

**REPORT ON EXAMINATION**  
**OF**  
**STAR & SHIELD INSURANCE**  
**EXCHANGE**

**TALLAHASSEE, FLORIDA**

**AS OF**  
**DECEMBER 31, 2010**

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

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Tallahassee, Florida

July 19, 2011

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

Dear Sir:

Pursuant to your instructions, in compliance with Rule 69O-138.005, Florida Administrative Code, Section 624.316, and Chapter 629 of the 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, 2010, of the financial condition and corporate affairs of:

**STAR & SHIELD INSURANCE EXCHANGE  
3717 APALACHEE PARKWAY, SUITE 201  
TALLAHASSEE, FLORIDA 32311**

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

## **SCOPE OF EXAMINATION**

This examination covered the period of January 1, 2010, through December 31, 2010. The Reciprocal was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2009. This examination commenced with planning at the Office on March 14, 2011. The fieldwork commenced on April 5, 2011, and concluded as of July 19, 2011.

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 Reciprocal by obtaining information about the Reciprocal including corporate governance, identifying and assessing inherent risks within the Reciprocal 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.

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

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

## **SUMMARY OF SIGNIFICANT FINDINGS**

### **Current Exam Findings**

There were no material findings, or exceptions noted during the examination as of December 31, 2010.

### **Prior Exam Findings**

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2009, along with resulting action taken by the Reciprocal in connection therewith.

#### **Actuarial Finding – Treatment of Salvage and Subrogation**

The consulting actuary Richard Lo, for this examination disagreed with the appointed actuary's decision to reduce the Reciprocal's anticipated Salvage and Subrogation, (S&S), of \$47,101 to arrive at its net loss and LAE reserves. Mr. Lo, stated that the loss ratios used by the appointed actuary already reflected loss costs net of S&S. While the differences between selected loss and LAE reserves and those for the appointed actuary and the Reciprocal are significant

percentage wise, the majority of the differences are attributable to the treatment of the Reciprocal's anticipated S&S of \$47,101. The differences were relatively insignificant as a percentage of the Reciprocal's reported surplus of approximately \$8 million as of 12/31/2009.

**Subsequent Event:** After discussion with the consulting actuary, the appointed actuary reissued his report and refiled with the Office a revised actuarial report which corrected the issue.

## **SUBSEQUENT EVENTS**

Star & Shield Holdings LLC (SSH) was the sole contributor of surplus notes on the Reciprocal's balance sheet totaling \$12.5 million as of December 31, 2010. In the 2<sup>nd</sup> Quarter of 2011, SSH contributed an additional \$2.5 million in surplus notes to the Reciprocal.

## **HISTORY**

### **General**

The Reciprocal is a domestic insurance exchange, organized in Florida on April 7, 2009, and commenced business on June 29, 2009, as Star & Shield Insurance Exchange. The Reciprocal was an unincorporated aggregation of subscribers governed by the Subscribers Advisory Committee (SAC) which is similar to a Board of Directors.

The Reciprocal was managed by its attorney-in-fact SSRM, in accordance with Section 629.091, of the Florida Statutes.

The Reciprocal was party to Consent Order 103560-09-CO, filed April 07, 2009, regarding the application for the issuance of a Certificate of Authority. The Reciprocal had complied with the Order.

The Reciprocal was authorized to transact the following insurance coverage in Florida on December 31, 2010:

Homeowners multi peril	Fire
Private passenger auto physical damage	Private Passenger Auto Liability

### **Dividends to Stockholders**

The Reciprocal was an unincorporated aggregate and therefore, had no stockholders.

### **Capital Stock and Capital Contributions**

The Reciprocal was an unincorporated aggregate and therefore, had no capital stock.

SSRM is owned and managed by SSH which was owned by Flagstone Reassurance Suisse SA (45.02%) and Aon Benfield Global, Inc., (45.02%), with the balance owned by 8 other individuals (9.96%).

### **Surplus Debentures**

The Reciprocal issued surplus notes on April 15, 2009, in the amount of \$10,000,000 to SSH, approved by the Office as part of Consent Order 103560-09-CO, filed April 7, 2009. On December 21, 2010, the Reciprocal issued an additional \$2,500,000 in surplus notes, approved by the Office on December 23, 2010, in exchange for cash to SSH. The surplus notes have restrictions which require prior approval from the Office prior to any payment of interest or repayment of principal.



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

The Reciprocal had no acquisitions, mergers, disposals, dissolutions, and purchase or sale through reinsurance for the period under examination.

## **CORPORATE RECORDS**

The recorded minutes of the SAC, and certain internal committees were reviewed for the period under examination. The recorded minutes of the SAC adequately documented its meetings and approval of the Reciprocal's transactions and events, including the authorization of investments as required by Section 625.304, Florida Statutes.

### **Conflict of Interest**

The Reciprocal adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

## **MANAGEMENT AND CONTROL**

### **Management**

The SAC members were appointed in accordance with Sections 629.201, Florida Statutes. SAC members serving as of December 31, 2010 were:

## Members

<b>Name and Location</b>	<b>Principal Occupation</b>
Allen Davis Durham Tallahassee, Florida	President and CEO, SSRM
Wallace Lamar McLendon Tallahassee, Florida	US Marshall, Retired
Donald Francis Eslinger Lake Mary, Florida	Sherriff, Seminole County
Ronald Rufus Parrish St. Lucie, Florida	Fire Chief, St. Lucie County

The senior officers of SSRM are as follows:

## Senior Officers

<b>Name</b>	<b>Title</b>
Allen Davis Durham	President and CEO
Jonathon Brent Palmquist	EVP, General Counsel & Secretary
John Edwin Hunt Jr.	Executive Chairman
Jaipersad Heerah	Chief Underwriting Officer

The Reciprocal maintained internal committee functions through the SAC with general responsibilities outlined in the Powers of the SAC. The Reciprocal maintained an Audit Committee, in accordance with Section 624.424(8)(c), Florida Statutes. The audit committee was comprised of the following individuals that were also members of the SAC:

**Audit Committee**  
Wallace McLendon  
Donald Eslinger  
Ronald Parrish

### **Affiliated Companies**

In accordance with Section 629.061, Florida Statutes, the Reciprocal was managed by SSRM, pursuant to the terms of an attorney-in-fact agreement between the Reciprocal and SSRM. SSRM was owned and managed by SSH. SSH is owned by Flagstone Reassurance Suisse SA (45.02%), and Aon Benfield Global, Inc., (45.02%), with the balance owned by 8 other individuals (9.96%). Aon Benfield Global, Inc. was a subsidiary of Aon Corporation and Flagstone Reassurance Suisse SA is owned by Flagstone Reinsurance Holdings Ltd.

The Reciprocal 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 March 29, 2011, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

### **Letter of Representation**

The Reciprocal failed to provide a signed letter of representation as requested and prescribed by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (2011 Edition) and adopted pursuant to Rule 69O-138.001(1)(b) & (2), Florida Administrative Code.

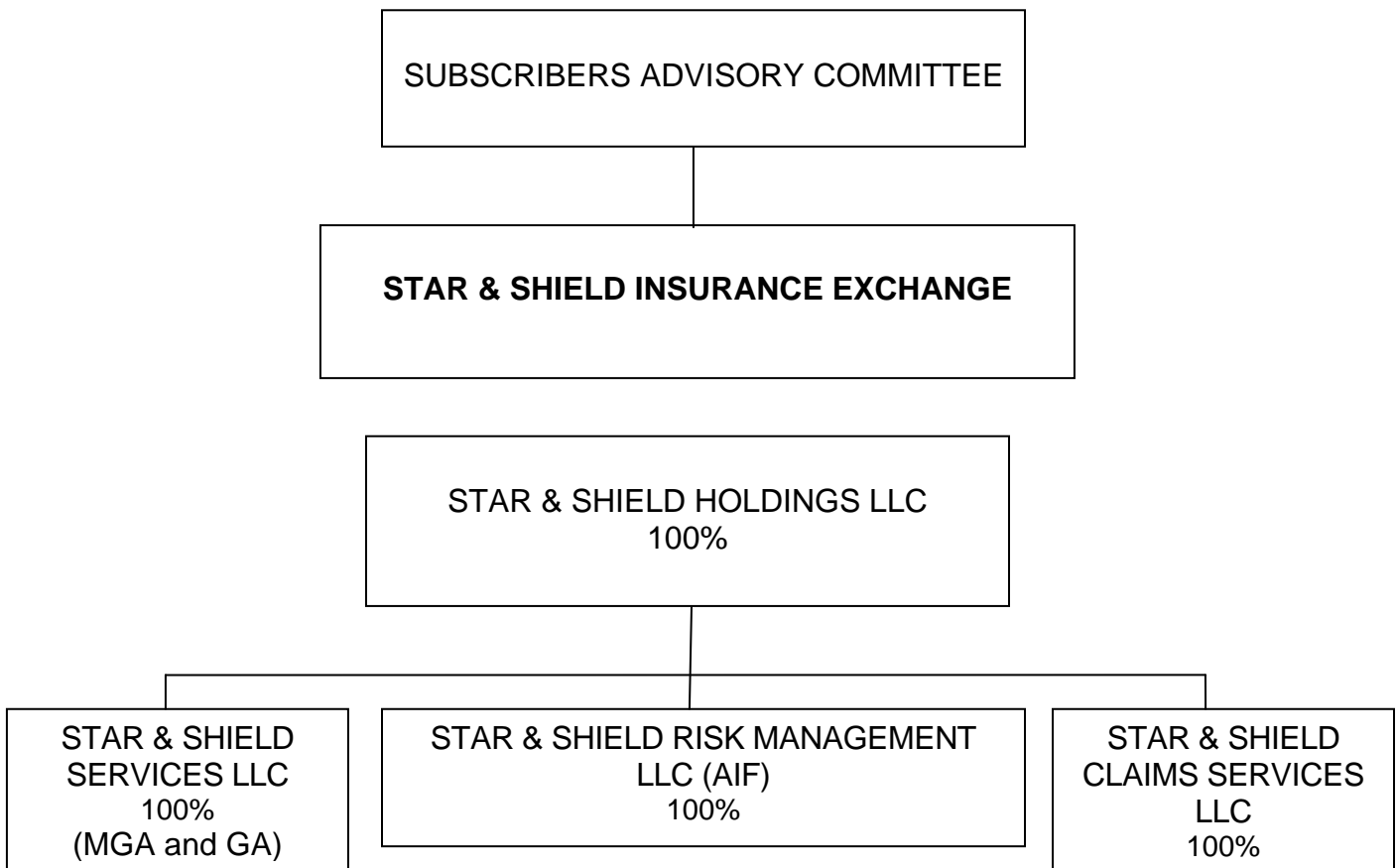
### **Subsequent Event**

The Reciprocal subsequently provided a signed Letter of Representation which was received and accepted on November 18, 2011. The Letter of Representation was dated June 16, 2011 to coincide with the conclusion of fieldwork.

An organizational chart as of December 31, 2010, reflecting the holding company system, is shown below. Schedule Y of the Reciprocal's 2010 annual statement provided a list of all related companies of the holding company group.

**STAR & SHIELD INSURANCE EXCHANGE  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2010**



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

### **Subscribers Agreement and Power of Attorney**

The Reciprocal sets the Powers of the SAC in a document dated April 14, 2009, in accordance with Section 629.201 of the Florida Statutes. Each new subscriber signed a Subscriber's Agreement and Power of Attorney which appointed SSRM as the Attorney-In-Fact, which allowed SSRM to conduct the lawful business of the Reciprocal.

### **Attorney-In-Fact Agreement**

The Reciprocal entered into an Attorney-In-Fact agreement with SSRM on April 15, 2009. The agreement provided that SSRM manage the affairs of the Reciprocal to include administrative services, management of daily operations, provision of all personnel for underwriting, claims, marketing, financial, legal, information technology and senior management.

In consideration for the management services to be performed by SSRM, the Reciprocal agreed to compensation of 23% of the Gross Written Premium of the Reciprocal.

### **Audited Financial Statements of Attorney-in-Fact**

Pursuant to Section 624.316 (1)(a) and Section 624.318 (2), Florida Statutes, the Office shall examine the affairs, transactions, accounts, records, and assets of each authorized insurer and of the attorney in fact of a reciprocal insurer as to its transactions affecting the insurer as often as it deems advisable. As of the end of fieldwork, copies of the audited financials of SSRM were not issued or provided to the Office for review. **Subsequent Event:** The 2010 audited financial statement for SSRM was completed on March 29, 2012, and filed with the Office on March 30, 2012.

## **Managing General Agent Agreement (MGA)**

SSRM had entered into a Managing General Agent (MGA) agreement with Star & Shield Services LLC (SSS). The agreement was entered into as of April 15, 2009, and is effective for a 5 year period which automatically renews for a successive 5 year period unless cancelled within 90 days prior to renewal by either party. In consideration of Underwriting and Marketing services provided to the Reciprocal, SSS received 23% of the Net Written Premiums as defined by the following calculation: net written premium less policy fees, inspection fees, billing fees, catastrophe charges, taxing authority surcharges, guarantee association charges and or non-premium assessments or recoupment. The MGA shall be entitled to charge and retain installment fees, as provided by Section 627.901, Florida Statutes, and a per policy MGA fee of \$25.

## **Service Agreement**

The Reciprocal entered into a service agreement with Aon Corporation on April 21, 2009. The agreement was for a 5 year period and includes the following services to be provided by Aon Corporation: Catastrophe Modeling, Actuarial and Risk Analysis, Market Analysis, Portfolio Analysis, Financial Analysis. In exchange for the service noted above, the Reciprocal agreed to compensation of \$400,000 annually.

## **Claims Servicing Agreement**

SSRM indirectly procured a claims servicing agreement with North American Risk Services (NARS) effective March 01, 2009 on behalf of the Reciprocal. The agreement is in-force until canceled by either party. NARS was contracted to process claims associated with policies issued by the Reciprocal and had the following authority limits: \$15,000 per liability claimant, \$20,000 per

auto physical damage/property damage claimant and \$20,000 per property damage claimant. NARS received \$404,000 in compensation for 2010.

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

The Reciprocal maintained fidelity bond coverage up to \$300,000 with a deductible of \$25,000, which adequately covered the suggested minimum as recommended by the NAIC. The Reciprocal also maintained Commercial General Liability, Umbrella Policy with limits of \$10,000,000 and self insured retention of \$10,000, Directors and Officers liability insurance and Errors and Omissions coverage with limits of \$6,000,000 and deductibles ranging from \$100,000 to \$200,000.

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

The Reciprocal had no employees and therefore had no pension, stock ownership or insurance plans.

### **TERRITORY AND PLAN OF OPERATIONS**

The Reciprocal was authorized to transact insurance only in the State of Florida at December 31, 2010.

#### **Treatment of Policyholders**

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



## RECIPROCAL GROWTH

The Reciprocal experienced net losses since inception of \$3,721,552 and \$1,923,367 in 2010 and 2009, respectively. The losses were primarily due to higher than industry average loss ratios and smaller quantities of earned premium associated with the initial start-up phase. The Reciprocal's surplus was supported by contributions in the form of surplus notes and the surplus notes offset prior losses.

### Profitability of Reciprocal

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

	2010	2009
Premiums Earned	5,565,022	(938,485)
Net Underwriting Gain/(Loss)	(3,789,208)	(1,931,262)
Net Income	(3,721,552)	(1,923,367)
Total Assets	14,190,942	8,855,129
Total Liabilities	7,099,331	881,820
Surplus As Regards Policyholders	7,091,613	7,973,309

## LOSS EXPERIENCE

During the current examination period, the Reciprocal shows adverse development of \$7,000 on the results recorded as of December 31, 2009. The one-year loss development is not an accurate indicator for the Reciprocal since this is the first year of operations and total direct earned premium for 2009 is \$ 259,000. The one-year development is .09 % of surplus recorded as of December 31, 2009.

The ratio of losses and loss adjustment expenses incurred to premiums earned for 2010 was 113.6%.

## **REINSURANCE**

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

### **Assumed**

The Reciprocal had no assumed business at December 31, 2010.

### **Ceded**

The Reciprocal ceded risk on a quota share and excess of loss basis to various third party reinsurers. The Reciprocal ceded 30% of the losses related to the quota share agreements. Effective June 1, 2010, a Quota share agreement was entered into for the residential property lines of business for both non-catastrophe and catastrophe losses and for auto physical damage losses associated with a catastrophic event. Also effective June 1, 2010, the Reciprocal purchased Florida Hurricane Catastrophe Fund (FHCF) reinsurance and property excess of loss reinsurance for catastrophic events. The Reciprocal purchased a related reinstatement premium protection contract for the excess of loss reinsurance effective June 1, 2010. All reinsurance agreements other than the FHCF are handled through Aon Benfield Global, Inc., the Reciprocal's designated reinsurance intermediary.

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

## **ACCOUNTS AND RECORDS**

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

An independent CPA firm audited the Reciprocal's statutory basis financial statements annually for the years 2009 and 2010, 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 Reciprocal's accounting records were maintained on a computerized system.

The Reciprocal and non-affiliates had the following agreements:

### **Custodial Agreement**

SSRM, on behalf of the Reciprocal, entered into a custodial agreement with First Tennessee Bank National Association on April 15, 2009. The Reciprocal was in compliance with Rule 69O-143.042, Florida Administrative Code.

### **Independent Auditor Agreement**

SSRM, on behalf of the Reciprocal, contracted with an independent CPA firm, to perform the annual audit of its financial statements as required by Rule 69O-137.002 (7) (c), Florida Administrative Code.

## Information Technology Report

InsFocus, LLC (InsFocus) performed an evaluation of the information technology and computer systems of the Reciprocal. Results of the evaluation were noted in the Information Technology Report provided to the Reciprocal.

### 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	Cash Deposit, 2.294%	\$300,000	\$300,000
TOTAL FLORIDA DEPOSITS		\$300,000	\$300,000
TOTAL SPECIAL DEPOSITS		<u>\$300,000</u>	<u>\$300,000</u>

### FINANCIAL STATEMENTS PER EXAMINATION

#### Annual Statement Presentation and Disclosure

The Reciprocal incorrectly reported its Private Passenger Auto Liability and Private Passenger Auto Physical Damage as combined premiums on Line 19.2, Private Passenger Auto Liability on its 2010 Annual statement. The Reciprocal failed to follow prescribed NAIC's Annual Statement Instructions pertaining to reporting lines of business. The NAIC Annual Statement Instructions for the 2010 reporting year, Page 510, Appendix for Property and Casualty Lines of Business clearly indicates for Line 19-Auto Liability and Line 21-Auto Physical Damage that the Lines are separate and should be reported accordingly. Rule 69O-137.001 (4)(a), Florida Administrative Code, formally adopts the NAIC Annual Statement Instructions for the 2010

reporting year. **Subsequent Event:** Beginning with the December 31, 2011 Financial Statement, the premiums were reported in accordance with the NAIC Annual Statement Instructions.

The following pages contain financial statements showing the Reciprocal's financial position as of December 31, 2010, 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."

**STAR & SHIELD INSURANCE EXCHANGE**  
**Assets**

**DECEMBER 31, 2010**

	Per Reciprocal	Examination Adjustments	Per Examination
Bonds	5,569,970		\$5,569,970
Cash	6,112,551		6,112,551
Investment Income			
Due and accrued	18,899		18,899
Premiums and Considerations			
Uncollected Premiums and Agent Balances	377,213		377,213
Deferred Premiums and Agent Balances	1,836,233		1,836,233
Net Deferred Tax Asset	276,076		276,076
<hr/>			
Totals	\$14,190,942		\$14,190,942
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**STAR & SHIELD INSURANCE EXCHANGE**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2010**

	<b>Per Reciprocal</b>	<b>Examination Adjustments</b>	<b>Per Examination</b>
Losses	\$2,586,983		\$2,586,983
Loss Adjustment Expenses	219,161		219,161
Other Expenses	102,741		102,741
Taxes, Licenses and Fees	122,631		122,631
Unearned Premiums	3,490,070		3,490,070
Advance Premiums	37,994		37,994
Ceded Reinsurance Premiums			
Payable	431,204		431,204
Payable to Parent, Subsidiary and Affiliates	108,547		108,547
Total Liabilities	\$7,099,331		\$7,099,331
Surplus Notes	\$12,500,000		\$12,500,000
Unassigned Funds (Surplus)	(5,408,387)		(5,408,387)
Surplus as Regards to Policyholders	\$7,091,613		\$7,091,613
Total Liabilities, Surplus and Other Funds	\$14,190,944		\$14,190,944

**STAR & SHIELD INSURANCE EXCHANGE**  
**Statement of Income**

**DECEMBER 31, 2010**

**Underwriting Income**

Premiums earned \$5,565,022

**Deductions**

Losses incurred	\$5,602,149
Loss adjustment expenses incurred	717,345
Other underwriting expenses incurred	3,034,736
Total underwriting deductions	\$9,354,230

Net underwriting gain (loss) (\$3,789,208)

**Investment Income**

Net investment income earned	\$67,656
Net realized capital gains (losses)	-
Net investment gain (loss)	\$67,656

**Other Income**

Net gain (loss) from agents' or premium balances charged off	-
Finance and service charges not included in premiums	-
Total other income	-

Net income after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	(\$3,721,552)
Federal and foreign income taxes incurred	-
	-

Net income (\$3,721,552)

**Capital and Surplus Account**

Surplus as regards to policyholders, December 31 prior year \$7,973,309

Net income (\$3,721,552)

Change in net unrealized capital gains (losses)

Change in net deferred income tax 1,615,805

Change in nonadmitted assets (1,275,949)

Change in surplus notes 2,500,000

Examination Adjustments -

Change in surplus as regards policyholders for the year (\$881,696)

Surplus as regards policyholders, December 31 current year \$7,091,613



A comparative analysis of changes in surplus is shown below.

**STAR & SHIELD INSURANCE EXCHANGE  
Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2010**

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, 2010, per Annual Statement \$7,091,613

	<u>PER RECIPROCAL</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No Adjustments			
LIABILITIES:			
No Adjustments			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2010, Per Examination			<u><u>\$7,091,613</u></u>

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

<b>Losses and Loss Adjustment Expenses</b>	<u>\$2,806,144</u>
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An outside actuarial firm appointed by the SAC, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2010, made a reasonable provision for all unpaid loss and loss expense obligations of the Reciprocal under the terms of its policies and agreements.

The Office engaged Ins Focus, LLC Actuary, George Turner, FCAS, MAAA, to review the Loss and Loss Adjustment Expense reserves carried in the Reciprocal's balance sheet as of December 31, 2010 and was in concurrence with this opinion.

### Capital and Surplus

The amount reported by the Reciprocal of \$7,091,613, exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Star & Shield Insurance Exchange** as of December 31, 2010, consistent with the insurance laws of the State of Florida.

Per examination findings, the Reciprocal's Surplus as regards policyholders was \$7,091,613 which exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Anthony V. DeLuca, MBA, CPA, Examiner-In-Charge, Marcus B. Ladd, CPA, Senior Examiner, George Turner, FCAS MAAA, Actuary, Carlos Ruesta, CISA, IT Manager of InsFocus and Syntia King, APIR, Financial Examiner/Analyst II, of the Office participated in the examination.

Respectfully submitted,

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