

REPORT ON EXAMINATION
OF
ROYAL PALM INSURANCE COMPANY
GAINESVILLE, FLORIDA

AS OF
DECEMBER 31, 2008

BY THE
OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION	1
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION	3
HISTORY	4
GENERAL	4
CAPITAL STOCK	5
PROFITABILITY OF COMPANY	6
DIVIDENDS TO STOCKHOLDERS	6
MANAGEMENT	6
CONFLICT OF INTEREST PROCEDURE	8
CORPORATE RECORDS	8
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASE OR SALES THROUGH REINSURANCE	8
SURPLUS DEBENTURES	8
AFFILIATED COMPANIES	9
ORGANIZATIONAL CHART	10
MANAGING GENERAL AGENCY AGREEMENT	11
FIDELITY BOND AND OTHER INSURANCE	11
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS	11
STATUTORY DEPOSITS	11
INSURANCE PRODUCTS	12
TERRITORY	12
TREATMENT OF POLICYHOLDERS	12
REINSURANCE	12
ASSUMED	13
CEDED	13
ACCOUNTS AND RECORDS	13
MANAGING GENERAL AGENCY AGREEMENT	14
CLAIMS SERVICE AGREEMENT	14
CUSTODIAL AGREEMENT	14
INVESTMENT MANAGER AGREEMENT	14
FINANCIAL STATEMENTS PER EXAMINATION	15
ASSETS	16
LIABILITIES, SURPLUS AND OTHER FUNDS	17
STATEMENT OF INCOME	18
COMMENTS ON FINANCIAL STATEMENTS	19
ASSETS	19
LIABILITIES	19

INCOME STATEMENT	20
CAPITAL AND SURPLUS	21
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS	22
SUMMARY OF FINDINGS	23
SUBSEQUENT EVENTS.....	25
CONCLUSION.....	26

Tallahassee, Florida

February 19, 2010

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2008, of the financial condition and corporate affairs of:

**ROYAL PALM INSURANCE COMPANY
7201 N.W. 11th PLACE
GAINESVILLE, FLORIDA 32605**

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, 2008, through December 31, 2008. This is the second year Risk-Focused Examination of the Company. This examination commenced with planning at the Florida Office of Insurance Regulation (Office), on November 16, 2009, to November 20, 2009. The fieldwork commenced on November 23, 2008, and concluded as of February 19, 2010.

This financial examination was a statutory 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.

Risk-focused examinations consist of a seven-phase process that can be used to identify and assess risk, assess the adequacy and effectiveness of strategies/controls used to mitigate risk and assist in determining the extent and nature of procedures and testing to be utilized in order to

complete the review of that activity. The process should generally include a determination of the quality and reliability of the corporate governance structure and risk management programs. In addition, it can be used for verification of specific portions of the financial statements or other limited-scope reviews, increased focus on, and can result in increased substantive testing of, accounts identified as being at high risk of misstatement. Conversely, the risk assessment process should result in decreased focus on, and fewer substantive tests on the accounts identified as being at low risk of misstatement. The risk-focused surveillance process can be used to assist examiners in targeting areas of high-risk.

In this examination, emphasis was directed to the quality, value and integrity of the statement of assets and the determination of liabilities, as those balances affect the financial solvency of the Company as of December 31, 2008. Transactions subsequent to year-end 2008 were reviewed where relevant and deemed significant to the Company's financial condition.

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

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 reports, the Demotech rating report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) and other reports as considered necessary were reviewed and utilized where applicable within the scope of this examination.

This report of examination was confined to financial statements and comments on matters that involved departures from laws, regulations or rules, or which were 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, 2007, along with resulting action taken by the Company.

General

The Company's custodial agreement contained all requirements under Florida rules and regulations. The agreement was not signed by both parties. **Resolution:** The Company complied with Rule 69O-143.042, Florida Administrative Code and executed a custodial agreement that was signed by both parties.

Management

The recorded minutes of the Board of Directors did not reflect approval of investments. **Resolution:** The Company complied with Section 625.304, Florida Statutes requiring approval of investments by the Board of Directors.

The Company did not provide evidence that the directors were elected at the annual meeting of the stockholder. **Resolution:** The Company complied with Section 628.231(2), Florida Statutes requiring directors to be elected at the annual meeting of the stockholders.

The Company did not maintain fidelity bond coverage. **Resolution:** The Company complied with Rule 69O-142.011(11)(b)16, Florida Administrative Code and purchased fidelity bond coverage in the recommended amount by the NAIC.

HISTORY

General

The Company was incorporated as a domestic, stock company licensed only in Florida. The Company's Certificate of Authority was issued under Florida law on March 31, 2006.

Initially, the Company assumed approximately 120,000 in-force policies from Allstate Floridian Insurance Company and Allstate Floridian Indemnity Company (collectively Allstate), which had elected to reduce their exposure in Florida following a few years of hurricane losses. The assumption agreement with Allstate allowed access to the Allstate agency force of approximately 1500 agents. Renewal of policies on all Allstate business was offered on the Company's paper. Assumption of policies from other carriers as well as new business from the voluntary market helped support policy levels.

The Company was party to two Consent Orders, which are still in effect:

- Consent Order 85590-06-CO, filed March 29, 2006, regarding the application for the issuance of a permit.
- Consent Order 85654-06-CO, filed March 31, 2006, regarding the application for the issuance of a certificate of authority.

The Company was in compliance with the provisions of the Consent Orders except as follows:

- The Company did not maintain sufficient and adequate internal controls and supervision of external contractors providing services to the Company. Upon dismissal of their MGA,

Security First Managers in November 2008, the Company could not recreate certain balances and activity, including losses incurred and premiums received. The Company did not maintain adequate in-house knowledge of its financial transactions, outside of what was provided by the MGA.

The Company was authorized to transact the following insurance coverage in Florida as of December 31, 2008:

Fire

Homeowner's multi peril

The Articles of Incorporation and the Bylaws were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2008, the Company's capitalization was as follows:

Number of authorized common capital shares	100,000
Number of shares issued and outstanding	55,000
Total common capital stock	\$5,500,000
Par value per share	\$100.00

The Company was a member of a holding company system and was 100% owned by Ritchie Risk-Linked, LLC which in turn was owned by Ritchie Risk-Linked Strategies Trading, Ltd. (Strategies Trading). The ultimate parent was Ritchie Capital Management, Ltd. Both Strategies Trading and Ritchie Capital Management, Ltd. disclaimed control over the Company and did not have voting rights.

Profitability of Company

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

	2008	2007	2006
Premiums Earned	116,438,960	87,861,860	34,341,069
Net Underwriting Gain/(Loss)	(3,768,651)	(32,726,723)	(21,712,477)
Net Income	(1,203,082)	(23,591,409)	(19,918,075)
Total Assets	198,172,293	243,117,765	182,313,476
Total Liabilities	149,138,299	181,803,582	88,034,997
Surplus As Regards Policyholders	49,033,994	61,314,183	94,278,479

Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2008.

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2008, were:

Directors

Name and Location

Principal Occupation

Thomas A. F. Moss (a)
Santa Fe, New Mexico

Banking and Finance
Ritchie Capital Management

Gerald R. Komlofske
Wilmette, Illinois

Consultant
Ritchie Capital Management

John D. Kermath
Houston, Texas

Consultant and Financial Advisor
Ritchie Capital Management

Phillip M. Thomasson
Lisle, Illinois

President – Retired
Tower Hill Insurance Group

Stephen S. Charles
Fairfield, Connecticut

Chief Risk Officer
Ritchie Capital Management

(a) Resigned on October 28, 2009 and was replaced by Kumar Gursahaney as a director.

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

Senior Officers

Name	Title
Gerald R. Komlofske	Chief Executive Officer and President
John D. Kermath	Vice President and Secretary
Thomas A. F. Moss (a)	Vice President and Treasurer

(a) Resigned on October 28, 2009 and was replaced by Kumar Gursahaney as Treasurer.

The Company's Board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following were the principal internal board committees and their members as of December 31, 2008:

Executive Committee	Audit Committee	Investment Committee
Thomas A. F. Moss ¹	Phillip M. Thomasson ¹	Stephen S. Charles ¹
Gerald R. Komlofske	John D. Kermath	Thomas A. F. Moss
John D. Kermath	Stephen S. Charles	John D. Kermath

Compensation Committee

John D. Kermath¹
Phillip M. Thomasson
Stephen S. Charles

Underwriting Committee

Gerald R. Komlofske¹
Phillip M. Thomasson
Thomas A. F. Moss

Reinsurance Committee

Thomas A. F. Moss¹
Gerald R. Komlofske
Phillip M. Thomasson

¹ Chairman

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook.

Corporate Records

The recorded minutes of the shareholder, Board of Directors, 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 in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

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

There were no acquisitions, mergers, disposals, dissolutions, or purchase or sales through reinsurance during the period of examination.

Surplus Debentures

On March 26, 2006, the Company executed a Subordinated Surplus Debenture with Ritchie Risk-Linked Strategies Trading, a Bermuda corporation, in order to increase the surplus of the

Company. The contribution to surplus in the amount of \$35 million in the form of cash was approved by the Office in compliance with Section 628.401, Florida Statutes. Pursuant to the agreement, accrued interest was payable quarter-annually commencing July 1, 2006, after first having been approved by the Office. The note bears interest at an annual rate equal to the prime rate (adjusted quarterly) plus 2.75%. The maturity date of the agreement is March 31, 2026. In December 2007, the \$35 million surplus note was reduced by \$10 million, after the Company received approval from the Office for principal repayment. At year-end 2008, the Office approved a second principal repayment of \$5 million, such that the balance of the note was reduced to \$20 million.

On December 20, 2006, the Company executed a surplus note with the State Board of Administration of Florida in the amount of \$25 million in new capital in order to participate in the Capital Build-up Incentive Program. The surplus note accrues interest at a rate equivalent to the 10-year U.S. Treasury Bond rate. The term of the agreement is 20 years.

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, 2009, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2008, reflecting the holding company system, is shown below. Schedule Y of the Company's 2008 annual statement provided a list of all related companies of the holding company group.

ROYAL PALM INSURANCE COMPANY, INC.

ORGANIZATIONAL CHART

DECEMBER 31, 2008



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

Managing General Agency Agreement

Effective April 1, 2006, the Company entered into a Managing General Agency Agreement and a Claims Administration Agreement with Security First Managers, LLC (SFM). The agreements were terminated in November 2008. **Subsequent Event:** The Company entered into a new Managing General Agency Agreement with its newly formed affiliate, Royal Palm Insurance Managers (RPIM), effective December 4, 2008. Pursuant to this agreement, RPIM will manage all business produced by the Allstate agents.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$1,250,000 with a deductible of \$50,000, which adequately covered the suggested minimum recommended by the NAIC.

The Company also maintained Professional Liability coverage, which included Directors and Officers (D&O), with an aggregate limit of \$12,000,000. A Special Property Coverage (umbrella) policy was also maintained offering business and personal property replacement cost coverage with an aggregate limit of \$10,000,000.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company did not participate in any pension, stock ownership or insurance plans.

STATUTORY DEPOSITS

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

STATE	Description	Par Value	Market Value
FL	FL State Treasury Inv Account	\$ 2,119,582	\$ 2,119,582
TOTAL FLORIDA DEPOSITS		<u>\$ 2,119,582</u>	<u>\$ 2,119,582</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 2,119,582</u>	<u>\$ 2,119,582</u>

INSURANCE PRODUCTS

The Company offered Fire and Homeowners Multi Peril insurance policies.

Territory

The Company was authorized to transact insurance only in the State of Florida.

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.

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

Effective April 1, 2006, the Company entered into a quota share reinsurance agreement with Allstate Floridian Insurance Company and Allstate Floridian Indemnity Company whereby the Company assumed 100 percent of the losses associated with a book of homeowner's policies in Florida. The assumed written premium remaining as of December 31, 2008, was \$163,000.

Ceded

The Company ceded risk on a per risk excess of loss and per occurrence catastrophe basis to the Florida Hurricane Catastrophe Fund and various unrelated reinsurers.

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

ACCOUNTS AND RECORDS

Until November 2008, the Company maintained its principal operational offices in Ormond Beach, Florida. Upon the termination of the MGA agreement with Security First Managers, the Company's principal operations were moved to Gainesville, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2008, 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:

Managing General Agency Agreement Claims Service Agreement

The Company entered into a Managing General Agency Agreement and Claims Service Agreement with Tower Hill Insurance Group (THIG), effective November 15, 2008, after terminating its agreements with Security First Managers. Pursuant to these agreements as well as separate agreements with Royal Palm Insurance Managers, THIG provided marketing, underwriting, accounting and administrative services, and claims handling services on all business.

Custodial Agreement

The Company maintained a custodial agreement with Morgan Stanley Trust, N. A. The Company was in compliance with Rule 69O-143.042, Florida Administrative Code which stipulates the requirements of a custodial agreement.

Investment Manager Agreement

On March 22, 2006, the Company entered into the Investment Manager Agreement with Sage Advisory Services, Ltd. Co. (Sage). Sage acted as investment manager and advisor with respect to certain of the Company's assets held by Morgan Stanley, pursuant to a separate custodial agreement. Sage supervised and directed investments on behalf of the Company subject to the terms of the written investment policies and guidelines established by the Company.

Information Technology Report

INS Services, Inc. performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were provided to the Company.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2008, 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."

ROYAL PALM INSURANCE COMPANY
Assets

DECEMBER 31, 2008

	Per Company	Examination Adjustments	Per Examination
Bonds	\$108,607,360	\$0	\$108,607,360
Common stocks	13,600,378		13,600,378
Cash and short-term investments	56,611,636	(17,116,177)	39,495,459
Investment income due and accrued	1,438,639		1,438,639
Agents' Balances:			
Uncollected premium	3,482,373		3,482,373
Deferred premium	12,035,631		12,035,631
Other amounts receivable under reinsurance contracts	887,829		887,829
Net deferred tax asset	101,600		101,600
Guaranty funds receivable or on deposit	161,692		161,692
Receivable from parents, subsidiaries and affiliates	1,244,530		1,244,530
Aggregate write ins for other than invested assets	625		625
Totals	<u>\$198,172,293</u>	<u>(\$17,116,177)</u>	<u>\$181,056,116</u>

ROYAL PALM INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2008

	Per Company	Examination Adjustments	Per Examination
Losses	\$28,253,219	\$2,641,000	\$30,894,219
Reinsurance payable on paid losses	251,397		251,397
Loss adjustment expenses	6,990,897		6,990,897
Commissions payable, contingent commissions and other similar charges	4,286,811		4,286,811
Other expenses	533,147		533,147
Taxes, licenses and fees	773,638		773,638
Unearned premiums	65,036,201		65,036,201
Advance premium	3,184,148		3,184,148
Ceded reinsurance premiums payable	34,231,709	(17,116,177)	17,115,532
Amounts withheld or retained by company for account of others	597,132		597,132
Payable to parent, subsidiaries and affiliates	5,000,000		5,000,000
Total Liabilities	\$149,138,299	(\$14,475,177)	\$134,663,122
Common capital stock	5,500,000		5,500,000
Surplus notes	45,000,000		45,000,000
Gross paid in and contributed surplus	49,500,000		49,500,000
Unassigned funds (surplus)	(50,966,006)	(2,641,000)	(53,607,006)
Surplus as regards policyholders	\$49,033,994	(\$2,641,000)	\$46,392,994
Total liabilities, surplus and other funds	\$198,172,293	(\$17,116,177)	\$181,056,116

ROYAL PALM INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2008

Underwriting Income

Premiums earned		\$116,438,960
	Deductions:	
Losses incurred		58,590,793
Loss expenses incurred		13,913,976
Other underwriting expenses incurred		\$47,702,842
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$120,207,611
Net underwriting gain or (loss)		(\$3,768,651)

Investment Income

Net investment income earned		\$4,654,323
Net realized capital gains or (losses)		(150,442)
Adjustment for unrecognized other-than-temporary impairments		(4,089,099)
Net investment gain or (loss)		\$414,782

Other Income

Net gain or (loss) from agents' or premium balances charged off		\$14,628
Finance and service charges not included in premiums		466,307
Aggregate write-ins for miscellaneous income		(13,083)
Total other income		\$467,852

Net income before dividends to policyholders and before federal & foreign income taxes		(\$2,886,017)
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		(\$2,886,017)
Federal & foreign income taxes		0
Net Income (Loss)		(\$2,886,017)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$61,314,183
Net Income		(\$2,886,017)
Change in net unrealized capital gains or losses		68,536
Change in net deferred income taxes		945,520
Change in non-admitted assets		(5,408,228)
Change in provision for reinsurance		0
Change in surplus notes		(5,000,000)
Examination Adjustment		(2,641,000)
Change in surplus as regards policyholders for the year		(\$14,921,189)
Surplus as regards policyholders, December 31 current year		\$46,392,994

COMMENTS ON FINANCIAL STATEMENTS

Assets

Cash \$39,495,459

A cash payment of ceded premiums in the amount of \$17,116,177 was made December 31, 2008, but was not recorded until January 1, 2009. Cash balance was reduced.

Bank confirmations were unable to be obtained from SunTrust Bank, holding assets of the Company. Office policy dictates that assets must be confirmed as to ownership, existence, pledging, indebtedness or hypothecation. Based on this, assets associated with these accounts, with a reported value of \$4,530,081, were non-admitted. In addition to the reclassification between Cash and Ceded Reinsurance Premiums Payable, this would have created a need for a provision for reinsurance, as the amounts payable to reinsurers would not have been sufficient to offset the balance of reinsurance recoverable. **Subsequent Event:** The Company closed the SunTrust Bank accounts subsequent to the examination period and the assets were admitted.

Liabilities

Losses and Loss Adjustment Expenses \$37,885,116

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, 2008, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

An independent actuarial review performed on behalf of the Office reflected estimated net loss and LAE reserves \$2.6 million higher than the Company's booked net loss and LAE reserves of \$35.2 million. Loss reserves were increased.

Ceded Reinsurance Premiums Payable \$17,115,532

A cash payment of ceded premiums in the amount of \$17,116,177 was made December 31, 2008, but was not recorded until January 1, 2009. The ceded reinsurance premiums payable balance was reduced to reflect the payment.

Income Statement

The Company did not recognize any other-than-temporary impairments (OTTI) on common stocks in the 2008 Annual Statement. In the audited statutory financial statements, the Company properly recognized OTTI in the amount of \$4,089,099. As a result, the Company reported a net income of \$1.2 million on the 2008 Annual Statement rather than a \$2.8 million net loss due to failure to recognize OTTI on investments. The following accounts were adjusted to reflect the proper treatment of the OTTI investments:

	As per the Annual Statement	Adjustment	As per the Examination
Net realized capital losses on investments	\$(150,442)	\$(4,089,099)	\$(4,239,541)
Loss before income taxes	1,203,082	(4,089,099)	(2,886,017)
Net loss	1,203,082	(4,089,099)	(2,886,017)
Change in net unrealized gains and losses, net	(2,373,560)	2,442,096	68,536
Change in net deferred income tax	(421,080)	1,366,600	945,520
Change in non-admitted assets	(5,688,631)	280,403	(5,408,228)

There was no impact on surplus as a result of these adjustments.

Capital and Surplus

The adjusted surplus amount of \$46,392,994 exceeded the minimum of \$13,466,000 required by Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

**ROYAL PALM INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2008

Surplus as Regards Policyholders
December 31, 2008, per Annual Statement \$49,033,994

	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS
ASSETS:			
Cash & Short Term Investments	\$56,611,636	\$39,495,459	(\$17,116,177)
LIABILITIES:			
Reinsurance Premiums Payable	34,483,106	17,366,929	17,116,177
Losses	28,253,219	30,894,219	(2,641,000)
INCOME STATEMENT:			
Net Income (Loss)	1,203,082	(2,886,017)	(4,089,099)
Change in net unrealized gains and losses, net	(2,373,560)	68,536	2,442,096
Change in net deferred income tax	(421,080)	945,520	1,366,600
Change in non-admitted assets	(5,688,631)	(5,408,228)	280,403
 Net Change in Surplus:			 (\$2,641,000)
 Surplus as Regards Policyholders December 31, 2008, Per Examination			 <u>\$46,392,994</u>

SUMMARY OF FINDINGS

Compliance with previous directives

The Company took the necessary actions to comply with the comments made in the 2007 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, 2008.

General

The Company did not maintain sufficient and adequate internal controls and supervision of external contractors providing services in connection with the insurance transactions of the Company. Upon dismissal of their MGA, Security First Managers in November 2008, the Company could not recreate certain balances and activity, including losses incurred and premiums received. The Company did not maintain adequate in-house knowledge of its financial transactions, outside of what was provided by the MGA. **We recommend that the Company strengthen its internal control and supervision of its MGA to be in compliance with Consent Orders 85590-06-CO and 85654-06-CO.**

Investments

The Company did not properly recognize other-than-temporary impairments on common stocks. **We recommend that the Company properly recognize and report other-than-temporary impairments on investments as stipulated by Statement of Statutory Accounting Principle 24.**

Loss and LAE Reserves

An actuarial review of the Company's loss and LAE reserves estimated net loss and LAE reserves \$2.6 million greater than the Company's booked loss and LAE reserves. **We recommend that the Company reevaluate its net loss and LAE reserve estimates and report reserves in accordance with Section 625.091, Florida Statutes.**

Cash Disbursements

A cash payment of ceded premiums was made December 31, 2008, but was not recorded until January 1, 2009. **We recommend that the Company properly report all transactions that have occurred in the reporting period in accordance with NAIC Annual Statement Instructions as adopted by Rule 69O-137.001 (4) and 69O-138.001, Florida Administrative Code.**

SUBSEQUENT EVENTS

Pursuant to Section 624.448, Florida Statutes, the Company provided notice to the Office of a material acquisition of assets transaction that occurred in June 2009. On June 9, 2009, the Company invested \$22,500,000 to participate in the Term Asset-Backed-Securities Loan Facility ("TALF") of the Federal Reserve Bank of New York ("Federal Reserve). Three bonds were acquired through Bank of America Securities LLC in its capacity as a primary dealer in the TALF program. As of June 30, 2009, the Company had \$315,000,000 of asset-backed securities purchased under the TALF and received secured financing from the Federal Reserve of \$292,750,000 related to the purchase of these securities.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Royal Palm Insurance Company** as of December 31, 2008, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as Regards Policyholders was \$46,392,994, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, John V. Normile, CFE, Ins Regulatory Insurance Services, Inc. (InsRis); Patricia Casey Davis, CPA, CFE, Supervisor; InsRis, Jean Alton, CFE, InsRis; Giles W. Larkin, CFE, InsRis; Robert McGee, CFE, InsRis; Vetrechia Smith, Financial Specialist, Office; Oswaldo Herrera, Financial Analyst/Examiner Supervisor, Office; and Brian Dunn, CFE, INS Consultants, Inc, participated in portions of the examination. Mike Morro, ACAS, MAAA, INS Consultants, Inc. and James R. Neidermyer, FCAS, MAAA, INS Consultants, Inc. completed the actuarial portion of this examination. We also recognize Claude Granese, CPA, INS Services, Inc. participation in the examination.

Respectfully submitted,

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