



**EXAMINATION REPORT
OF**

STAR CASUALTY INSURANCE COMPANY

NAIC Company Code: 32387

MIAMI, FLORIDA

AS OF

DECEMBER 31, 2015

BY THE

FLORIDA OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

| | |
|---|-----------|
| LETTER OF TRANSMITTAL | - |
| SCOPE OF EXAMINATION | 1 |
| SUMMARY OF SIGNIFICANT FINDINGS | 2 |
| CURRENT EXAMINATION FINDINGS | 2 |
| PRIOR EXAMINATION FINDINGS | 3 |
| COMPANY HISTORY | 3 |
| GENERAL | 3 |
| DIVIDENDS | 3 |
| CAPITAL STOCK AND CAPITAL CONTRIBUTIONS..... | 4 |
| SURPLUS NOTES | 4 |
| ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS AND PURCHASE OR SALES THROUGH REINSURANCE | 4 |
| CORPORATE RECORDS | 5 |
| CONFLICT OF INTEREST..... | 5 |
| MANAGEMENT AND CONTROL | 5 |
| MANAGEMENT | 5 |
| AFFILIATED COMPANIES | 8 |
| SIMPLIFIED ORGANIZATIONAL CHART | 9 |
| MANAGING AGENCY CONTRACT..... | 10 |
| COST SHARING AGREEMENT | 10 |
| CLAIMS HANDLING AGREEMENT..... | 11 |
| PRODUCERS AGREEMENT | 11 |
| TERRITORY AND PLAN OF OPERATIONS | 12 |
| TREATMENT OF POLICYHOLDERS | 12 |
| REINSURANCE | 12 |
| REINSURANCE ASSUMED..... | 12 |
| REINSURANCE CEDED..... | 12 |
| ACCOUNTS AND RECORDS | 13 |
| CUSTODIAL AGREEMENTS | 13 |
| INSURANCE PROCESSING SOFTWARE SUPPORT AND LICENSE AGREEMENT | 13 |
| CLOUD SERVICES AGREEMENT..... | 13 |
| INDEPENDENT AUDITOR AGREEMENT | 14 |
| INFORMATION TECHNOLOGY REPORT | 14 |
| STATUTORY DEPOSITS | 15 |
| FINANCIAL STATEMENTS | 16 |

| | |
|--|-----------|
| ASSETS | 17 |
| LIABILITIES, SURPLUS AND OTHER FUNDS | 18 |
| STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT | 19 |
| RECONCILIATION OF CAPITAL AND SURPLUS..... | 20 |
| COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS..... | 21 |
| COMMENTS ON FINANCIAL STATEMENTS..... | 22 |
| LIABILITIES | 22 |
| CAPITAL AND SURPLUS | 24 |
| SUBSEQUENT EVENTS..... | 25 |
| SURPLUS..... | 25 |
| CORPORATE GOVERNANCE | 25 |
| SUMMARY OF RECOMMENDATIONS..... | 26 |
| ELECTION OF THE BOARD OF DIRECTORS..... | 26 |
| COMPANY RELATED PARTY AGREEMENTS..... | 26 |
| PRIOR PERIOD ADJUSTMENTS | 26 |
| ACTUARIAL ANALYSIS..... | 26 |
| CONCLUSION..... | 27 |

March 17, 2017

David Altmaier
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 an examination as of December 31, 2015, of the financial condition and corporate affairs of

Star Casualty Insurance Company
5539 SW 8 Street
Miami, Florida 33134

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, 2011 through December 31, 2015 and commenced with planning at the Florida Office of Insurance Regulation (Office) on November 15, 2016 November 16, 2016. The fieldwork commenced on December 5, 2016 and concluded as of March 17, 2017. The Company was last examined by representatives of the Office covering the period of January 31, 2006 through December 31, 2010.

The examination was a multi-state examination conducted in accordance with the NAIC Financial Condition Examiners Handbook (Handbook). The Handbook requires that the examination be planned and performed to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statements of Statutory Accounting Principles (SSAP).

This examination report includes significant findings of fact, as mentioned in Section 624.319, Florida Statutes and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (for example, subjective conclusions or proprietary information), are not included within the examination report but separately communicated to other regulators and/or the Company.

SUMMARY OF SIGNIFICANT FINDINGS

Current Examination Findings

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

Election of the Board of Directors

The Board of Directors were not elected by the Shareholders, as required by Section 628.231(2), Florida Statutes and the Company Bylaws.

Company Related Party Agreements

The Company and Estrella Insurance Agency, Inc. (Estrella Insurance Agency) are party to two (2) related party agreements, Managing General Agency Agreement, and Producer Agreement. Estrella Insurance Agency was not operating under these agreements as of the examination date.

The Company has a Producers Agreement with Estrella Insurance, Inc. (Estrella Insurance) with an inception date of January 3, 2006. In May 2008, Estrella Insurance changed its agency distribution structure by forming Estrella Franchising Corp. (Estrella Franchising) and offered to sell through Estrella Insurance the franchise rights to market business as independent agents. The Company continued to distribute all Florida business through this agency force. Upon restructure, Estrella Insurance's sole business is the sale of agency franchises and the collection of franchise fees. Due to changes in the distribution of Florida policies, operations are no longer conducted according to the Producers Agreement.

The Company and Centrex Premium Finance are party to one (1) related party agreement – a Cost Sharing Agreement. Centrex Premium Finance was not in existence as of the examination date.

Prior Period Adjustments

The Company corrected a prior period error for the calculation of ceded earned premiums and ceded commission income from prior periods as an adjustment to 2015 earnings in violation of

SSAP No. 3, Accounting for Changes and Corrections of Errors. This resulted in an overstatement of income in 2015 of \$880,924. The Report on Examination financial statements was adjusted to correctly report the prior period adjustment as a direct increase in surplus.

Actuarial Analysis

Methodologies and assumptions applied in the Company's actuarial analysis of unpaid losses were determined to result in a shortfall of \$600,000 net of reinsurance. The Report on Examination financial statements were adjusted by increasing loss reserves for the estimated shortfall.

Prior Examination Findings

There were no material adverse findings, significant non-compliance findings or material changes in the financial statements in the Office's prior examination report as of December 31, 2010.

COMPANY HISTORY

General

Star Casualty Insurance Company was incorporated on August 20, 1987 as a stock property and casualty insurance company under the applicable provisions of the Florida Statutes and commenced business on July 25, 1988.

The Company was authorized to transact insurance in Florida on July 25, 1988 and is currently authorized for the following coverages as of December 31, 2015:

Private Passenger Auto Liability
Other Liability

Private Passenger Auto Physical Damage

Dividends

The Company did not declare or pay any dividends during the period of this examination.

Capital Stock and Capital Contributions

As of December 31, 2015, the Company's capitalization was as follows:

| | |
|--|-------------|
| Number of authorized common capital shares | 5,000,000 |
| Number of shares issued and outstanding | 750,000 |
| Total common capital stock | \$1,005,000 |
| Par value per share | \$1.34 |

The following four (4) stockholders maintained control of the Company, each owning equal twenty-five percent (25%) shares of the Company's outstanding shares of stock:

| | |
|-----------------------|--------------------------|
| Nicolas Estrella, Sr. | Amanda Josefina Estrella |
| Nicolas Estrella, Jr. | Jose Evelio Estrella |

The stockholders also own affiliated companies, Estrella Insurance Inc., Estrella General Agency, Inc., Value Underwriters, Inc. and Penta Insurance Adjusters, Inc., that were parties to various service and cost sharing agreements.

Surplus Notes

The Company did not have any surplus notes during the period of this examination.

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

The Company had no acquisitions, mergers, disposals, dissolutions and purchase or sales through reinsurance during the period of this examination.

CORPORATE RECORDS

The recorded minutes of the Shareholder(s), Board of Directors (Board) and Audit Committee were reviewed for the period under examination. The recorded minutes of the Board documented its meetings and approval of Company transactions and events, in compliance with the Handbook adopted by Rule 69O-138.001, Florida Administrative Code, including the authorization of investments as required by Section 625.304, Florida Statutes.

Conflict of Interest

The Company adopted a policy statement requiring periodic disclosure of conflicts of interest in accordance with the Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

MANAGEMENT AND CONTROL

Management

Directors serving as of December 31, 2015 are shown below:

| Directors | | |
|-------------------------------------|-----------------------|---|
| Name | City, State | Principal Occupation |
| Nicolas Estrella, Sr. | Key Biscayne, Florida | Cattle Rancher |
| Amanda Josefina Estrella | Key Biscayne, Florida | Student, New York University |
| Jose Evelio Estrella ^(a) | Miami Beach, Florida | Vice President, Star Casualty Insurance Company |
| Nicolas Estrella Jr. | Key Biscayne, Florida | Administrator/Manager, Estrella Insurance Inc. |

| | | |
|-------------------------------------|-------------------|---|
| Paul Gerard Gabe Jr. ^(b) | Weston, Florida | Chairperson of the Board, President and Secretary, Star Casualty Insurance Company |
| James Paul Kennedy ^(c) | Marietta, Georgia | Retired Insurance Executive |

(a) Appointed Chief Executive Officer on January 6, 2017.

(b) Resigned as Chief Executive Officer and Chairperson of the Board on October 19, 2016

(c) Resigned as Director on October 22, 2016 and was replaced by Gisela Evangelina Martinez on November 15, 2016.

The annual shareholder meeting was held in accordance with Section 628.231, Florida Statutes. However, review of Shareholders minutes determined that the Directors serving the Company were not elected by the Shareholders, as required per Section 628.231(2), Florida Statutes and the Company Bylaws.

In accordance with the Company's bylaws, the Board appointed the following senior officers:

Senior Officers

| Name | City, State | Title |
|--------------------------------------|--------------------|---|
| Paul Gerard Gabe Jr. ^(a) | Weston, Florida | President, Secretary, Chairman of the Board, Chief Executive Officer, Star Casualty Insurance Company |
| Alejandro Ruben Zajac ^(b) | Miami, Florida | Chief Financial Officer and Treasurer, Star Casualty Insurance Company |
| Rakesh Mishra ^(c) | Miami, Florida | Senior Vice President, Star Casualty Insurance Company |
| Francis Walter Brill | Miami, Florida | Vice President, Star Casualty Insurance Company |
| Jose Evelio Estrella ^(d) | Miami, Florida | Vice President, Star Casualty Insurance Company |

(a) Resigned as Chief Executive Officer and Chairman of the Board on October 19, 2016.

(b) Appointed as temporary Chief Executive Officer on October 20, 2016.

(c) Appointed as President on July 5, 2016 to replace Paul Gerard Gabe, Jr. after his departure on October 19, 2016.

(d) Appointed Chief Executive Officer on January 6, 2017.

The Company's Board appointed and maintained an audit committee as required by Section 624.424(8)(c), Florida Statutes. Following were the committee members as of December 31, 2015:

Audit Committee

| Name | City, State | Title |
|--------------------------------------|--------------------|--|
| Paul Gerard Gabe Jr. ^{1(a)} | Weston, Florida | President, Chief Executive Officer and Secretary, Star Casualty Insurance Company |
| James Paul Kennedy ^(b) | Marietta, Florida | Director, Star Casualty Insurance Company |
| Jose Evelio Estrella ^(c) | Miami, Florida | Director and Vice President, Star Casualty Insurance Company |

¹Chairperson

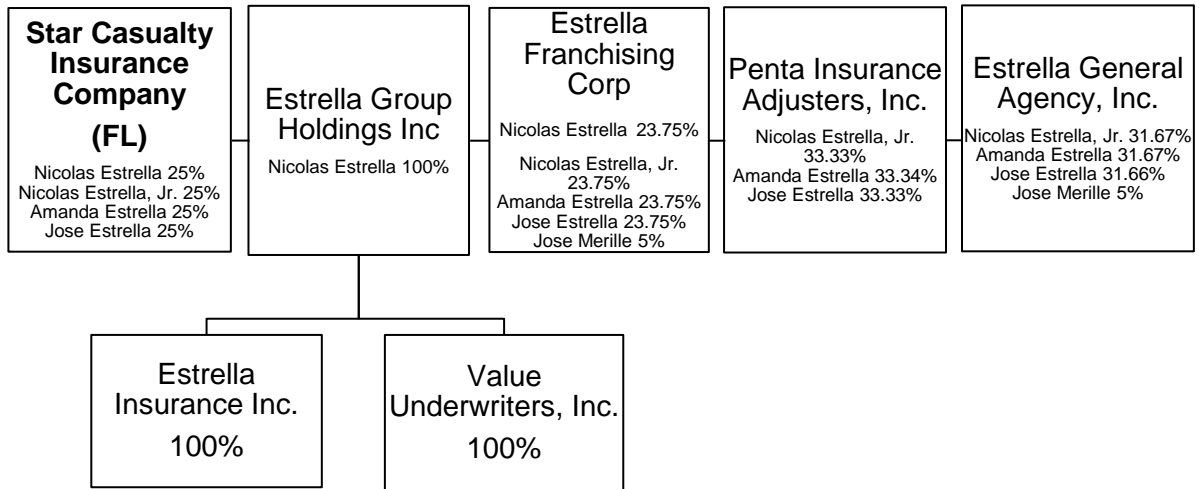
- (a) Resigned as Chief Executive Officer and Chairman of the Board on October 19, 2016.
- (b) Resigned as Director on October 22, 2016 and was replaced by Gisela Evangelina Martinez on November 15, 2016.
- (c) Appointed Chief Executive Officer on January 6, 2017

Affiliated Companies

Holding Company Registration Statements were filed with the Office on February 29, 2016 and March 31, 2017, in accordance with Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2015, reflecting the holding company system, is shown on the following page. Schedule Y of the Company's 2015 annual statement provided a list of all related companies of the holding company group.

Star Casualty Insurance Company
Simplified Organizational Chart
December 31, 2015



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

Managing Agency Contract

The Company and its affiliate, Value Underwriters, Inc. (Value Underwriters) have a Managing Agency Contract that was amended and restated January 3, 2006. Under this agreement, the Company retained Value Underwriters to provide management and administration services of the Company's insurance business, including: underwriting and policy issuance; reinsurance program management; loss prevention and analysis; premium collection; regulatory liaison; business policy advisor and consultant; accounting; maintenance of books and records; retention of certified public accountants and actuaries; marketing and agent relations; and ministerial functions. The manager undertook the duties and responsibilities set forth on behalf of, and subject to, the supervision of the Company and its Board. Value Underwriters was compensated at two and one-half percent (2.5%) of net premiums written and collected for all business originated or produced by Estrella Insurance Agency, Inc. (Estrella Insurance Agency). When placing business with the Company, Value Underwriters may charge and retain a per-policy fee not to exceed \$25 from all producing agencies. Compensation paid to Value Underwriters in 2015 totaled \$97,122.

As discussed in greater detail under "Producer Agreement," according to management, Estrella Insurance Agency no longer operates as an insurance agency, and as such, was not a party to this agreement as of the examination date.

Cost Sharing Agreement

The Company was party to a Cost Sharing Agreement with Value Underwriters, Centrex Premium Finance, Estrella Insurance, Inc., Penta Insurance Adjusters, Inc. (Penta), and Estrella General Agency, with an inception date of May 1, 2010. This agreement provided for an allocation of office and salary expenses in cases where an affiliate paid for expenses incurred for costs that pertained to another affiliate or affiliates. Amounts due from affiliates under this agreement as of December 31, 2015 from Penta, Value Underwriters, and Estrella General Agency, Inc. were \$205,118, \$249,834, and \$0, respectively.

According to management, Centrex Premium Finance is no longer in existence, and therefore, does not appear to be a party to this agreement as of the examination date.

Claims Handling Agreement

The Company has a Claims Handling Agreement with Penta with an inception date of March 5, 2010. Under this agreement, Penta functions as the claims department for the Company. In return, the Company pays a fee based on a schedule in the agreement that is linked to the type of claim being settled. This fee is reported as Allocated Loss Adjustment Expense. Fees incurred in 2015 totaled \$1,392,540.

Producers Agreement

The Company has a Producers Agreement with Estrella Insurance, Inc. (Estrella Insurance) with an inception date of January 3, 2006. This agreement provided the agency the right to solicit, quote, receive applications, bind coverage, and collect, receive, and issue receipts for premiums. In return, the Company pays a commission on policies and renewals based on applicable commission schedules in effect as of the inception date of each policy or renewal. In May 2008, Estrella Insurance changed its agency distribution structure by forming Estrella Franchising Corp. (Estrella Franchising) and offered to sell through Estrella Insurance the franchise rights to market business as independent agents. The Company continued to distribute all Florida business through this agency force. Upon restructure, Estrella Insurance's sole business is the sale of agency franchises and the collection of franchise fees. According to management, franchisee agencies pay a "royalty" of fifteen percent (15%) of commissions paid to franchise agents for the issuance of Company policies. The Company paid commissions to franchisee agencies of \$582,732 in 2015. It was unclear which entity is paid the royalty fee for the issuance of the Company's business.

Due to changes in the distribution of Florida policies, operations are no longer conducted according to the Producers Agreement.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance in the following states:

| | | |
|----------|----------|---------------|
| Arkansas | Indiana | Nebraska |
| Florida | Iowa | Tennessee |
| Georgia | Kentucky | West Virginia |
| Idaho | | |

Treatment of Policyholders

The Company established procedures for handling written complaints in accordance with Section 626.9541(1)(i)(3)(a), 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)(j), Florida Statutes.

REINSURANCE

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, intermediary clause, transfer of risk, reporting and settlement information deadlines.

Reinsurance Assumed

The Company did not assume any reinsurance during the period of this examination.

Reinsurance Ceded

The Company has three (3) reinsurance agreements with General Reinsurance Corporation, an authorized reinsurer.

ACCOUNTS AND RECORDS

The Company maintained its principal operational offices in Miami, Florida.

The Company and non-affiliates had the following agreements:

Custodial Agreements

The Company maintained two (2) custodial agreements. The first agreement was a working capital management account with Merrill Lynch, Fenner & Smith, Incorporated dated August 2009, and the second agreement was with US Bank National Association executed on February 27, 2007. Both agreements complied with Rule 69O-143.042, Florida Administrative Code.

Insurance Processing Software Support and License Agreement

The Company utilized software by Modotech, Inc. to process all transactions. A Modotech, Inc. computer system was utilized to handle hardware requirements for policy issuance, premium collections, general ledger accounting, and claims record keeping. The software IT Policy Management System (managed by Modotech, Inc.) was utilized for all reporting regarding general ledger and accounts payable information. Under terms of the Insurance Processing Software Support and License Agreement dated April 16, 2008, Modotech provided installation and customization services of the insurance processing software, support services, and data conversion.

Cloud Services Agreement

The Company utilized WHOA Networks, Inc., to provide secure cloud network security and data storage under an agreement dated April 28, 2015.

Independent Auditor Agreement

An independent CPA, Dixon Hughes Goodman LLP, audited the Company's statutory basis financial statements annually for the years 2013, 2014 and 2015, in accordance with Section 624.424(8), Florida Statutes. Supporting workpapers were prepared by the CPA firm as required by Rule 69O-137.002, Florida Administrative Code.

INFORMATION TECHNOLOGY REPORT

Michael R. Nadeau, CISA, CFE, AES, Insurance Regulatory Manager and IT Specialist, of Eide Bailly LLP, performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology Report provided to the Company.

STATUTORY DEPOSITS

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

| State | Description | Par Value | Market Value |
|------------------------|--------------------|---------------------|---------------------|
| FL | Cash & CD | \$ 1,000,000 | \$ 1,000,000 |
| TOTAL FLORIDA DEPOSITS | | <u>\$ 1,000,000</u> | <u>\$ 1,000,000</u> |
| GA | Cash & CD | <u>25,000</u> | <u>25,000</u> |
| TOTAL OTHER DEPOSITS | | <u>\$ 25,000</u> | <u>\$ 25,000</u> |
| TOTAL SPECIAL DEPOSITS | | <u>\$ 1,025,000</u> | <u>\$ 1,025,000</u> |

FINANCIAL STATEMENTS

The examination does not attest to the fair presentation of the financial statements included herein. If an adjustment is identified during course of the examination, the impact of such adjustment will be documented separately following the Company's financial statements. Financial statements, as reported and filed by the Company with the Florida Office of Insurance Regulation, are reflected on the following pages.

Star Casualty Insurance Company

Assets

December 31, 2015

| | Per Company | Examination Adjustments | Per Examination |
|---|--------------|----------------------------|--------------------|
| Bonds | \$0 | | \$0 |
| Stocks: | | | |
| Common | 0 | | 0 |
| Real Estate: | | | |
| Properties | | | |
| Properties Occupied by Company | 2,055,642 | | 2,055,642 |
| Other properties | | | |
| Cash and Short-Term Investments | 9,293,788 | | 9,293,788 |
| Aggregate write-in for Investment income due and accrued | 7,986 | | 7,986 |
| Agents' Balances: | | | |
| Uncollected premium | 366,641 | | 366,641 |
| Deferred premium | 1,493,352 | | 1,493,352 |
| Reinsurance recoverable | 449,905 | | 449,905 |
| EDP Equipment | | | |
| Federal income taxes recoverable | 37,865 | | 37,865 |
| Net deferred tax asset | 119,142 | | 119,142 |
| Receivable from parents, subsidiaries and affiliates | 194,878 | | 194,878 |
| Equities and deposits in pools and associations | | | |
| Aggregate write-in for other than invested assets | 30,692 | | 30,692 |
| Totals | \$14,049,891 | \$0 | \$14,049,891 |

Star Casualty Insurance Company
Liabilities, Surplus and Other Funds
December 31, 2015

| | Per Company | Examination Adjustments | Per Examination |
|--|----------------------------|----------------------------|----------------------------|
| Losses | \$1,967,616 | \$600,000 | \$2,567,616 |
| Loss adjustment expenses | 475,030 | | 475,030 |
| Commissions Payable | 118,962 | | 118,962 |
| Other expenses | 134,598 | | 134,598 |
| Taxes, licenses and fees | 22,193 | | 22,193 |
| Unearned premium | 1,509,482 | | 1,509,482 |
| Ceded Reinsurance Premiums Payable | 1,006,186 | | 1,006,186 |
| Drafts outstanding | 1,079,369 | | 1,079,369 |
| Payable to parent, subsidiaries and affiliates | 19,990 | | 19,990 |
| Aggregate write-ins for liabilities | | | |
| Total Liabilities | <u>\$6,333,426</u> | <u>\$600,000</u> | <u>\$6,933,426</u> |
| Common capital stock | \$1,005,000 | | \$1,005,000 |
| Gross paid in and contributed surplus | 1,407,325 | | 1,407,325 |
| Unassigned funds (surplus) | <u>5,304,140</u> | <u>(600,000)</u> | <u>4,704,140</u> |
| Surplus as regards policyholders | <u>\$7,716,465</u> | <u>(\$600,000)</u> | <u>\$7,116,465</u> |
| Total liabilities, surplus and other funds | <u><u>\$14,049,891</u></u> | <u><u>\$0</u></u> | <u><u>\$14,049,891</u></u> |

Star Casualty Insurance Company
Statement of Income and Capital and Surplus Account
December 31, 2015

Underwriting Income

| | | |
|---|--------------------|---------------|
| Premiums earned | | \$9,127,559 |
| | Deductions: | |
| Losses incurred | | \$5,793,281 |
| Loss expenses incurred | | 2,655,211 |
| Other underwriting expenses incurred (Note2) | | 2,928,804 |
| Aggregate write-ins for underwriting deductions | | 0 |
| Total underwriting deductions | | \$11,377,296 |
| Net underwriting gain or (loss) | | (\$2,249,737) |

Investment Income

| | | |
|--|--|----------|
| Net investment income earned | | \$25,917 |
| Net realized capital gains or (losses) | | 0 |
| Net investment gain or (loss) | | \$25,917 |

Other Income

| | | |
|---|--|---------------|
| Net gain or (loss) from agents' or premium balances charged off | | (\$125,263) |
| Finance and service charges not included in premiums | | 578,797 |
| Aggregate write-ins for miscellaneous income | | 0 |
| Total other income | | \$453,534 |
| Net income before dividends to policyholders and before federal & foreign income taxes | | (\$1,770,286) |
| Dividends to policyholders | | 0 |
| Net Income, after dividends to policyholders, but before federal & foreign income taxes | | (\$1,770,286) |
| Federal & foreign income taxes | | 1,245 |
| Net Income | | (\$1,771,531) |

Capital and Surplus Account

| | | |
|--|--|---------------|
| Surplus as regards policyholders, December 31 prior year | | \$9,645,990 |
| Net Income | | (\$1,771,531) |
| Net unrealized capital gains or losses | | 653,559 |
| Change in non-admitted assets | | (811,553) |
| 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 | | (600,000) |
| Change in surplus as regards policyholders for the year | | (\$2,529,525) |
| Surplus as regards policyholders, December 31 current year | | \$7,116,465 |

Star Casualty Insurance Company
Reconciliation of Capital and Surplus
December 31, 2015

As of December 31, 2015, exam adjustments totaling \$1,480,924 were made to surplus as regards policyholders as a result of this examination.

Capital/Surplus Change During Examination Period

| | | | |
|--|-----------------|-----------------|---------------------------|
| Surplus at December 31, 2010, per Annual Financial Statement | | | \$7,028,391 |
| | <u>Increase</u> | <u>Decrease</u> | |
| Net income (loss) | | (\$813,059) | (\$813,059) |
| Change in net deferred income tax | \$543,145 | | \$543,145 |
| Change in nonadmitted assets | | (\$522,936) | (\$522,936) |
| Examination adjustment to surplus | \$880,924 | | \$880,924 |
| Net increase (or decrease) | | | <u>\$88,074</u> |
| Surplus at December 31, 2015, after adjustment | | | <u><u>\$7,116,465</u></u> |

Star Casualty Insurance Company
Comparative Analysis of Changes in Surplus
December 31, 2015

Analysis of Changes in Surplus
 Surplus at December 31, 2015,
 per Annual Financial Statement

| | <u>Increase</u> | <u>Decrease</u> | |
|---|-----------------|-----------------|--------------------|
| | | | \$7,716,465 |
| Losses | \$0 | (\$600,000) | |
| Net increase (or decrease) | | | <u>(\$600,000)</u> |
| Surplus at December 31, 2015, after adjustment | | | <u>\$7,116,465</u> |

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses

An actuarial firm, Cornerstone Actuarial Solutions (Cornerstone), appointed by the Board, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2015 made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office consulting actuary, Daniel Reppert, FCAS, MAAA, Principal & Consulting Actuary of Financial Risk Analysts, LLC, reviewed the loss and loss adjustment expense work papers provided by the Company and he determined unpaid losses were likely deficient by at least \$1,000,000 on a gross basis, or \$600,000 net of quota-share reinsurance. As such, losses were increased \$600,000 for purposes of this report. The examination review did not include an independent analysis of Loss Adjustment Expenses (LAE); therefore, LAE was not adjusted for purposes of this report.

There would likely be other material effects on the Company's financial statements by increasing losses. Specifically, the Company's quota-share reinsurance treaty includes a sliding scale commission with rates that decrease as reinsurance loss ratios increase. Any effect of the increase in losses on reinsurance ceded commissions, was not considered for purposes of this report. Since the Company is in a net loss position as of the examination date, any tax benefit to this increase would be deferred to future periods.

Based on review, it was determined that the methods used by Cornerstone were reasonable for the business written by the Company, but concerns were noted regarding certain assumptions and selections made. In summary, based on review of the Cornerstone Statement of Actuarial Opinion, actuarial reports, and the Company's financial statements, there was concern with the following:

- 1) applying development factors based heavily on minimum limits nonstandard business to standard business written at high limits;

- 2) not including loss trend in the calculations of adjusted loss ratios and using long term averages in the selection of initial expected loss ratios; and

consistently selecting ultimate losses below the average results of Cornerstone's methods which may result in estimates that are too low.

Additional analysis for each of these items is included in Mr. Reppert's report "Star Casualty 2015 Financial Examination Review Report," dated February 20, 2017.

It was noted that adverse one-year development reported in the Annual Statement Schedule P – Part 2 was \$1,800,000, \$1,400,000, \$2,000,000, \$1,400,000, \$783,000 in years 2015, 2014, 2013, 2012, and 2011, respectively. This consistent adverse development across all years appears to support the conclusions reached by the examination actuary.

Correction of an Error

In 2015, the Company identified an error in calculating ceded earned premiums and ceded commission income for an excess of loss reinsurance treaty. The error was due to failure to reduce premiums by amounts ceded under a quota-share treaty prior to calculating premiums ceded under the excess of loss treaty. This error occurred consistently going back to year 2008. The effect of the error was an understatement of surplus of \$880,924 as of December 31, 2014. The Company erroneously reported the prior period change as an adjustment in 2015 as a component of premiums earned and other underwriting expenses incurred in 2015 income in violation of SSAP No. 3, Accounting Changes, and Corrections of Errors. The Company's independent accountants adjusted the 2015 audited financial statements to correct for this entry. This resulted in a difference in reported net income between the audited financial statements and the Annual Statement.

The financial statements have been adjusted to reverse the Company's reporting error by decreasing premiums earned by \$1,360,537 and decreasing other underwriting expenses by \$479,613, resulting in a net increase in net loss of \$880,924. Unassigned funds (surplus) was increased by \$880,924 to appropriately report the prior period error. The effect on surplus for this error was \$0. The Company did not amend its 2015 annual statement for this error.

Capital and Surplus

The amount of capital and surplus reported as a result of this examination of \$7,116,465, exceeded the minimum of \$4,000,000 required by Section 624.408(e), Florida Statutes.

SUBSEQUENT EVENTS

Surplus

Surplus levels in 2016 are adequate but declined significantly approaching the minimum requirement of \$4,000,000 per Section 624.408(e), Florida Statutes. The Company reported a net loss of \$4,300,000 and surplus of \$4,100,000 as of December 31, 2016, which included \$1,200,000 additional paid in surplus.

Corporate Governance

As noted in "Management," the Company experienced significant changes and turnover in senior management in 2016. Rakesh Mishra was appointed President of the Company on July 5, 2016. Paul Gabe, Jr. retained the titles of Chief Executive Officer, Secretary and Chairman of the Board. On October 19, 2016, Mr. Gabe was removed from the positions of Chief Executive Officer, Secretary and Chairman of the Board. In 2017, Jose Estrella was appointed Chief Executive Officer. Rakesh Mishra retained the title of President.

SUMMARY OF RECOMMENDATIONS

Election of the Board of Directors

We recommend that the Company comply with its Bylaws and Section 628.231(2), Florida Statutes, with respect to election of its Directors.

Company Related Party Agreements

We recommend that the Company amend its related party agreements to ensure they are consistent with actual business practices.

Prior Period Adjustments

We recommend that the Company file an amended 2015 Annual Statement to remove the income statement effect of adjustment of a prior period error in violation of SSAP No. 3, Accounting Changes, and Corrections of Errors.

Actuarial Analysis

We recommend that the Company review the assumptions utilized to estimate unpaid losses, in order to estimate losses more in line with actual historical trends. It is further recommended that the Company separate the nonstandard automobile business with minimal limits from the standard business with significantly greater limits for actuarial analysis. If consistent actuarial methodology is applied going forward, it is suggested that management place greater scrutiny over actuarial results considering historical adverse development and voluntarily increase reserves to a more reasonable level.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Star Casualty Insurance Company** as of December 31, 2015, consistent with the insurance laws of the State of Florida.

Per examination of the annual financial statements, the Company's surplus as regards policyholders as of December 31, 2015, was \$7,116,465, which exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, James Menck, CFE, Examiner-in-Charge, Ryan Havick, CFE, and Bob Burch, CFE, CIE, of Eide Bailly LLP, also participated in the examination. Members of the Office who participated in the examination include Jeffrey Rockwell, MBA, Financial Examiner/Analyst Supervisor, Examination Manager, and Marie Stuhlmuller, Financial Examiner/Analyst Supervisor, Participating Examiner. Additionally, Daniel Reppert, FCAS, MAAA, Principal & Consulting Actuary of Financial Risk Analysts, LLC, and Michael R. Nadeau, CISA, CFE, AES, IT Specialist of Eide Bailly LLP, are recognized for participation in the examination.

Respectfully submitted,

Brian Sewell, CFE, MCM
Chief Examiner
Florida Office of Insurance Regulation