REPORT ON LIMITED SCOPE EXAMINATION

OF

MENDOTA INSURANCE COMPANY

EAGAN, MINNESOTA

AS OF

DECEMBER 31, 2011

BY THE

FLORIDA OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

Tallahassee, Florida

September 7, 2012

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 corporate governance, affiliated agreements, investments, underwriting, loss and loss adjustment expense (LAE) reserves, and reinsurance as of December 31, 2011, of:

MENDOTA INSURANCE COMPANY
2805 DODD ROAD, SUITE 300
EAGAN, MINNESOTA 55121

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

SCOPE OF EXAMINATION

This was a limited scope examination of Mendota Insurance Company (Company) to the extent and in the manner directed by the Florida Office of Insurance Regulation (Office). The last financial examination was as of December 31, 2006, and was performed by the Minnesota Department of Commerce. 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 April 23, 2012 and concluded as of September 7, 2012. The limited scope examination included material events occurring subsequent to December 31, 2011, and noted during the course of the examination as they related to the foregoing areas within the limited scope of the examination. This examination was conducted concurrently with a full scope risk-focused examination performed by the Minnesota Department of Commerce.

This examination covered the corporate governance, affiliated agreements, investments, underwriting, loss and LAE reserves, and reinsurance, as of December 31, 2011 and was conducted by INS Regulatory Insurance Services, Inc.

HISTORY

The Company was incorporated in Minnesota on May 1, 1989, and commenced business on June 1, 1989, as Mendota Insurance Company. Prior to 2007, the Company was a part of the St. Paul Travelers Companies Group. On April 1, 2007, Kingsway America, Inc. (Kingsway America). Kingsway America purchased 100% of the issued and outstanding common stock of the Company and its subsidiary, Mendakota Insurance Company. Kingsway America was an insurance holding company and ultimately a wholly owned subsidiary of Kingsway Financial Services, Inc., a publicly-owned holding company based in Mississauga, Ontario, Canada. The Company was the parent of its wholly owned subsidiaries, Mendakota Insurance Company, Mendota Insurance Agency, MIC Insurance Agency, Inc. and Boston General Agency, Inc.

The Company was authorized to transact the following insurance coverage in Florida on January 19, 1995 and February 10, 1997 and continued to be authorized as of December 31, 2011.

Private passenger auto liability	Private passenger auto physical damage
Inland marine	Other liability

CORPORATE GOVERNANCE

Examination procedures were conducted that included inquiry and interviews of selected senior management and review of the corporate minutes. The Company had a Board of Directors (Board) that consisted of five (5) members, two (2) of which were independent of Company management. The Board consisted of individuals with experience in the insurance and/or financial services industry.

Directors serving as of December 31, 2011, were:

Directors

Name and Location	**Principal Occupation**
Daniel David Schlemmer (a) Chicago, Illinois	Chief Actuary 1347 Advisors, LLC
Leeann Hazel Repta Woodridge, Illinois	Director of Operations KFS Capital, LLC
Hassan Raza Baqar (a) Streamwood, Illinois	Vice President – Claims 1347 Advisors, LLC
William August Hickey, Jr. Winnetka, Illinois	Managing Director KFS Capital, LLC
Richard Arnold Slater, Jr. Buffalo Grove, Illinois	Vice President – Product Development Mendota Insurance Company

(a) As of September 21, 2012, Daniel David Schlemmer and Hassan Raza Bagar resigned as directors. On September 22, 2012, Joan Harriet Stevens and Robert Thomas Rotondo were appointed as new directors.

The Board appointed the following senior officers:

Senior Officers

Name	**Title**
William August Hickey, Jr.	President
Hassan Raza Baqar (b)	Vice President & Treasurer
Dorothy Ann Brooks	Secretary
Corinne Lee Pawlenty (c)	Vice President - Operations
Richard Arnold Slater, Jr.	Vice President – Product Development
Michael Scott Livermore (c)	Vice President – Claims

(b) Hassan Raza Bagar resigned as Vice President and Treasurer on May 1, 2012. He was replaced with Annette Frances Schmidt on May 1, 2012.

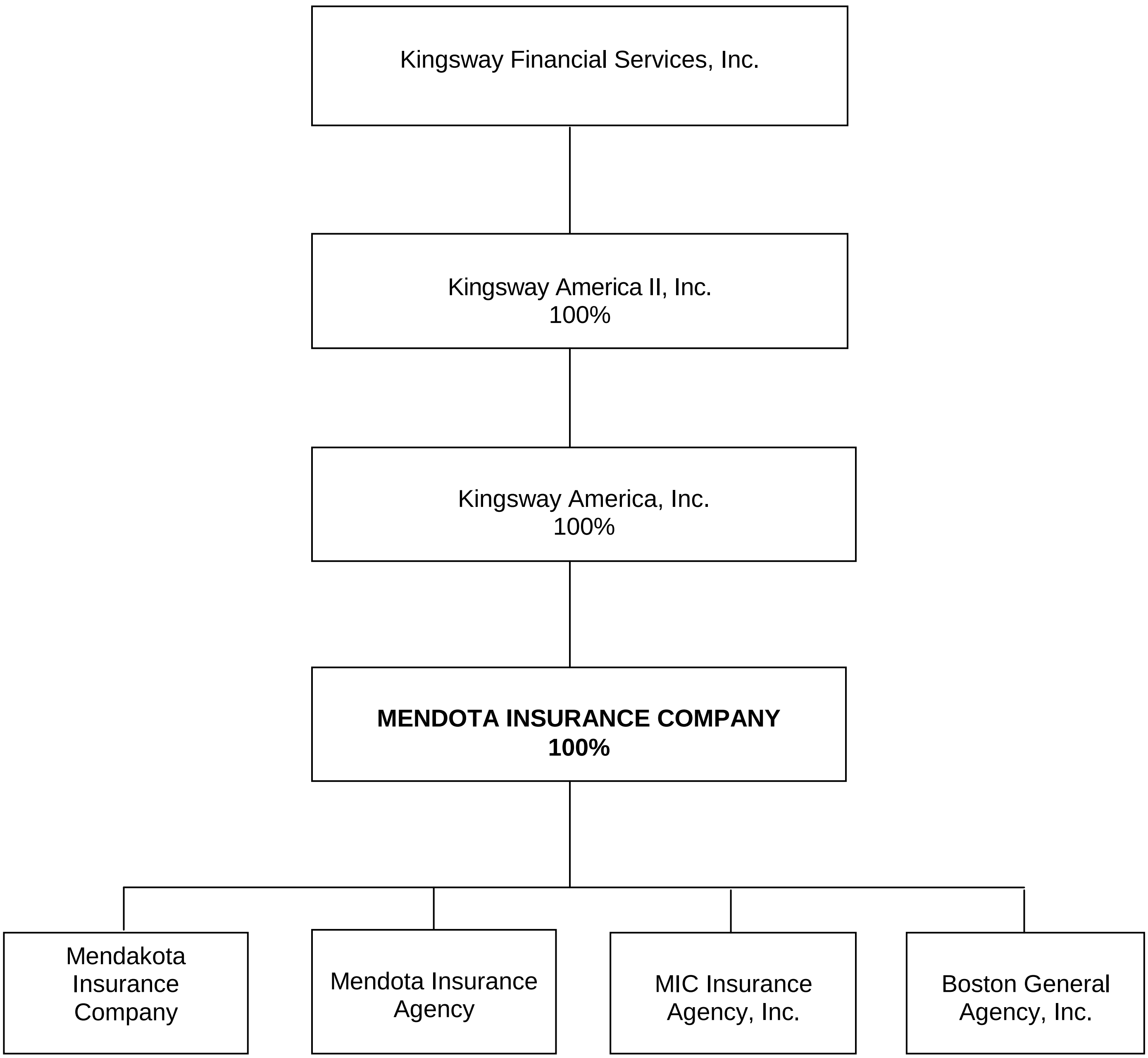
(c) Corinne Lee Pawlenty resigned as Vice President – Operations on September 7, 2012. Michael Scott Livermore resigned as Vice President – Claims on September 28, 2012.

The Board has not established any committees. The audit committee of the Company's parent, Kingsway America, functions as the audit committee for the Company although there is no formal agreement or Board resolution related to this arrangement.

A simplified organizational chart as of December 31, 2011, reflecting the holding company system, is shown below. Schedule Y of the Company's 2011 annual statement provided a list of all related companies of the holding company group.

MENDOTA INSURANCE COMPANY
ORGANIZATIONAL CHART

December 31, 2011



AFFILIATED AGREEMENTS

Procedures were performed to identify and ensure that all related parties, as defined by SSAP No. 25, paragraphs 2-5, were properly disclosed and reported. Based on those procedures the following related parties and associated agreements were found to be in place at December 31, 2011:

Services Agreement

The Company entered into a services agreement with its parent, Kingsway America, Inc. on November 8, 2011. Pursuant to the agreement, Kingsway America, Inc. provided services to the Company which included executive management, human resources, internal audit, actuarial, information technology and financial planning and reporting. Fees were based on actual cost and were allocated based on one percent (1%) of budgeted gross written premium at the beginning of each year. Quarterly, pursuant to the agreement, a comparison of actual cost incurred year-to-date to allocated costs was to be prepared and adjustments made. Any overage was to be refunded and any shortage was to be paid by the Company within thirty (30) days of the end of each quarter.

Services Agreement

A services agreement between the Company and subsidiary, Mendota Insurance Agency was entered into on October 17, 2005. Pursuant to the agreement, Mendota Insurance Agency is acting as general agent responsible for the production of business in the state of Texas. Fees were based on actual cost. Any overage was to be refunded and any shortage was to be paid by the Company within thirty (30) days of the end of each quarter.

Services Agreement

A services agreement between the Company and KAI Advantage Auto, Inc., an affiliated insurer in the state of Illinois, was entered into on September 15, 2011. Pursuant to the agreement, the Company provided services to KAI Advantage Auto, Inc. which included accounting, treasury management and financial reporting. Fees were based on actual cost and were allocated based on projected costs at the beginning of each year. Quarterly, pursuant to the agreement, a comparison of actual cost incurred year-to-date to allocated costs was to be prepared and adjustments made. Any overage was to be refunded and any shortage was to be paid by the Company within thirty (30) days of the end of each quarter.

Services Agreement

A services agreement between the Company and Universal Casualty Company (UCC), an affiliated insurer, was entered into on August 9, 2011. Pursuant to the agreement, the Company provided services to UCC which included accounting, treasury management and financial reporting. Fees were based on actual cost and were allocated based on projected costs at the beginning of each year. Quarterly, pursuant to the agreement, a comparison of actual cost incurred year-to-date to allocated costs was to be prepared and adjustments made. Any overage was to be refunded and any shortage was to be paid by the Company within thirty (30) days of the end of each quarter.

Cost Allocation Agreement

A cost allocation agreement between the Company and affiliates Mendakota Insurance Company and Mendota Insurance Agency was entered into on January 1, 2008. Pursuant to the agreement, the Company performed or obtained services for or incurred expenses on behalf of both affiliates and acted as a common paymaster or cash steward for both affiliates. Costs were allocated to both affiliates based on the costs incurred by the Company. Amounts paid by the Company pursuant to the agreement were either settled immediately or in certain cases settled through inter-company transfer within thirty days after the statement of account was received by the affiliates.

Marketing Agreement

A marketing agreement between the Company and two affiliated insurers, American Service Insurance Company (ASIC) & American Country Insurance Company (ACIC), was entered into on January 1, 2011. Pursuant to the agreement, the Company was to assist ASIC and ACIC establish distribution relationships with certain agents. Fees were based on a calculated compensation factor multiplied by the agent's collective written premium.

Tax Allocation Agreement

Effective October 28, 2009, a group tax allocation agreement was executed between the various U.S. entities within the KFSI organization, including the Company. Pursuant to the agreement, the income taxes were allocated to each subsidiary in proportion to the amount of taxable income that each subsidiary contributed to the consolidated taxable income.

Quota Share Reinsurance Agreement

A 100% quota share reinsurance agreement between the Company and subsidiary, Mendakota Insurance Company, was entered into on October 9, 2008. Pursuant to the reinsurance agreement, the Company assumed 100% of all liabilities under any and all policies bound, written, renewed or assumed by or on behalf of Mendakota Insurance Company.

It was found that several intercompany service agreements in which the Company was a party, including the agreement with parent company, Kingsway America, called for fees to be calculated at the beginning of each calendar year based on projected costs or premiums. Monthly payments, based on the calculated amount, were to be paid by the recipient of the services. Quarterly, a comparison of actual costs incurred to allocated costs was to be prepared and adjustments made. Any overage was to be refunded and any shortage paid. Per the Company, these quarterly comparisons have not been occurring.

INVESTMENTS

Bonds and Common Stocks

At December 31, 2011, all bonds held by the Company had NAIC designations of 1 and 2. Bonds were carried at their amortized cost using the interest method. Amortization of the discount or premium on the bonds was tested to determine the appropriateness of the amortization method utilized. Common stocks were held at fair value.

Direct confirmation of all securities as of the examination date was obtained from custodians as well as applicable state insurance departments' security divisions. Confirmed securities listings (e.g., description, par value, number of shares, cost) were compared with applicable Schedule D parts. In additional to the securities listing provided, the custodians verified how securities were registered (e.g., company name, company's nominee name or custodian's nominee name) and whether securities deposited were subject to any liens, claims or held as collateral for any loans made to an officer, director or employee of the Company.

Cash and Short Term Investments

Direct confirmation of all reported cash and short term investment balances as of the examination date was obtained from the applicable depository. Bank reconciliations obtained from the Company were utilized to identify reconciling items. Bank statements subsequent to the examination date were obtained and reviewed to ensure proper inclusion of withdrawals. In addition to the confirmed balance, the depository verified that the amounts held were free and clear of any hypothecation, pledges, liens or guarantees.

It was found that the Company shared a cash operating account held at Wells Fargo Bank with subsidiary, Mendakota Insurance Company. In addition, there was no cash pool agreement in place. Without a formalized agreement in place restricting the use of one entities funds by the other, the related funds were not the absolute property of the reporting entity, nor held free and clear as attested to on the jurat page of the annual statement.

It was found that pursuant to a 100% quota share agreement with Consumers County Mutual Insurance Company (Consumers County Mutual), the Company, as reinsurer, had placed securities with a reported carrying value at December 31, 2011 of $12.234 million at JP Morgan Chase. These securities, which were reported as admitted assets, were held in trust for Consumers County Mutual, pursuant to a trust agreement. This trust agreement contained clauses that limit the Company's control over these securities, including the ability of Consumers County Mutual to immediately take possession of the securities without the consent of the Company. The Company reported a compensating liability in the form of recognized known case losses and LAE in the amount of $3.230 million, unearned premiums of $3.809 million and $1 million of Incurred But Not Reported (IBNR) claims. However, there was no compensating liability for the remaining $4.195 million.

Among other characteristics, SSAP No. 4 Paragraph 2(b) defines an asset as being one "a particular entity can obtain the benefit and control others' access to." Based on the fact that the Company did not have control over Consumer County Mutual's access to the securities held at

JP Morgan Chase pursuant to the trust agreement, these securities did have all the required characteristics of a reportable asset. Accordingly, a financial adjustment was reflected in the financial statements.

Subsequent Event: The Company reached an agreement with Consumers County Mutual during the first quarter of 2013 whereby all remaining excess from the collateral trust account was returned to the Company and the remaining excess is being funded by the Company's parent, Kingsway America, Inc. As a result, the Company currently has $0 of excess collateral under the Quota Share Reinsurance Agreement between the Company and Consumers County Mutual.

UNDERWRITING

The Company and wholly-owned subsidiary Mendakota Insurance Company wrote mostly non-standard automobile liability and physical damage coverage to those who can't obtain coverage from standard insurers due to poor driving records, vehicle age, inconsistent prior coverage or limited financial resources. Products were distributed through a network of independent agents in approximately twenty states with Florida and California representing the largest markets based on direct written premium.

A new class of business was developed by KAI Advantage Auto, Inc. and written on Mendakota Insurance Company paper. KAI Advantage Auto, Inc. is a managing underwriter owned by Kingsway America. KAI Advantage Auto, Inc. specialized in non-standard automobile business in Illinois and Indiana, concentrating on the Metro Chicago market, which has a unique non-standard market compared to the rest of the business. There was only $168,000 of earned premium reported in 2011.

The following table shows underwriting results (in dollars) and of the Company for the past three years of operations, as reported in the filed annual statements.

	2011	2010	2009
Gross Premiums Written	73,562,081	114,742,367	122,217,984
Net Premiums Written	73,256,870	113,638,236	104,481,316
Net Underwriting Loss	(12,087,845)	(23,093,376)	(12,262,325)
Net Written Premium to Surplus	2.97 : 1	4.27 : 1	2.97 : 1

The Company attributed the decrease in production to the decline in the economy, a reduction in exposures per policy due to policyholders insuring fewer vehicles and dropping optional coverages, as well as actions taking by the Company, including rate increases, selective new business moratoriums, and underwriting restrictions.

A sample of in-force policy data was tested for accuracy and completeness by the external auditor The data was tested to verify and validate individual determinants, such as effective date; term and expiration date of the coverage; contract or identification number; premium amount; and negative amounts. Reliance was placed on the work performed by the external auditor.

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Office engaged an independent actuarial firm, INS Consultants, Inc. (INS) to perform an independent analysis of the Company's loss and LAE reserves as of December 31, 2011. Since the Company assumed 100% of Mendakota Insurance Company's Loss and Loss Adjustment Expense (LAE) reserves and ceded no loss or LAE reserves, the Company's gross (direct and assumed) loss and LAE reserves are identical to their net loss and LAE reserves. The conclusions presented in INS' report was based on information provided to INS, including the 2011 Annual Statement and the 2011 Actuarial Opinion Statement and Summary, with a supporting actuarial report. The Company's reserves were certified by Daniel David Schlemmer, ACAS, MAAA, and Director of Actuarial Services for Kingsway America, Inc.

Based on the review, INS found the Company's carried gross and net Loss and Loss Adjustment Expense (LAE) reserves to be considerably below INS' indications. Carried gross/net reserve of $42.176 million was lower than INS' estimate of $45.472 million by $3.296 million or 7.8% of the carried reserve or 13.4% of the reported $24,669,070 policyholders' surplus.

In addition, at the request of the Company, INS presented a range of estimated gross Loss and LAE reserves. INS' estimated range of the gross Loss and LAE reserves was $43.153 million to $47.712 million. When compared to the Company's booked gross loss and LAE reserves of $42.176 million, INS' range of gross loss and LAE reserves varied from being $977,000 higher to $5.536 million higher than the Company's booked gross loss and LAE reserves. Accordingly, an adjustment has been reflected in the financial statements.

Subsequent Events: As of March 31, 2012, the Company recognized a $457,000 deficiency for accident years 2011 and prior. As of September 30, 2012, the Company increased Loss and LAE reserves by $2.165 million for accidents years 2001 and prior. The Company's 2011 gross Loss and LAE reserves of $44.342 million, inclusive of the effect of the September 30, 2012 adjustment, exceeded the appointed actuary central estimate and fell within INS' examination range of reasonable estimates.

REINSURANCE

The Company, as cedant, was party to one reinsurance agreement, an excess clash cover, brokered through a reinsurance intermediary. Participating reinsurers were all unaffiliated companies.

The Company was party to two assuming reinsurance agreements. One with subsidiary, Mendakota Insurance Company and one with unaffiliated, Consumers County Mutual. Both agreements were 100% quota share in which the Company assumed all of the risk associated with the policies written. Of the $33.5 million in assumed premiums, $21.46 million was assumed from Mendakota Insurance Company and $12.11 was assumed from Consumers County Mutual.

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. The work performed by the external auditor was relied upon to assess the contracts for proper risk transfer in accordance with SSAP No. 62, paragraphs 9-16.

Financial information was obtained and reviewed for reinsurers to whom significant business was ceded. Sources of information included financial reports and insurance industry reporting and rating services.

Procedures were performed to address the completeness and accuracy of the ceded reinsurance premium payable balance of $3,610 reported by the Company as of December 31, 2011. Work performed by the external auditors was obtained and reviewed to ensure premiums remitted and losses and LAE payments billed as part of the reinsurance agreements were accurately recorded and reported.

There were no exceptions or findings as of December 31, 2011, related to reinsurance.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2011, 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."

MENDOTA INSURANCE COMPANY
Assets

December 31, 2011

	Per Company	Examination Adjustments	Per Examination
Bonds	$17,732,193		$17,732,193
Common stocks	13,843,813		13,843,813
Cash	(4,533,422)		(4,533,422)
Cash equivalents	9,899,769		9,899,769
Short-term investments	30,378,720	($4,195,000)	26,183,720
Other invested assets	3,926,000		3,926,000
Subtotals, cash and invested assets	$71,247,073	($4,195,000)	$67,052,073
Investment income due and accrued	144,876		144,876
Uncollected premiums and agents' balances	2,723,646		2,723,646
Deferred premiums, agents' balances and installments	13,022,680		13,022,680
Current federal and foreign income tax recoverable	213,282		213,282
Net tax deferred asset	2,259,284		2,259,284
EDP equipment and software	198,335		198,335
Receivables from parent, subs, and affiliates	1,208,947		1,208,947
Aggregate write-ins for other than invested assets	19,397		19,397
Total assets	$91,037,520	($4,195,000)	$86,842,520

MENDOTA INSURANCE COMPANY
Liabilities, Surplus and Other Funds

December 31, 2011

	Per Company	Examination Adjustments	Per Examination
Losses	$33,879,837	$1,852,000	$33,731,837
Loss adjustment expenses	8,297,568	$1,444,000	9,741,568
Commissions payable, contingent commission	443,563		443,563
Other expenses	487,078		487,078
Taxes, licenses, and fees	(126,525)		(126,525)
Unearned premium	22,109,858		22,109,858
Ceded reinsurance premiums payable	3,610		3,610
Amounts withheld or retained by Company for others	84,609		84,609
Remittances and items not allocated	567		567
Payable to parent, subs, and affiliates	72,033		72,033
Aggregate write-ins for liabilities	1,116,251		1,116,251
Total Liabilities	$66,368,449	$3,296,000	$67,664,449
Common capital stock	$2,442,452		$2,442,452
Gross paid in and contributed surplus	34,196,570		34,196,570
Unassigned funds (surplus)	(11,969,952)	(7,491,000)	(16,460,952)
Surplus as regards policyholders	$24,669,070	($7,491,000)	$17,178,070
Total liabilities, surplus and other funds	$91,037,519	($4,195,000)	$84,842,519

MENDOTA INSURANCE COMPANY
Statement of Income

December 31, 2011

Deductions:	
Losses incurred	60,329,282
Loss adjustment expenses incurred	12,811,995
Other underwriting expenses incurred	26,016,904
Total underwriting deductions	$99,158,181
Net underwriting gain or (loss)	($12,087,846)
Investment Income	
Net investment income earned	$738,706
Net realized capital gains or (losses)	963,591
Net investment gain or (loss)	$1,702,297
Other Income	
Net gain or (loss) from agents' or premium balances charged off	($3,113,928)
Finance and service charges not included in premiums	6,501,106
Total other income	$3,387,178
Net income before dividends to policyholders, after capital gains tax and before all other federal & foreign income taxes	($6,998,371)
Net Income, after dividends to policyholders, after capital gains tax and before all other federal & foreign income taxes	($6,998,371)
Federal & foreign income taxes	(297,805)
Net Income	($6,700,566)
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	$26,644,325
Net Income	($6,700,565)
Change in net unrealized capital gains or (losses)	(419,277)
Change in net deferred income tax	2,450,548
Change in nonadmitted assets	(3,146,983)
Surplus adjustment: Paid in	5,839,022
Aggregate write-ins for gains and losses in surplus	2,000
Examination adjustment	(7,491,000)
Change in surplus as regards policyholders for the year	$9,466,256
Surplus as regards policyholders, December 31 current year	$17,178,070

A comparative analysis of changes in surplus is shown below.

MENDOTA INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS

DECEMBER 31, 2011

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, 2011, per Annual Statement				$24,669,070
	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
ASSETS:				
Short Term Investments	$30,378,720	$26,183,720	($4,195,000)	
LIABILITIES:				
Losses	$33,879,837	$35,731,837	($1,852,000)	
Loss adjustment expenses	8,297,568	9,744,568	(1,444,000)	
Net Change in Surplus:				(7,491,000)
Surplus as Regards Policyholders December 31, 2011, Per Examination				$17,178,070

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 December 31, 2011.

Affiliated Agreements

Several intercompany service agreements in which the Company was a party, including the agreement with parent company, Kingsway America, called for fees to be calculated at the beginning of each calendar year based on projected costs or premiums. Monthly payments, based on the calculated amount, were to be paid by the recipient of the services. Quarterly, a comparison of actual costs incurred to allocated costs was to be prepared and adjustments made. Any overage was to be refunded and any shortage paid. Per the Company, these quarterly comparisons have not been occurring. **We recommend that the quarterly comparison of costs be performed for those intercompany contracts in which this is outlined, to ensure that that the proper amount of fees are being paid and received for services rendered.**

Investments

The Company shared a cash operating account held at Wells Fargo Bank with subsidiary, Mendakota Insurance Company. In addition, there was no cash pool agreement in place. Without a formalized agreement in place restricting the use of one entities funds by the other, the related funds were not the absolute property of the reporting entity, nor held free and clear as attested to on the jurat page of the annual statement. **We recommend that the Company enter into a cash pool or similar agreement with its subsidiary, Mendakota Insurance Company or cease utilizing a shared account.**

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of the **Mendota Insurance Company** as of December 31, 2011, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was $17,178,070, which exceeded the minimum of $6,540,712, required by Section 624.408, Florida Statutes.

In addition to the undersigned, Kethessa Carpenter, CPA, Examination Manager, Florida Office of Insurance Regulation, James Russo, CFE, CPCU, FLMI, CIE, CFSA, CFE (Fraud), CICA, Examiner-In-Charge; John V. Normile, CFE, Examiner-In-Charge and Patricia Casey Davis, CPA, CFE, Manager of INS Regulatory Insurance Services, Inc.; David J. Macesic, ACAS, MAAA, and Robert W. Gardner, FCAS, MAAA, consulting actuaries of INS Consultants, Inc., participated in the examination.

Respectfully submitted,

____

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