

**REPORT ON EXAMINATION**  
**OF**  
**SOUTHERN FIDELITY INSURANCE**  
**COMPANY**  
**TALLAHASSEE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2008**

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

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Tallahassee, Florida

June 25, 2009

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:

**SOUTHERN FIDELITY INSURANCE COMPANY  
2255 KILLEARN CENTER BOULEVARD  
TALLAHASSEE, FLORIDA 32309**

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

## SCOPE OF EXAMINATION

This examination covered the period of January 1, 2008, through December 31, 2008. This was a third year examination of the Company. This examination commenced, with planning at the Florida Office of Insurance Regulation (Office), on March 30, 2009, to April 2, 2009. The fieldwork commenced on April 6, 2009, and concluded June 25, 2009.

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.

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

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 reports, 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 in connection therewith.

### **Custodial Agreement – SunTrust Bank**

The custodial agreement with SunTrust Bank was amended on August 10, 2006, and was not authorized by the Board. Rule 69O-143.042(2), Florida Administrative Code, requires that the agreement shall be authorized by a resolution of the Board of Directors or an authorized committee of the Company. **Resolution: The Company's Board authorized the custodial agreement with SunTrust Bank.**

### **Custodial Agreement – Branch Banking and Trust**

The custodial agreement with Branch Banking and Trust was not authorized by the Board. Rule 69O-143.042(2), Florida Administrative Code, requires that the agreement shall be authorized by a resolution of the Board of Directors or an authorized committee of the Company. **Resolution: The Company's Board authorized the custodial agreement with Branch Banking and Trust.**

## **HISTORY**

### **General**

The Company was incorporated under Florida law on March 15, 2005, and commenced business on April 7, 2005, as Southern Fidelity Insurance Company. The Company was a member of a holding company and the ultimate parent was Southern Fidelity Holding Company, LLC. The Company was licensed to write Fire, Homeowners Multi-Peril, Farmowners Multi-peril and Mobile Home Multi-peril lines of business in Florida. The Company was formed as a take-out company

that would also sell policies in the voluntary market. The Company received regulatory approval during 2006 to participate in the Insurance Capital Build-Up Incentive Program. Under this program the Company obtained a \$25 million surplus note from the State Board of Administration of Florida. In addition, the Company obtained matching funds of \$25 million contributed by investors.

The Company was party to the following three consent orders: Consent Order 79986-05-CO filed February 17, 2005, with the Office regarding the application for the issuance of a Certificate of Authority; Consent Order 81384-05, filed April 28, 2005, with the Office regarding the proposal to remove selected policies from Citizens Property Insurance Corporation; and Consent Order 87386-06, filed September 1, 2006, with the Office regarding the acquisition of more than 5% of the outstanding units of Southern Fidelity Holding, LLC, which owns 100% of the Company. The Company was in compliance with the aforementioned Consent Orders.

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

Fire  
Homeowners Multi peril  
Commercial Multi peril

The Company did not write the Commercial Multi Peril line of business as of December 31, 2008, and did not request to have that line removed from the Certificate of Authority. Therefore, the Company was not in compliance with Section 624.430, Florida statutes.

### **Subsequent event**

The Company requested the retention of Commercial Multi-Peril line of business in anticipation of writing that line in 2009.



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	20,000
Number of shares issued and outstanding	16,000
Total common capital stock	\$1,600,000
Par value per share	\$100

Control of the Company was maintained by its parent, Southern Fidelity Holding LLC, which owned 100% of the stock issued by the Company.

## Profitability of Company

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

	2008	2007	2006
Premiums Earned	76,956,729	64,786,088	15,448,241
Net Underwriting Gain/(Loss)	224,838	860,256	(638,096)
Net Income	1,627,887	2,471,842	233,810
Total Assets	150,851,184	114,929,474	81,756,315
Total Liabilities	88,057,698	55,159,147	24,959,083
Surplus As Regards Policyholders	62,793,486	59,770,327	56,797,232

## Dividends to Stockholders

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

## Management

The annual shareholders 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

<b>Name and Location</b>	<b>Principal Occupation</b>
Catherine Mashburn Amos Cumming, Georgia	Manager, Mashburn Farms
William Ronald Cox Bainbridge, Georgia	Consultant, Cox Funeral Home
Tracy Allen Dixon Bainbridge, Georgia	Banker, First National Bank of Decatur
John Adams Dowdy, Jr. Bainbridge, Georgia	CPA, Dowdy & Whittaker, CPAs
James Anthony Graganella Tallahassee, Florida	President, Southern Fidelity Insurance Company
Charles Howard Keaton Marietta, Georgia	Retired
Keith Edward Martin Tallahassee, Florida	Treasurer, Southern Fidelity Insurance Company
Ralph Powell, Jr. Bainbridge, Georgia	Insurance Executive, Tim Smith & Associates
Henry Coleman Satterfield, III Tallahassee, Florida	Engineer, City of Tallahassee
Timothy Lee Smith Bainbridge, Georgia	Insurance Executive, Tim Smith & Associates
Byron Hamelin Wells Tallahassee, Florida	Insurance Executive, Southern Fidelity Insurance Company
Charles William Whittaker Bainbridge, Georgia	CPA, Dowdy & Whittaker, CPAs

The Board of Directors, in accordance with the Company's bylaws, appointed the following senior officers that were serving at December 31, 2008:

### **Senior Officers**

<b>Name</b>	<b>Title</b>
James Anthony Graganella	President & CEO
Keith Edward Martin	Vice President & Treasurer
Kristie Beavers Mock	Secretary

Following are the principal internal board committees and their members as of December 31, 2008:

### **Audit Committee**

John Adams Dowdy, Jr., Chairman  
Tracy Allen Dixon  
Henry Coleman Satterfield, III

The Company maintained an audit committee, as required by Section 624.424(8) (c), Florida Statutes.

### **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 (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

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**

The Company had no acquisitions, mergers, disposals, dissolutions, and purchases or sales through reinsurance.

### **Surplus Debenture**

The Company has an outstanding liability for a surplus note in the amount of \$25,000,000 due to the State Board of Administration of Florida. The surplus note was issued on September 12, 2006, under the provisions of the Insurance Capital Build-Up Program for a term of 20 years with interest charged at a rate equivalent to the 10-year U.S. Treasury Bond rate.

### **Louisiana Grant**

Effective January 11, 2008, the Company entered into a Cooperative Endeavor Contract (Contract) with the Louisiana Department of Insurance (Louisiana Department) as part of the Insure Louisiana Incentive Program. Under the terms of the Contract, the Company received a grant of \$7,000,000 from the Louisiana Department and agreed to commit an equal amount of its surplus to writing new property insurance in Louisiana. The Company is entitled to earn the grant at a rate of 20% per year for each year the requirements of the grant are met.

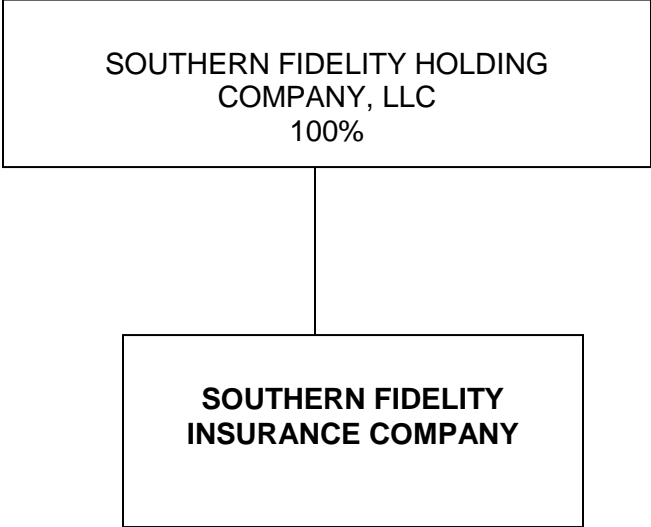
## **AFFILIATED COMPANIES**

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 11, 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 2007 Annual Statement provided a list of all related companies of the holding company group.

**SOUTHERN FIDELITY INSURANCE COMPANY  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2008**



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

### **Tax Allocation Agreement**

The Company, along with its parent, filed a consolidated federal income tax return. The Tax Allocation Agreement was entered into on June 30, 2006. The method of allocation between the Company and its parent was based on separate return calculations. Current credit for net losses was provided to the extent that 1) a consolidated liability exists, and 2) the loss of one company was utilized to offset the taxable income of the other company in the consolidated return filing. Resulting inter-company tax balances are settled in the first quarter of each year.

### **Managing General Agent Agreement**

Effective February 18, 2005, the Company entered into a Managing General Agency Agreement with Southern Fidelity Managing Agency, LLC (Agency). The Agency was affiliated by common ownership and common management. The Agency provided claims and policy administration services on behalf of the Company. The Agency received for its services an MGA policy fee of \$25 per policy written by the Company and a commission of 31% of the gross earned premium of the Company.

The Company recorded the \$25 per policy MGA fee as premium in accordance with Section 627.403, Florida Statutes.

### **Management Agreement**

The Company entered into a management agreement on February 22, 2005, with Preferred Managing Agency, Inc. (Preferred), a party related by common management, whereby Preferred

provided assistance in the information and development of policies and procedures of the Company.

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

The Company maintained fidelity bond coverage up to \$1,000,000 with a deductible of \$10,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained an Employee Practices Liability and a Directors and Officers policy.

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

The Company had no pension, stock ownership, or insurance plans as of December 31, 2008.

### **STATUTORY DEPOSITS**

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

STATE	Description	Book Value	Fair Value
FL	CD, 2.4%, 3/16/2009	<u>\$ 300,000</u>	<u>\$ 300,000</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 300,000</u>	<u>\$ 300,000</u>
LA	CD,	\$ 120,000	\$ 120,000
SC	FNMA, 4.625%, 12/15/09	<u>1,615,842</u>	<u>1,657,008</u>
TOTAL OTHER DEPOSITS		<u>\$1,648,196</u>	<u>\$1,651,672</u>
TOTAL SPECIAL DEPOSITS		<u>\$1,948,196</u>	<u>\$1,951,672</u>



## **INSURANCE PRODUCTS**

### **Territory**

The Company was authorized to transact insurance in Florida, Louisiana and South 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.

## **REINSURANCE**

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

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 assumed policies during 2008 under a policy assumption agreement with Louisiana Citizens Property Insurance Corporation as part of the Insure Louisiana Incentive Program.

## **Ceded**

The Company ceded risk on an excess of loss basis to various authorized and unauthorized reinsurers as listed on Schedule F, Part 3 of the Annual Statement. The primary authorized reinsurers were Everest Reinsurance Corporation and various Syndicates of Lloyd's. The primary unauthorized reinsurers were Ariel Reinsurance Company, Ltd; Renaissance Reinsurance Ltd.; Montpelier Reinsurance Ltd.; DaVinci Reinsurance Ltd; and Flagstone Reinsurance. The Company participated in the Florida Hurricane Catastrophe Fund. The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion. The Company used the services of a reinsurance intermediary, Benfield, Inc.

## **ACCOUNTS AND RECORDS**

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

An independent CPA audited the Company's statutory basis financial statements annually for the year ending December 31, 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 in effect at December 31, 2008:

### **Custodial Agreements**

The Company had securities held under two different Custody Agreements at December 31, 2008. One of the Custody Agreements was with Branch Banking and Trust and the other was with SunTrust Bank. Both of these agreements were in accordance with Rule 69O-143.042, Florida Administrative Code.

### **Independent Auditor Agreement**

The Company had an agreement with Thomas, Howell, Ferguson, PA to perform an audit of its statutory financial statements for the years 2008.

## **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".

**SOUTHERN FIDELITY INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2008**

	Per Company	Examination Adjustments	Per Examination
Bonds	\$83,889,872		\$83,889,872
Real Estate	5,501,328		5,501,328
Cash	52,585,982		52,585,982
Investment income due and accrued	1,003,168		1,003,168
Agents' Balances:			
Uncollected premiums and agents' balances	794,672		794,672
Deferred premium	2,894,105		2,894,105
Reinsurance			
Amounts recoverable from reinsurers	159,149		159,149
Current federal income tax recoverable	735,477		735,477
Net deferred tax asset	2,764,981		2,764,981
Aggregate write-ins	522,450		522,450
Totals	<u>\$150,851,184</u>	<u>\$0</u>	<u>\$150,851,184</u>

**SOUTHERN FIDELITY INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2008**

	<b>Per Company</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Losses	\$23,978,154		\$23,978,154
Loss adjustment expenses	1,568,653		1,568,653
Commissions payable	2,916,502		2,916,502
Other expenses	47,916		47,916
Taxes, licenses and fees	180,968		180,968
Unearned premiums	32,146,975		32,146,975
Advance premium	2,789,700		2,789,700
Ceded reinsurance premiums payable	14,064,691		14,064,691
Funds held by company under reinsurance treaties	3,063,751		3,063,751
Amounts withheld or retained by the company	78,747		78,747
Provision for reinsurance	36,000		36,000
Aggregate write-ins	7,185,641		7,185,641
Total Liabilities	\$88,057,698	\$0	\$88,057,698
Common capital stock	\$1,600,000		\$1,600,000
Surplus Notes	25,000,000		25,000,000
Gross paid in and contributed surplus	30,900,000		30,900,000
Unassigned funds (surplus)	5,293,486		5,293,486
Surplus as regards policyholders	\$62,793,486		\$62,793,486
Total liabilities, surplus and other funds	\$150,851,184		\$150,851,184

**SOUTHERN FIDELITY INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2008**

**Underwriting Income**

Premiums earned	\$76,956,729
<b>Deductions</b>	
Losses incurred	\$35,869,662
Loss expenses incurred	3,028,428
Other underwriting expenses incurred	37,833,801
<b>Total underwriting deductions</b>	<b>76,731,891</b>
Net underwriting gain or (loss)	<b>\$224,838</b>

**Investment Income**

Net investment income earned	\$3,465,673
Net realized capital gains (losses)	0
Net investment gain or (loss)	<b>\$3,465,673</b>

**Other Income**

Net gain or (loss)	(11,082)
Finance and service charges not included in premiums	\$195,058
Total other income	<b>\$183,976</b>

Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$3,874,487
Federal income taxes	\$2,246,600
	<b>\$1,627,887</b>

Net Income	<b>\$1,627,887</b>
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**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year	\$59,770,327
Net Income	\$1,627,887
Change in net unrealized capital gains	\$0
Change in net deferred income tax	1,075,239
Change in non-admitted assets	11,033
Change in provision for reinsurance	309,000
Capital changes	0
Paid in surplus	0
Aggregate write-ins for gains and losses in surplus	0
Change in surplus as regards policyholders for the year	<b>\$3,023,159</b>
Surplus as regards policyholders, December 31 current year	<b>\$62,793,486</b>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

**Losses and Loss Adjustment Expenses** \$ 25,546,807

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.

### Actuarial Review

The Office contracted with independent actuaries, INS Consultants, Inc., to perform an actuarial review. The independent actuaries' reported that the recorded December 31, 2008, reserves made reasonable provisions for the gross and net unpaid loss and loss adjustment expenses.

### Capital and Surplus

The policyholders surplus amount reported by the Company of \$62,793,486 exceeded the minimum of \$8,483,357 required by Section 624.408(1)(a) 4, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

**SOUTHERN FIDELITY INSURANCE COMPANY  
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

**DECEMBER 31, 2008**

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, 2008, per Annual Statement	\$62,793,486
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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>			
No adjustment			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2008, Per Examination			<u><u>\$62,793,486</u></u>



## **SUMMARY OF FINDINGS**

### **Compliance with previous directives**

The Company has taken the necessary actions to correct the findings in the 2007 examination report issued by the Office.

### **Current examination comments and corrective action**

There were no findings or corrective action needed for this examination.

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Southern Fidelity 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 \$62,793,486 in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Patricia Casey Davis, CFE, CPA, INSRIS Examiner Supervisor; Greg Taylor, CFE, INSRIS Examiner in Charge; Matt Perkins, CFE, INSRIS Examiner, and Mike Young, AFE, OIR Financial Examiner/Analyst II participated in the examination. We also recognize INS Consultants, Inc. and INS Services, Inc.'s participation in the examination.

Respectfully submitted,

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Jerry T. Golden  
Financial Examiner/Analyst II  
Florida Office of Insurance Regulation