	3,532,036
Loss expenses incurred	1,475,408
Other underwriting expenses incurred	2,322,253
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$7,329,697</u>
Net underwriting gain or (loss)	(\$769,240)

Investment Income

Net investment income earned	\$718,571
Net realized capital gains or (losses)	1,042
Net investment gain or (loss)	<u>\$719,613</u>

Other Income

Total other income	\$0
Net income before dividends to policyholders and before federal & foreign income taxes	(\$49,627)
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	<u>(\$49,627)</u>
Federal & foreign income taxes	0
Net Income	(\$49,627)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$3,247,704
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Gains and (Losses) in Surplus

Net Income	(\$49,627)
Net unrealized capital gains or losses	(20,231)
Change in non-admitted assets	153,186
Change in provision for reinsurance	0
Change in excess statutory over statement reserves	0
Surplus adjustments: Paid in	0
Aggregate write-ins for gains and losses in surplus	0
Examination Adjustment	(450,000)
Change in surplus as regards policyholders for the year	<u>\$366,672</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$2,881,032</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses	<u>\$2,941,000</u>
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An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2002, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office actuary reviewed work papers provided by the Company and determined that the point estimate for the loss reserves resulted in the loss reserves being deficient by \$450,000; which placed the Company in a financially impaired position since their adjusted surplus was below the required minimum amount for year-end 2002. The actuary for the Company did not concur with this loss reserve estimate.

Subsequent event:

The Office actuary reviewed work papers provided by the Company and determined that the point estimate for the loss reserves as of December 31, 2003 was adequate.

SOUTHERN GROUP INDEMNITY, INC.
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2002

The following is a reconciliation of surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders per December 31, 2002, Annual Statement	\$3,331,032
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
No adjustment required.			
LIABILITIES:			
Losses & LAE	\$5,661,494	\$6,111,494	(450,000)
 Net Change in Surplus:			 (450,000)
 Surplus as Regards Policyholders December 31, 2002, Per Examination			 \$2,881,032

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 1999 examination report issued by the Office.

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2002.

Liabilities

The Office Actuary determined that the Company had a reserve deficiency of \$450,000 at December 31, 2002; however, the actuary reviewed work papers provided by the Company as of December 31, 2003 and determined that the loss reserves were adequate.

Accounts and Records

The Company did not maintain an aging of premiums receivable per policy as required by Rule 69O-138.024, FAC.

The Company is directed to maintain an aging of the premiums receivable by policy, and to provide evidence of compliance to the Office within 90 days of the issuance of this report.

Custodial Agreement

The Company did not have a custodial agreement but maintained stocks with Ameritrade. Ameritrade and not PaineWebber are qualified custodians per Rule 69O-143.041, FAC.

The Company is directed to utilize a qualified custodian and execute a custodial agreement with a custodian approved by the Office.

Information Technology

The Company had several findings from the evaluation, including the lack of a written business continuity plan and risk profile assessment.

The Company is directed to address the concerns of the IT Specialist as noted in the IT section of this report.

SUBSEQUENT EVENTS

The Company's parent, Club Marketing and Sales, Inc., concluded bankruptcy proceedings in August 2003. The parent company became Statewide Holding Group, Inc., an insurance holding company domiciled in the State of Florida.

CONCLUSION

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

Per examination findings, the Company's surplus as regards policyholders was \$2,881,032, which was not in compliance with Section 624.408, FS.

In addition to the undersigned, Mary M. James, CFE, CPM, Financial Examiner/Analyst Supervisor, Xi Luo, Financial Examiner/Analyst, Computer Aid, Inc., Larry Steinert, Actuary, and March Fisher, Senior Actuarial Analyst, participated in the examination.

Respectfully submitted,

Rose Cady
Financial Examiner/Analyst II
Florida Office of Insurance Regulation