

REPORT OF EXAMINATION

OF

**COASTAL INSURANCE RISK
RETENTION GROUP, INC.**

MONTGOMERY, ALABAMA

as of

December 31, 2012

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EXAMINER'S AFFIDAVIT

STATE OF ALABAMA
MONTGOMERY COUNTY

Blase Francis Abreo, CFE, being duly sworn, states as follows:

1. I have authority to represent Alabama in the examination of Coastal Insurance Risk Retention Group, Inc.
2. Alabama is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination workpapers and examination report, and the examination of Coastal Insurance Risk Retention Group, Inc. was performed in a manner consistent with the standards and procedures required by the State of Alabama.

The affiant says nothing further.

Francis Blase Abreo

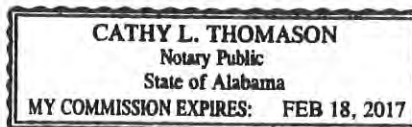
Blase Francis Abreo

Subscribed and sworn before me by Francis Blase Abreo on this 7th day of February 2014

(SEAL)

Cathy L. Thomason

(Signature of Notary Public)



My commission expires _____



ROBERT BENTLEY
GOVERNOR

STATE OF ALABAMA
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EDWARD S. PAULK
GENERAL COUNSEL
REYN NORMAN
RECEIVER
DENISE B. AZAR
LICENSING MANAGER
JIMMY W. GUNN

February, 7, 2014

Honorable Jim L. Ridling
Commissioner of Insurance
Alabama Department of Insurance
201 Monroe Street, Suite 502
Montgomery, Alabama 36104

Dear Commissioner Ridling:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2012, has been made of

Coastal Insurance Risk Retention Group, Inc.
Montgomery, Alabama

at its home office located at 509 Oliver Road, Montgomery, Alabama. The report of examination is submitted herewith. Where the description "The Company" appears herein, without qualification, it will be understood to indicate Coastal Insurance Risk Retention Group, Inc.

SCOPE OF EXAMINATION

The Company was last examined for the five-year period ended December 31, 2007. The current examination covers the intervening period from January 1, 2008 through December 31, 2012, and was conducted by examiners from Alabama. Where deemed appropriate, transactions, activities and similar items subsequent to December 31, 2012, were reviewed.

The examination was conducted in accordance with applicable statutory requirements of the State of Alabama Insurance Code and the Alabama Insurance Department regulations and bulletins in addition to the procedures and guidelines promulgated by the National Association of Insurance Commissioners (NAIC), as deemed appropriate, and in accordance with generally accepted examination standards and practices.

The examination was conducted in accordance with the NAIC *Financial Condition Examiners Handbook*. The examination was planned and performed to evaluate the financial condition of the Company as of December 31, 2012, and to identify the Company's prospective risks by obtaining information about the Company including corporate governance. In addition, the examination was planned and performed to identify and assess inherent risks within the Company and to evaluate system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements, management's compliance with statutory accounting principles and annual statement instructions.

An examination of the Company's information systems (IS) was conducted concurrently with the financial examination. The IS examination included a review of management and organizational controls, logical and physical security controls, changes in application controls, contingency planning controls, service provider controls, operation controls, processing controls, and network and internet controls. The review was based on Exhibit C of the 2012 NAIC *Financial Condition Examiner's Handbook*.

A market conduct examination was performed concurrently with the financial examination. The market conduct examination included a review of the Company's territory and plan of operation, advertising and marketing, claims payment and practices, policy forms, rates and underwriting practices, policyholder complaints, compliance with agents licensing requirements and privacy standards. See the caption MARKET CONDUCT ACTIVITIES – Page 20.

The Company's annual statements for each year under examination were compared with the corresponding general ledger account balances. During the period covered by the examination, the Company was audited by Faulkner, Mackie & Cochran, Nashville, TN (CPA's). The CPA's workpapers were used in the examination as deemed appropriate by the examiners.

A signed certificate of representation was obtained during the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2012.

ORGANIZATION AND HISTORY

The Company was incorporated on February 28, 2003, pursuant to the Alabama Business Corporation Act. The Articles of Incorporation were filed in the office of Probate Judge Reese McKinney, Jr. in Montgomery County, Alabama on February 28, 2003. Item 6 of the Articles of Incorporation stated:

The corporation is organized as a stock insurance company in accordance with the provisions of Chapter 27 of the Alabama Insurance Code, as amended, for the purpose of writing insurance and reinsurance as an insurance risk retention group pursuant to the federal Liability Risk Retention Act, 15 USC §§ 3901 et. Seq., and the Alabama Risk Retention Act, §§ 27-31A-1 through 27-31A-15 of the Code of Alabama (1975)....(a) To engage in the business of writing contracts of casualty insurance and reinsurance, including, without limitation, the type defined as "malpractice" insurance and "liability" insurance in Chapter 5, Section 6 of the Alabama Insurance Code, as amended....

Effective March 21, 2013, the Articles of Incorporation were amended and the name of the Company was changed to Coastal Insurance Company Inc. See caption SUBSEQUENT EVENTS - Page 48

The Company provides the following insurance coverages to hospitals and physicians in the state of Alabama at December 31, 2012:

- Medical malpractice – claims made
- Other liabilities – claims made

ARTICLE II of the Articles of Incorporation dated February 28, 2003, stated:

2. The aggregate number of shares of capital stock which the corporation shall have authority to issue is 2,500,000 shares of common stock, of which 500,000 shares shall have a par value of \$1.00 per share and shall be designated "Class A Shares" and 2,000,000 shares shall have a par value of \$.01 per share and shall be designated "Class B Shares." The relative rights, privileges, and limitations of the Class A Shares and Class B Shares shall be in all respects identical, share for share.

The Articles of Incorporation filed with the Judge of Probate on June 9, 2006, amended the Articles of Incorporation by deleting ARTICLE II in its entirety. The amended ARTICLE II, states:

2. The aggregate number of shares of capital stock which the corporation shall have authority to issue is 4,750,000 shares of common stock, of which 500,000 shares shall have a par value of \$1.00 per share and shall be designated "Class A Shares," 2,000,000 shares shall have a par value of \$.01 per share and shall be designated "Class B Shares," 1,000,000 shares shall have a par value of \$.01 per share and shall be designated "Class C Shares," 1,000,000 shares shall have a par value of \$.01 per share and shall be designated "Class D Shares," and 250,000 shares shall have a par value of \$.01 per share and shall be designated "Class E Shares." The relative rights, privileges, and limitations of the Class A Shares, Class B Shares, Class C Shares, Class D Shares and Class E Shares shall be in all respects identical, share for share, except that there are differences in purchase requirements and payment plans for each class of stock. In addition, Classes D and E Shares shall not have voting or dividend rights.

At December 31, 2012, the Common capital stock was \$507,297, Gross paid in and contributed surplus was \$11,790,094, and Unassigned funds (surplus) was \$9,272,063. Treasury stock was \$3,555,270. See caption FINANCIAL CONDITION/GROWTH OF THE COMPANY - Page 24.

Coastal Insurance Services, Inc. (CIS) and Healthcare Improvement PSO of Alabama, Inc. (HIPSO) are wholly-owned subsidiaries of the Company. The Company has Management Services Agreements with both CIS and HIPSO. See the heading Transactions and Agreements with Affiliates – Page 11.

MANAGEMENT AND CONTROL

Stockholders

The Company is a stock corporation with ultimate control vested in its stockholders. DCH Health Care Authority and Southern Medical Health System, each, owned over 10% of the outstanding shares. At December 31, 2012, there were 317 shareholders.

Board of Directors

The *By-Laws* of the Company provided that the business and affairs of the Corporation shall be managed by its Board of Directors. ARTICLE III, Section 3.2 states: "...Thereafter, the board of directors shall consist of 8 to 14 directors. The directors shall be divided into four groups consisting of up to three directors in each group...."

The following directors were elected by the stockholders and were serving at December 31, 2012.

<u>Name and Residence</u>	<u>Principal Occupation</u>
Robert Curtis Chapman Cropwell, Alabama	Retired Chief Executive Officer of Eastern Health System, Inc.
William Hardin Coleman, M.D, PhD Scottsboro, Alabama	President of Family Practice, Scottsboro, Alabama
Barry Smith Cochran Fayette, Alabama	Administrator Fayette Medical Center
William Allen Foster Opp, Alabama	Retired Administrator, Mizell Memorial Hospital
Frank Willard Harris Highlands, North Carolina	Retired Chief Executive Officer, Russell Medical Center
Bryan Neal Kindred Tuscaloosa, Alabama	President and Chief Executive Officer DCH Health System
John James, MD Alexander City, Alabama	Physician Alexander City, Alabama
Lother Ephraim Peace, III Jackson Gap, Alabama	Chief Executive Officer Russell Medical Center
Jennie Rogers Rhinehart Tallasse, Alabama	Administrator Community Hospital, Inc.
Louie Cecil Wilson, M.D Mobile, Alabama	Retired – Cardio Thoracic and Vascular Surgery Assoc., P.C.

Gerald Leon Wallace, Jr.
Mobile, Alabama
Melvin Lamar Capell
Montgomery, Alabama
James Michael Horsley
Montgomery, Alabama

President and CEO
Southern Medical Health System
President and Chief Executive Officer of the
Company
President
Alabama Hospital Association

Officers

ARTICLE V, SECTION 5.1 of the *By-Laws* states: "Positions. The officers of the corporation shall be elected by the board of directors and shall consist of a chairman of the board, a president, a secretary, and such other officers and assistant officers as may be deemed necessary by the board of directors. Any two or more offices may be held by the same person."

The following officers were elected by the Board of Directors and were serving at December 31, 2012

<u>Officer</u>	<u>Title</u>
Melvin Lamar Capell	President and Chief Executive Officer
Thornton Dudley Perry	Vice President, General Counsel and Secretary
John Mark Killingsworth	Senior Vice President – Treasurer and Chief Financial Officer
Frank Labbie Parsons	Senior Vice President of Claims
Dawn Wilkes Adams	Vice President Workers' Compensation of Claims
Earnest Wray Smith	Senior Vice President of Underwriting
Donald Anthony Eagen	Vice President Information Technology
Gardner Jackson Posey	Vice President – Risk Management

Committees

The following committees were functioning as of December 31, 2012:

Executive Committee

Robert Curtis Chapman
Frank Willard Harris

Bryan Neal Kindred
Louie Cecil Wilson, M.D

Compliance and Audit Committee

Frank Willard Harris

Robert Curtis Chapman

Jennie Rogers Rhinehart
Barry Smith Cochran

James Michael Horsley
Gerald Leon Wallace, Jr.

Nominating and Corporate Governance Committee

Bryan Neal Kindred
William Hardin Coleman, M.D, PhD
Lothar Ephraim Peace, III

Robert Curtis Chapman
William Allen Foster

Conflict of Interest

The Company follows an established procedure for the disclosure of conflicts between the Company's interests and personal interests of directors and officers. The conflict of interest statements filed annually by the officers and directors of the Company were reviewed for the period covered by the examination. The examiners determined the following:

- Directors: The Company had twelve directors from 2008 – 2011 and thirteen directors in 2012. Three conflict of interest statements in 2008, five in 2009, four in 2010, five in 2011 and three in 2012 were not provided.
- Officers: The Company had eight officers in 2008 – 2009 and seven officers in 2011 - 2012. One conflict of interest statements in 2008, eight in 2009, eight in 2011 and one in 2012 were not provided.

The Company did not comply with its own Conflict of Interest policy and was not in compliance with ALA. CODE § 27-27-29 (a) (1975), which states:

Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep in this state complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.

Company management indicated that the Company understands the importance to ensure that the conflict of interest statements are signed by the directors and officers of the Company and make the necessary disclosures. However, since there have been changes in personnel working in the legal department, the conflict of interest statement could not be located. The Company will devise a better filing system and keep this from happening in the future.

Dividends to Policyholders

The Company paid the following cash dividends to policyholders during the period covered by the examination:

<u>Year</u>	<u>Amount</u>
2008	\$ -0-
2009	-0-
2010	500,000
2011	-0-
2012	5,100,000

CORPORATE RECORDS

The Articles of Incorporation and *By-Laws* and amendments thereto were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practice and applicable statutes and regulations. There were no amendments since the last examination.

Minutes of the meetings of the Stockholders and Board of Directors were reviewed for the period under examination. The minutes appeared to be complete with regard to actions taken on matters before the respective bodies for deliberation and action, except as otherwise noted in this Report.

HOLDING COMPANY AND AFFILIATE MATTERS

Holding Company Registration and Reporting

The Company is subject to the *Alabama Insurance Holding Company Regulatory Act*, as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company is registered with the Alabama Department of Insurance as joint registrant of an Insurance Holding Company System. The Company is responsible for holding company registration and periodic filings in accordance with ALA. CODE § 27-29-4 (1975), and ALA. ADMIN. CODE 482-1-055 (1994).

Appropriate filings required under the Holding Company Act are made from time to time by the Company as registrant of an Insurance Holding Company System. A review of the Company's filings during the period under review indicated that required disclosures were included in the Company's filings.

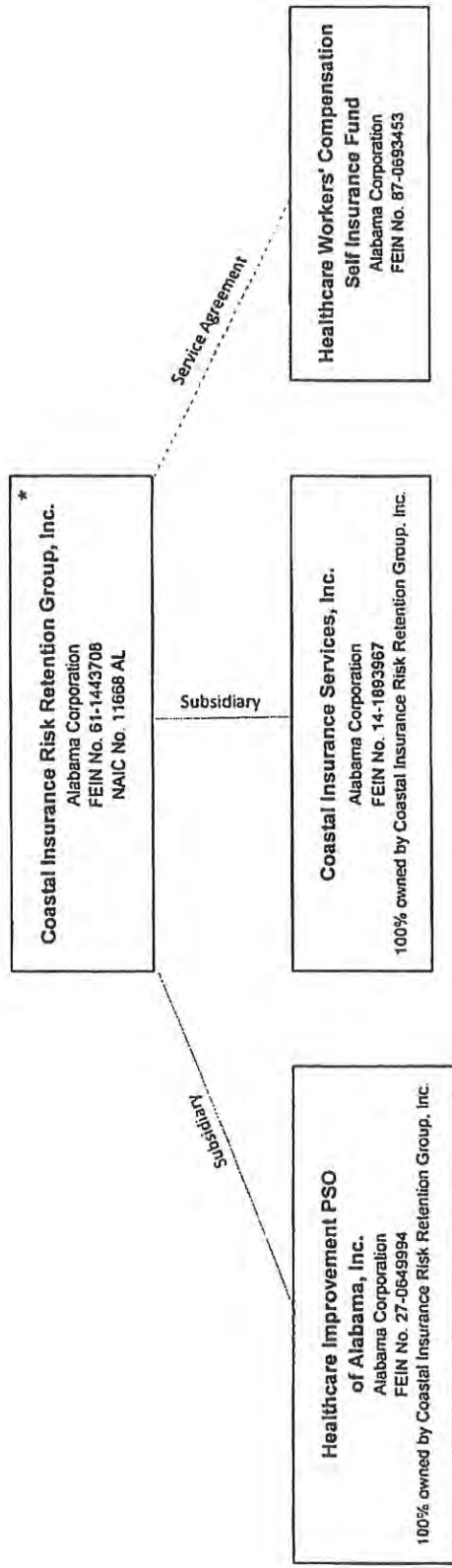
Dividends to Stockholders

The following dividends were declared and paid to stockholders of the Company during the period under examination:

<u>Year</u>	<u>Amount</u>
2008	\$ 333,182
2009	
2010	
2011	
2012	<u>4,903,103</u>
Total	\$ <u>5,236,285</u>

Organizational Chart

See the next page for the Company's organizational chart as of December 31, 2012.



* Shareholders with 5% or more stock ownership:
 - DCH Healthcare Authority 27.06% Class A and B stock as of December 31, 2012
 - Springhill Memorial Hospital 10.94% Class A and B stock as of December 31, 2012

Transactions and Agreements with Affiliates

Management Agreement with Coastal Insurance Services, Inc.

The Company entered into a management agreement with Coastal Insurance Services, Inc., (CIS) a 100% owned affiliated Company. The agreement has been in effect since September 1, 2003, with the initial term of the agreement 36 months, which automatically renewed for an additional term of 36 months. The agreement could be terminated, by either party, by serving a 365 days written notice upon the other party.

CIS was organized to provide Third Party Administration Services, Insurance Agency Operations and such other contract services as deemed appropriate to clients who desire to obtain these services.

The terms of the agreement include the following:

- The Company will provide the professional personnel, support services and physical assets that CIS needs to comply with its client contracts. Company accepts such retention and agrees to provide professional personnel, support services and physical assets as set forth in the agreement.
 - Professional personnel: Trained personnel having expertise in workers' compensation claims, liability claims, underwriting, risk management, information technology, accounting, management and marketing.
 - Support services: Services that are needed by CIS clients to accomplish insurance and/or risk management functions on a self-retained basis.
 - Physical assets: Office space, desk, computers, computer software, etc. needed by CIS.
- CIS has the responsibility and the commensurate authority to negotiate service contracts with its clients for a fee. However, CIS will communicate with the Company during negotiations in order to make certain that the Company could provide needed services for CIS clients. The obligations of CIS are listed below:
 - Negotiate, prepare and gain acceptance of service contracts with its clients for Third Party Administrative services, Insurance Agency services or other contract services.
 - Develop sufficient contract fees from CIS clients to meet the requirements of the Company as established by Company's management.
 - CIS will make every effort to assist the Company in dealing with its clients, possible clients, and with day-to-day operations.

- CIS agrees to pay the Company a fee for the performance of its duties as enumerated by this Management Agreement. The fee would be eighty-five percent of revenues received by CIS from service contracts with its clients.
 - The parties to the agreement agreed that there might be the need to incur certain expenses for the benefit of CIS not herein contemplated. In those instances, the Company would prepare cost projections for submission to CIS Board of Directors.
- CIS would not retain any independent expert or technical personnel without prior agreement of the Company.
 - CIS retention and actions hereunder are in the status of an independent contractor of the Company. The Company and CIS acknowledge and agree that one is neither the employee nor the employer of the other, and that they are not partners or joint ventures.
 - The Company would maintain accounting of all monies involved with the operations of CIS. It would (1) produce monthly and/or quarterly financial reports; and, (2) prepare expense reports and an annual budget to be approved by CIS Board of Directors. The Company would also open the books and records of CIS to inspection by the CIS Board of Directors or their duly authorized and appointed agent whenever requested.
 - The President/CEO of the Company and such other employees would attend all CIS Board of Directors meetings and make such reports as required to keep the Board of Directors advised of current operations and the financial situation of CIS.

The examiners reviewed the minutes of the Board of Directors meetings to identify approval of the management service agreement. The examiners established that the approval of the Management Services Agreement between the Company and Coastal Insurance Services Inc., a wholly-owned subsidiary, was not recorded in the minutes on the Board of Directors meeting as required by ALA. CODE § 10-2B-16.01(a) (1975), which states:

A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.

A similar recommendation was made during the prior examination.

Management Agreement with Healthcare Improvement Patient Safety Organization, Inc.:

The Company entered into a Management Agreement with Healthcare Improvement Patient Safety Organization Inc. (HIPSO), a 100% owned affiliated company, on January 1, 2013 and the agreement was amended on April 1, 2013 to accommodate the reorganization of the Company from a Risk Retention Group to Coastal Insurance Company Inc. The Company will act as an administrator for the management of HIPSO under the laws and regulation of the State of Alabama and the provisions of the Patient Safety and Quality Improvement Act of 2005 (PSQIA) and associated regulations. The terms of the agreement are as follows:

I. OBLIGATIONS OF THE COMPANY AS ADMINISTRATOR

- A. The Company will perform any and all legal duties imposed upon it in this Agreement with HIPSO. The obligations shall include, but are not necessarily limited to, the following items:
 - A. The Company will pay HIPSO for its services based on a fee schedule which is part of the agreement. The fee is to be paid in monthly increments.
 - B. Invoicing and collection of all sums due HIPSO from its clients.
 - C. Pay all approved items of expense as directed by the Board of Directors.
 - D. Account for all monies handled by monthly and /or quarterly reports. Prepare expense reports and an annual budget to be approved by the Board of Directors. The budget may be amended from time to time and approved by the Board of Directors to meet changing obligations.
 - E. Open the books and records of HIPSO maintained by the Company to inspection by the Board of Directors or their duly authorized and appointed agent.
 - F. The President/CEO of the Company and such other employees of the Company as the President/CEO designates shall attend all Board of Directors meetings. They shall make such reports as required to keep the Board of Directors advised of current operations and the financial situation of HIPSO.
 - G. Retain an attorney, when necessary, for the proper administration of HIPSO.
 - H. Procure all necessary and appropriate liability and other insurance coverage.

- I. Perform any and all other duties imposed upon it by the rules and regulations of the Director of the Alabama Department of Insurance and all applicable state and federal laws.
- B. The Company is responsible for the day-to-day operations of HIPSO. The Company will perform and do for HIPSO every other act and thing contemplated by the Agreement to ensure HIPSO's orderly function and operation.

II. OBLIGATIONS OF HIPSO

1. HIPSO agrees to pay the Company a fee for the performance of the duties as enumerated by the Agreement. The fee shall be the direct and indirect expenses incurred by the Company on behalf of HIPSO, which includes all of the services performed by the Company's employees. Such fee is to be paid in monthly increments.
2. The fee for services, as enumerated in paragraph one above, shall be determined at the beginning of each fiscal year based on the Company's budgeted projections of the actual costs required to operate HIPSO. Such fee shall be approved by the Board of Directors in connection with the approval of operating budget. Monthly, the management fees shall be adjusted to equal actual expenses attributable to HIPSO with any common expenses allocated to HIPSO through an approved allocation process.
3. HIPSO, by executing the Agreement, hereby contracts the Company to be the Administrator under the terms and conditions as set out in the Agreement.

III. GENERAL PROVISIONS

1. In accordance with accepted employment standards and/or policies and procedures as followed by other programs similar to the program of HIPSO, HIPSO and the Company agree to the following:
 - A. The Company will ensure that the required service to all HIPSO Clients is provided by a trained staff of employees.
 - B. The Company will ensure that it will follow a fair and adequate compensation program for its employees.

- C. Under these arrangements, HIPSO recognizes the right of the Company to employ, dismiss and determine the compensation of Company employees.
2. The term of the Agreement shall begin April 1, 2013 and continue until terminated by one of the parties as provided herein and under the provisions of the Patient Safety and Quality Improvement Act of 2005 and associated regulations.
 3. Upon any controversy or dispute hereunder where the parties are unable to reach agreement as to the interpretation of the language contained herein, the matter shall be submitted to arbitration. Each party shall choose an arbitrator with a third arbitrator being chosen by the first two arbitrators. The decision of two or more arbitrators shall be final and binding on all parties hereto. The laws of the State of Alabama shall be applied by the arbitrators in reaching a decision.
 4. The Agreement constitutes the entire agreement of the parties and supersedes any prior agreement and/or understanding. This instrument shall not be varied, amended, or supplemented except by an instrument in writing of even date herewith, or subsequent hereto, executed by the parties' of this agreement.
 5. No party shall have the right to assign all or portion of this Agreement without the prior written consent of the other party.
 6. This Agreement shall inure to the benefit of and bind the parties and their respective successors and assigns. Nothing expressed in this Agreement is intended or shall be construed to give any person other than the parties hereto or their respective successors or permitted assigns, any legal or equitable rights, remedy or claim under or in respect of this Agreement or any provision contained herein, it being the intention of the parties hereto that this Agreement shall be the sole and exclusive benefit of such parties or their successors and assigns and not for the benefit of any other person.
 7. Any and all notices or communications pursuant to or with respect to the terms of this Agreement shall be in writing and addressed to the respective parties.

The management services agreement with HIPSO was effective January 1, 2013; however, the Form D filing was made on June 21, 2013. The Company did not comply with ALA. CODE § 27-29-5 (b) (1975), which states:

The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period....

(4) All management agreements, service contracts, and all cost-sharing arrangements;

The examiners reviewed the minutes of the Board of Directors meetings to identify approval of the management service agreement. The examiners established that the approval of the Management Services Agreement between the Company and HIPSO, a wholly-owned subsidiary, was not recorded in the minutes on the Board of Directors meeting as required by ALA. CODE § 10-2B-16.01(a) (1975), which states:

A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation

The management service agreements between the Company and CIS and the Company and HIPSO did not provide for timely settlement of amount owed as required by SSAP No. 96, paragraph 2, of the NAIC Accounting Practices and Procedures Manual, which states:

Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted, except to the extent this is specifically addressed by other statements of statutory accounting principles (SSAPs). If the due date is not addressed by the written agreement, any uncollected receivable is nonadmitted

FIDELITY BONDS AND OTHER INSURANCE

The Company was insured by a policy issued by St. Paul Fire and Marine Insurance Company, St. Paul, Minnesota. The single loss limit of the bond met the NAIC

suggested minimum requirements for fidelity insurance. The Financial Institution Bond provided the following extended coverages:

- Dishonesty of Employees
 - Fidelity
 - Restoration Costs of Electronic Information
- On Premises
- In Transit
- Counterfeit Currency

In addition to the above mentioned coverages, the Company was insured under the following insurance policies:

- Property – General Liability & Umbrella Liability
 - Business Personal Property: Replacement Cost
 - Personal Property of Others:
 - Inside the Premises
 - Outside the Premises
 - Property Optional Coverages
 - Computer and Media
 - Limited Fungi, Bacteria or Virus
 - Business Income and Extra Expenses
 - Equipment Breakdown
 - Identity Recovery
 - Business Liability
 - Liability and Medical Expenses
 - Personal and Advertising Injury
 - Damage To Premises Rented To You
 - Umbrella Liability
 - Business Liability
 - Comprehensive Automobiles
 - Employer's Liability
- Commercial Auto Insurance
- Workers Compensation
- Employment Practices Liability
- Management & Professional Liability
- Errors & Omissions Liability
- Crime: Fidelity, Forgery or Alteration, On Premises and In Transit.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company offered the following benefit plans for its employees including producers who are employees of the Company at December 31, 2012:

- Annual Leave
- Paid Holidays
- Personal Leave
- Military Leave
- Maternity Leave
- Paid Sick Leave
- Paid Jury Duty
- Bereavement
- Health Insurance
- Group Insurance
 - Term Life and AD&D Insurance
 - Short-term Disability Insurance
 - Long-term Disability Insurance
- Retirement Savings 401 (k) plan

The employees and producers have no option to own Company stock.

Section 1033 of Title 18 of the U.S. CODE **(ALA. ADMIN. CODE 482-1-146-.11 (2009))**

The Company was asked how it determined if those working on its behalf were not in conflict with Section § 1033 of Title 18 of the U.S. CODE and ALA. ADMIN. CODE 482-1-146-.11(2009).

Company management indicated that all employees and prospective employees are required to submit to a criminal background check by signing a criminal background history release form. The examination determined that there was no criminal background check performed on an ongoing basis on employees after the initial background checks. It was also determined that the Company did not have a written policy and procedure for criminal background checks after the initial employment. The Company did not comply with Section § 1033 of Title 18 of the U.S. CODE and ALA. ADMIN. CODE 482-1-146-.11(2009), which states:

Responsibilities of Section § 1033 of Title 18 of the U.S. CODE; Insurers.

(1) A Section 1033 insurer subject to the Commissioner's examination authority shall have and apply the following:

(a) An internal procedure for determining, by means of background checks or investigations or otherwise, whether applicants for employment or individuals with whom the insurer intends to contract for activities in the business of insurance, whether or not in a capacity requiring a license, have a felony conviction for a Section 1033 offense.

(b) An internal procedure after initial employment or contracting, applied on a periodic basis, to ascertain the existence of a felony conviction for a Section 1033 offense.

(c) An internal procedure for assuring that affected employees or individual contractors have obtained and hold any required Section 1033 consent during the period of employment or contracting.

(2) Such procedures shall be maintained in a format capable of being furnished to the Department as part of the examination process or otherwise as requested by the Department.

(3) As part of an examination or otherwise, the Department may determine the existence of such procedures, whether and how they are being followed, and the effectiveness of the procedures.

Company management indicated that the criminal background check would be conducted on its current employees on a rotation basis to ascertain the existence of felony after the initial checks. The examiner determined that as of the date of the examination report no criminal background checks had been conducted on a rotation basis to verify the existence of felony convictions on its current employees.

In order to verify compliance with US Code, Title 18, Section 1033 (e)(1)(A) and ALA. ADMIN. CODE 482-1-146-.11 (2009), the Company was requested to provide the criminal background checks on the board of directors, officers and employees on record as of December 31, 2012. It was determined that officers and employees who were with the Company during the prior exam had the background check performed in the last quarter of 2010 and in 2011 and new employees at the time of employment. The Company did not provide the background checks on one Director. Company management indicated that the criminal background checks documents could not be located; therefore, the Company did not comply with ALA. CODE § 27-27-29 (a) (1975), which states:

Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete

records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.

SPECIAL DEPOSITS

In order to comply with the statutory requirements for doing business in the state of Alabama, the Company had the following security on deposit with the Alabama Department of Insurance at December 31, 2012.

<u>Description</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Fair Value</u>
US Treasury Note	\$ <u>105,000</u>	\$ <u>105,226</u>	\$ <u>106,353</u>
Total	\$ <u>105,000</u>	\$ <u>105,226</u>	\$ <u>106,353</u>

MARKET CONDUCT ACTIVITIES

Territory

At December 31, 2012, the Company was licensed to transact business in the state of Alabama. The certificate of authority was inspected for the period under review and found to be in order. There were no pending licenses at the examination date.

Plan of Operation

During the period covered by the examination, the Company offered medical malpractice and other liability products to hospitals and physicians in the state of Alabama. As of December 31, 2012, the Company's operational plan included the following goals: 1) Refine operating margins, 2) Retain current business, 3) Add new business, 4) Strengthen name recognition, 5) Develop presence in health information exchange activities, and 6) Develop a Patient Safety Organization.

As of December 31, 2012, the Company had seven producers licensed in Alabama and appointed for the Company. Two of the seven producers were marketing producers and another four performed underwriting duties. The Chief Executive Officer of the Company had a producer's license and was appointed by the Company. None of the seven licensed producers received commissions.

Effective March 21, 2013, the Articles of Incorporation were amended and the name of the Company was changed to Coastal Insurance Company Inc. See caption Subsequent Events - Page 48

Policy Forms, Rates and Underwriting Practices

The Company's cancelled/rejected/declined and new premiums listings were reviewed and it was determined that the two listing had 454 policies. The examiners utilized the sampling table from the NAIC *Market Regulations Handbook* and selected a sample of 84 policies from the two listings to verify if the policies were appropriately cancelled/rejected/declined and if the premiums were calculated in accordance with the filed rates.

Fifteen policies were selected from the cancelled/rejected/declined and reviewed for compliance with the Company's underwriting guidelines and unfair discriminatory acts and practices. The examiners determined that the policies were cancelled for non-payment of premiums or insured requested cancellation. The files were determined to be complete and had documentation for cancellation/rejection and declination.

Sixty-nine policies from the new-premiums listing were reviewed to identify if the rating factors such as territory, surcharge and deductible factors were consistently applied to the hospitals and physician policies and that the rates in use were filed with the Alabama Department of Insurance.

The examiners determined that the forms in use were appropriately filed with the Alabama Department of Insurance. The new application forms included the fraud language as required by ALA. CODE § 27-12A-20 (a) (1975), which states:

A fraud warning shall be included on at least one of the following: Claim release forms, applications, reinstatements for insurance, participation agreements, declaration pages, and claim documents, regardless of the method or form of transmission and shall contain the following statement or a substantially similar statement: "Any person who knowingly presents a false or fraudulent claim for payment of a loss or benefit or who knowingly presents false information in an application for insurance is guilty of a crime and may be subject to restitution, fines, or confinement in prison, or any combination thereof."

Advertising and Marketing

The Company did not have a formal advertising and marketing program. The advertising and marketing materials used by the Company during the period covered by the examination were reviewed. The marketing of the Company's products was accomplished through brochures, medical news publications and the Company's

website. Advertising is designed to generate interest of small rural hospitals and physicians to the Company's medical malpractice and other liability products.

The Company's webpage (www.coastalins.org) was reviewed and found to include the following links: Home, Underwriting, Claims, Risk Management, Allied Health Care, Sponsorships & Testimonials, Applications & News, Physician CME and Contacts. To request additional information, under the link "Contacts" an e-mail address info@coastalins.org can be used by prospective consumers to request additional information from the Company.

Producers of the Company are not allowed to create their advertising and marketing materials.

Treatment of Policyholders and Other Claimants

Paid Claim

The paid claims listing had 58 indemnity claim payments made during 2008 – 2012. The examiners took the entire population of hospital and physicians paid claims and reviewed the claims for compliance with policy provisions, timeliness of payments and adequacy of documentation. The examiners did not come across any significant issues.

Denied and Closed without Payment Claims

A sample of 82 items was taken from a population of 274 items from the denied and closed without payment claims. The claims were reviewed for compliance with policy provisions and adequacy of documentation. The examiners did not come across any significant issues.

Compliance with Producers' Licensing Requirements

The Company's listing of licensed and appointed producers was compared with the listings obtained from the Alabama Department of Insurance. The two listings agreed.

The examination determined that one producer was terminated during the period under examination. The Company did not provide the termination letter sent to the Alabama Department of Insurance and the letter notifying the producer of the termination of employment. Therefore, the examiners could not determine if the Alabama Department of Insurance was notified of the termination within thirty days

following the effective date of the termination as required by ALA. CODE § 27-7-30 (e) (1975), which states:

Subject to the producer's contract rights, if any, an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner.

The examiners could not determine if the Company notified the producer of the termination of employment in a timely manner. The Company was not in compliance with ALA. CODE § 27-7-30.1(a) (1975), which states:

Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier.

Policyholders' Complaints

The Company implemented the complaints handling policy and procedures during the period covered by the examination. The complaints handling policy and procedures addressed all written complaints forwarded by the Alabama Department of Insurance and those received directly from the policyholders. Within ten days of the receipt of the complaint, the General Counsel is required to provide an appropriate response to the complaint. The Company's policy and procedures complied with the requirements of ALA. ADMIN. CODE 482-1-118 (1999), which states:

The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the commissioner....

The examiners reviewed the Company's complaint register. There were no complaints logged on the register, and there were no complaints filed with the Alabama Department of Insurance.

Privacy Policies and Practices

The Company's Privacy Notice was reviewed for compliance with ALA. ADMIN. CODE 482-1-122 (2002). The Company does not allow the disclosure of personal information to any non-affiliated third parties except as permitted by law or by prior written authorization for release of the information. The information collected is restricted to employees or third parties who require that information in order to provide products and services. The Privacy Notice is automatically generated when new policies are issued and thereafter at renewals. The Company complied with the privacy requirements of ALA. ADMIN. CODE 482-1-122 (2002).

FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

<u>Year</u>	<u>Gross Premiums Written</u>	<u>Premiums Earned</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Policyholders Surplus</u>
2007*	\$ 14,238,528	\$ 7,159,536	\$ 40,097,084	\$ 27,931,821	\$ 12,165,263
2008	12,401,649	6,530,225	41,783,124	30,692,510	11,090,614
2009	11,236,990	10,617,965	45,255,339	27,177,182	18,078,157
2010	10,918,439	6,052,197	48,532,577	27,951,304	20,581,273
2011	8,942,604	6,867,696	49,861,820	27,010,629	22,851,191
2012*	8,843,713	7,361,496	50,490,466	32,476,282	18,014,184

*Per examination. Amounts for the remaining years were obtained from the filed copy of the Annual Statements.

LOSS EXPERIENCE

The following were the net underwriting gains/(losses) for the years under examination stated as a percentage of premiums earned for the respective year.

<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
1.4%	69.6%	24.5%	31.3%	66.1%

In addition, the following are the One Year Loss Development and the Two Year Loss Development for each year under examination.

(000 Omitted)	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
One Year Loss	\$ (4,068)	\$ (4,890)	\$ (2,819)	\$ (3,319)	\$ (5,269)
Two Year Loss	\$ (5,853)	\$ (8,172)	\$ (6,446)	\$ (5,336)	\$ (7,251)

ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained on electronic data processing equipment and personal computers. The Company provided management services to its 100% owned subsidiaries Coastal Insurance Services, Inc., and Healthcare Improvement PSO of Alabama, Inc. The Company also provided management services to Healthcare Workers' Compensation Self Insurance Fund under a Management Services Agreement.

The Company was audited annually by the certified public accounting firm of Faulkner, Mackie and Cochran, PC. Nashville, Tennessee. The audit reports and workpapers of the external auditors were made available to the examiners and were utilized as deemed appropriate.

The Company's reserves were certified by Mr. John F. Gibson, FCAS, MAAA during 2008 – 2011 and by Mr. R. Scott Cederburg, FCAS, MAAA in 2012. The examiners determined that the Company did not inform the commissioner of the Alabama Department of Insurance of the change in the opining actuary as required by the NAIC *Annual Statement Instructions*, which states:

If an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the insurer shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The insurer shall also furnish the domiciliary Commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scopes, procedure, category of opinion issued, wording of the opinion, or data quality. The disagreements required to be reported in response to this paragraph include both those resolved to the former actuary's satisfaction and those not resolved to the former actuary's satisfaction. The insurer shall also in writing request such former actuary to furnish a letter addressed to the insurer stating whether the actuary agrees with the statements contained in the insurer's

letter and, if not, stating the reasons for which he does not agree; and the insurer shall furnish such responsive letter from the former actuary to the domiciliary Commissioner together with its own.

Unclaimed Property Filings

The review of the unclaimed property filings indicated that the Company made the appropriate filings in a timely manner.

Premium Taxes

The Examiner reviewed the premium tax forms filed by the Company for the examination period. It was determined that in 2010 the Company deducted stock solicitation permit fee in the amount of \$250 and Form B filing fee of \$500 paid to the Alabama Department of Insurance from premiums taxes. The examination determined that these deductions were not allowed as deductions by ALA.CODE § 27-4A-3 (c) (1975) which states:

The tax imposed by this section shall be subject to credit and deduction of the full amount, with 25 percent of the full amount paid, or estimated to be paid, being credited or deducted on each quarterly payment date, for all of the following:

- (1) Ad valorem property taxes paid by an insurer on any building and real estate in this state which is owned and occupied, in whole or in part, by the insurer for the full period of the tax year as its principal office in the state of Alabama.
- (2) All ad valorem taxes paid by an insurer during the calendar year on any other real estate and improvements thereon in this state which is owned and at least 50 percent occupied by the insurer for the full period of the tax year.
- (3) Ad valorem property taxes paid by an insurer on the insurer's offices in this state during the calendar year, but with respect to the office apportioned to the square foot area occupied by the insured, whether the ad valorem taxes are paid directly by the insurer or in the form of rent to a third-party landlord.
- (4) All license fees and taxes paid to any county in this state during the calendar year for the privilege of engaging in the business of insurance within the county.
- (5) All expenses of examination of the insurer by the commissioner paid during the calendar year.
- (6) Sixty percent of the franchise or privilege taxes paid by the insurer to the State of Alabama for the calendar year....

The Company must contact the Alabama Department of Insurance to get the aforementioned issue resolved including paying back the excess credit taken by the Company.

REINSURANCE

Reinsurance Assumed

The Company did not assume any business during the period covered by the examination.

Reinsurance Ceded

The Company's ceded reinsurance program consisted of treaty reinsurance agreements designed to reinsure certain portions of the policy limits above the Company's desired loss retention and reduce its net exposure on any one risk. The following reinsurance treaties were in-force at December 31, 2012:

1. First Excess Casualty Reinsurance
2. Excess Umbrella.

The treaties were negotiated through Guy Carpenter & Company, LLC and included a number of authorized and unauthorized reinsurers. The participating reinsurers are listed below:

<u>Reinsurers</u>	<u>Excess Casualty</u>	<u>Excess Umbrella</u>
<i>Domestic, European & Bermuda Reinsurance Market</i>		
• American Safety Reinsurance Ltd.	6.00%	3.50%
• Catlin Insurance Ltd.	7.50%	6.00%
• Hannover Re Group	10.00%	7.00%
• Scor Re	<u>7.50%</u>	<u>6.00%</u>
<i>Subtotal</i>	<u>31.00%</u>	<u>22.50%</u>
<i>London Markets Through Tower Watson</i>		
• Aspen Insurance UK Ltd.	17.00%	17.00%
• <u>Lloyd's Underwriters</u>		
○ FDY Syndicate #0435	7.50%	8.00%
○ STN Syndicate #0566	5.00%	5.00%
○ BAR Syndicate #1955	4.50%	2.25%
○ AML Syndicate #2001	5.00%	2.50%

○ AML (Bermuda)	2.50%	1.50%
○ SJC Syndicate #2003	13.00%	12.50%
○ MAP Syndicate #2791	10.00%	14.50%
○ ARK Syndicate #4020	4.50%	4.75%
○ LIB Syndicate #4472	<u>0.00%</u>	<u>7.00%</u>
	<i>Subtotal</i>	<i>69.00%</i>
Total	<u>100.00%</u>	<u>97.50%</u>

First Excess Casualty Reinsurance Contract

The reinsurance contract was effective July 1, 2012, and remained in-force until July 1, 2013. The contract indemnifies the Company of the liability resulting from losses under policies written or renewed by the Company during the term of the contract and policies classified as Hospital Professional Liability, Allied Healthcare, General Liability, Physicians and Surgeons Liability, and related Health Care business.

The contract will provide coverage of \$750,000 of the ultimate net loss in excess of the Company's retention of \$250,000 each insured, each and every occurrence or claim made. In addition to the ultimate net loss, the reinsurer will also pay its proportional share of the loss adjustment expenses in proportion to the Company's total loss.

According to the terms of the contract, within thirty days after the end of each calendar quarter, the Company is required to pay a provisional premium on collected net written premium. The provisional premium is adjusted for loss experience and the adjusted premium is calculated after the end of each twelve month period until all reported losses during the term of the contract are finally settled. The adjusted premium will not exceed a negotiated percentage of the Company's net written premium.

Excess Umbrella Reinsurance Contract

The reinsurance contract was effective July 1, 2012, and remained in-force until July 1, 2013. The contract indemnifies the Company of the liability in excess of \$1,000,000 limit provided by the First Excess Casualty Reinsurance Contract. The contract includes coverages which are related to the classes of business reinsured by the First Excess Casualty Reinsurance Contract and business classified under Excess Umbrella Liability policies.

If an insured elects to carry excess limits greater than the \$1,000,000 under Coverage A, the reinsurers are responsible for up to \$10,000,000 of the ultimate net loss in excess of the Company's maximum retention of \$1,000,000 each insured, each and

every occurrence or claim made, and under Coverage B, the reinsurers will be responsible for \$10,000,000 of the ultimate net loss each insured, each and every occurrence of claim made, in excess of \$1,000,000 and \$13,000,000 ultimate net loss in the aggregate as respects all claims made in excess of \$3,000,000. The Company cedes 97.5% of the liabilities under the contract, retaining 2.5% for its own account. In addition to the ultimate net loss, the reinsurer will also pay its share of the loss adjustment expenses in proportion to the Company's total loss.

The reinsurance premium payable for Coverage A is calculated in accordance with the reinsurance premium factors which are billed by layers, with additional premiums equal to 10% for Coverage B. The reinsurance premiums payable for General Liability and Automobile exposures are rated in accordance with the Company's Underwriting Manual of Rates and Rules. The Company will receive a 15% ceding commission on all premiums ceded by the Company with an allowance payable to the reinsurer for all return premiums at the same rate.

The reinsurance treaties have the Insolvency clause, with standard insolvency language without cut-through provisions, and the Intermediary clause, with standard intermediary credit risk assumption language.

The review of Schedule F - Part 3 - Ceded Reinsurance as of December 31, 2012 indicated that the Company listed AML Bermuda Branch of Amlin AG under Authorized - Other Non - US Insurers instead of unauthorized reinsurers.

The Company should complete Schedule F - Part 3 in accordance with the guidance provided by the NAIC Annual Statement Instructions.

FINANCIAL STATEMENT INDEX

The Financial statements included in this report were prepared on the basis of the Company's records, and the valuation and determinations made during the examination of the Company at December 31, 2012. Amounts shown in the comparative statements for the years 2008, 2009, 2010, and 2011 were compiled from Company copies of the filed Annual Statements. The statements are presented in the following order:

	Page
Statement of Assets, Liabilities, Surplus and Other Funds (Assets)	31
Statement of Assets, Liabilities, Surplus and Other Funds (Liabilities)	32
Statement of Income	33
Reconciliation of the Capital and Surplus Account	34

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

COASTAL INSURANCE RISK RETENTION GROUP, INC.
STATEMENT OF ASSETS
For the Year Ended December 31, 2012

	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
ASSETS			
Bonds (Note 1)	\$ 31,915,610		\$ 31,915,610
Stocks:			
Common stocks	990,712	\$ 80,530	910,182
Cash (\$2,008,398, Sch. E-Part 1), cash equivalents (\$11,999,600 Sch. E – Part 2) & short-term investments (\$1,131,734 Sch. DA)	<u>15,139,732</u>	<u>-0-</u>	<u>15,139,732</u>
Subtotals, cash and invested assets	\$ <u>48,046,054</u>	\$ <u>80,530</u>	\$ <u>47,965,524</u>
Investment income due and accrued	\$ 314,296		\$ 314,296
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection	92,805		92,805
Deferred premiums, agents' balances and installments booked but deferred and not yet due (Note 2)	576,421		576,421
Reinsurance:			
Amounts recoverable from reinsurers	85,901	49,511	36,390
Current federal and foreign income tax recoverable and interest thereon	10,367		10,367
Net deferred tax asset	1,335,924	689,604	646,320
Electronic data processing equipment and software (Note 4)	39,984	13,025	26,959
Furniture and equipment, including health care delivery assets	846,769	846,769	-0-
Receivables from parent, subsidiaries and affiliates	170,105	62,853	107,252
Aggregate write-ins for other than invested assets:			
Cash value of corporate owned life insurance	615,466		615,466
Officers annuity	137,700	137,700	
Prepaid expenses	79,700	79,700	
Accounts receivable – hospital deductible	74,811	6,614	68,197
Accounts receivable – premium tax (Note 3)	30,455		30,455
Accounts receivable - other	14,974	14,960	14
TOTALS	\$ <u>52,471,732</u>	\$ <u>1,981,266</u>	\$ <u>50,490,466</u>

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.**

COASTAL INSURANCE RISK RETENTION GROUP, INC.
STATEMENT OF LIABILITIES, CAPITAL AND SURPLUS
For the Year Ended December 31, 2012

LIABILITIES

Losses	\$ 9,147,337
Loss adjustment expenses	6,678,267
Commissions payable, contingent commissions and other similar charges	181
Other expenses (Note 4)	1,671,432
Unearned premiums	729,432
Advance premium	8,501
Dividends declared and unpaid:	
Stockholders	4,903,103
Policyholders (Note 5)	5,100,000
Ceded reinsurance premiums payable	2,613,019
Remittances and items not allocated (Note 2)	0
Aggregate write-ins for liabilities (Note 4)	<u>1,625,010</u>
Total Liabilities	\$ <u>32,476,282</u>
Common capital stock	507,297
Aggregate write-ins for other than special surplus funds	
Gross paid in and contributed surplus	11,790,094
Unassigned funds (surplus) (Note 6)	9,272,063
Less treasury stock, at cost:	
393,858 shares common (value included in Line 30 \$189,916)	<u>3,555,270</u>
Surplus as regards policyholders	\$ <u>18,014,184</u>
TOTAL LIABILITIES, CAPITAL AND SURPLUS	\$ <u>50,490,466</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.

COASTAL INSURANCE RISK RETENTION GROUP, INC
STATEMENT OF INCOME
For the Years Ended December 31, 2012, 2011, 2010, 2009 and 2008

<u>Underwriting Income</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Premiums earned	\$ 7,361,496	\$ 6,867,696	\$ 6,052,197	\$ 10,617,965	\$ 6,530,225
<u>Deductions:</u>					
Losses incurred	- 395,251	- 1,135,918	1,040,478	814,296	817,327
Loss adjustment expenses incurred	- 206,048	3,398,475	1,047,241	- 215,233	3,071,123
Other underwriting expenses incurred	<u>3,097,252</u>	<u>2,453,840</u>	<u>2,482,628</u>	<u>2,624,908</u>	<u>2,553,262</u>
Total underwriting deductions	\$ <u>2,495,953</u>	\$ <u>4,716,397</u>	\$ <u>4,570,347</u>	\$ <u>3,223,971</u>	\$ <u>6,441,712</u>
Net underwriting gain (loss)	\$ <u>4,865,543</u>	\$ <u>2,151,299</u>	\$ <u>1,481,850</u>	\$ <u>7,393,994</u>	\$ <u>88,513</u>
<u>Investment Income</u>					
Net investment income earned	\$ 1,184,371	\$ 1,444,411	\$ 1,545,671	\$ 1,571,082	\$ 1,581,033
Net realized capital gains (losses)	<u>223,335</u>	<u>758,454</u>	<u>622,973</u>	<u>-1,250,033</u>	- 554,292
Net investment gain	\$ <u>1,407,706</u>	\$ <u>2,202,865</u>	\$ <u>2,168,644</u>	\$ <u>321,049</u>	\$ <u>1,026,741</u>
<u>Other Income</u>					
Aggregate write-ins for miscellaneous income	\$ <u>929</u>	\$ <u>12,756</u>	\$ <u>27,011</u>	\$ <u>2,065</u>	\$ <u>1,362</u>
Total other income	\$ <u>929</u>	\$ <u>12,756</u>	\$ <u>27,011</u>	\$ <u>2,065</u>	\$ <u>1,362</u>
Net income before dividends to policyholders, after capital gains tax and before all other federal & foreign income taxes	\$ <u>6,274,178</u>	\$ <u>4,366,920</u>	\$ <u>3,677,505</u>	\$ <u>7,717,108</u>	\$ <u>1,116,616</u>
Dividends to policyholders	<u>5,100,000</u>	<u>-0-</u>	<u>500,000</u>	<u>-0-</u>	<u>-0-</u>
Net income after dividends to policyholders, after capital gains tax and before all other federal & foreign income taxes	\$ 1,174,178	\$ 4,366,920	\$ 3,177,505	\$ 7,717,108	\$ 1,116,616
Federal and foreign income taxes incurred	<u>241,436</u>	<u>1,220,348</u>	<u>691,227</u>	<u>2,730,475</u>	<u>373,083</u>
NET INCOME	\$ <u>932,742</u>	\$ <u>3,146,572</u>	\$ <u>2,486,278</u>	\$ <u>4,986,633</u>	\$ <u>743,533</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

COASTAL INSURANCE RISK RETENTION GROUP, INC
STATEMENT OF CHANGES IN CAPITAL AND SURPLUS
For the Years Ended December 31, 2012, 2011, 2010, 2009 and 2008

Capital and Surplus Account	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Surplus as regards policyholders, December 31, prior year	\$ 22,851,191	\$ 20,581,273	\$ 18,078,157	\$ 11,090,614	\$ 12,321,730
Net income (loss)	932,742	3,146,572	2,486,278	4,986,633	743,533
Change in net unrealized capital gains (losses)	2,798	-395,392	266,722	1,492,846	-1,259,005
Change in net deferred income tax	133,052	-142,910	67,116	-9,779	74,070
Change in nonadmitted assets	-980,376	-148,303	-72,633	803,145	-393,782
Change in provision for reinsurance	96,087	-37,419	-50,436	-8,232	
Cumulative effect of changes in accounting principles	137,843	-0-			
Capital changes: Paid in	20	5	11	440	25
Surplus adjustments: Paid in	19,830	4,735	12,398		24,595
Dividends to stockholders	-4,903,103	-0-			-333,182
Change in treasury stock	-275,900	-157,370	-206,340	-277,510	-87,370
Change in surplus as regards policyholders for the year	\$ <u>-4,837,007</u>	\$ <u>2,269,918</u>	\$ <u>2,503,116</u>	\$ <u>6,987,543</u>	-1,231,116
Surplus as regards policyholders, December 31, current year	\$ <u>18,014,184</u>	\$ <u>22,851,191</u>	\$ <u>20,581,273</u>	\$ <u>18,078,157</u>	\$ <u>11,090,614</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.

NOTES TO FINANCIAL STATEMENTS

Note 1 - Bonds

\$ 31,915,610

The captioned amount is the same as reported in the Company's 2012 Annual Statement.

The review of Schedule D - Part 1 indicated that Company's bond portfolio included a long-term certificate of deposit in the amount of \$265,049 with ServisFirst Bank an FDIC-insured bank. The Company reported the certificate of deposit as a bond with a designation of 1. The Kroll Bond Rating Agency an NAIC ARO, rated ServisFirst Bank with a "C" rating in March 2011, which is an NAIC designation equivalent of 6. The Company did not comply with Part Two, Section 4(f) of the Purposes and Procedures Manual of the NAIC Securities Valuation Office, which states:

(i) A Certificate of Deposit that meets the definition of a bond in SSAP No. 26 is exempt from filing with the SVO if it is issued by a bank whose deposits are fully insured by the FDIC and is for an amount: (A) Equal to or less than the maximum FDIC deposit insurance, provided however, that the insurer's aggregate deposits with the bank are equal to or less than the maximum FDIC insurance limit or, (B) Greater than the maximum FDIC deposit insurance provided the issuing bank is rated and monitored by an NAIC ARO, (ii) The NAIC Designation for Certificates of Deposit described in (f) (i) (A) above shall be NAIC 1. The NAIC Designation for Certificates of Deposit described in (f) (i) (B) above shall be derived by application of the filing exempt conversion process discussed in Section 4(d) (i)(A) of this Part above and in Part One, Section 3 (e) of this Manual.

The Company reported Hewlett-Packard Company bond with a rating of 1FE. Company management provided documentation showing that Moody's rating agency an NAIC ARO had a Baa1 rating which is equivalent to 2FE. The Company did not comply with Part Two, Section 4(d)(i)(A) of the Purposes and Procedures Manual of the NAIC Securities Valuation Office, which states:

Rated and monitored by one NAIC CRP will be assigned the equivalent NAIC Designation. If rated and monitored by two NAIC CRPs, then the lowest rating will be assigned. In case of a security rated and monitored by three or more NAIC CRPs, the NAIC CRP's ratings for a security will be ordered according to their NAIC equivalents and the rating falling second lowest will be selected, even if that rating is equal to that of the first lowest.

<u>Note 2 - Deferred premiums, agents' balances and</u>	
<u>installment booked but deferred and not yet due</u>	<u>\$ 576,421</u>
<u>Remittances and items not allocated</u>	<u>\$ -0-</u>

The captioned \$576,421 is the same as reported by the Company in its 2012 Annual Statement, but \$15,440 less than that determined by the examination. The captioned \$0 is the same as reported by the Company in its 2012 Annual Statement, but \$15,440 less than that determined by the examination. No changes were made to the financial statements because the error was determined to be a reclassifying error.

The examination determined that the premiums received in the amount of \$15,440 were not applied to particular policies at December 31, 2012. The amount was netted against *Deferred premiums, agents' balances and installments booked but deferred and not yet due*, instead of recording the amount under *Remittances and items not allocated*. The accounting guidance provided by SSAP No. 67, paragraph 9, of the NAIC Accounting Practices and Procedures Manual, states in pertinent parts:

Remittances and Items Not Allocated: Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts....

The guidance provided by the NAIC Annual Statement Instructions, which states:

Line 15 - Remittances and Items Not allocated
 Report a liability for cash receipts that the insurer cannot identify for a specific purpose or, for other reasons, the insurer cannot apply to a specific account when received. Refer to SSAP No. 67, Other Liabilities, for accounting guidance.
 Include: Items in suspense.

<u>Note 3 - Aggregate write-ins for other than</u>	
<u>Invested assets</u>	<u>\$ 714,132</u>

The captioned amount is the same as reported by the Company in its 2012 Annual Statement, but \$30,455 more than the \$683,677 determined by the examination. Due to immateriality no changes were made to the financial statements.

The review of the accounts and records indicated that the Company admitted prepaid premium taxes to the Alabama Department of Insurance, which was not in accordance with the guidance provided by SSAP No. 29, paragraph 2 of the NAIC Accounting Practices and Procedures Manual, which states:

A prepaid expense is an amount which has been paid in advance of receiving future economic benefits anticipated by the payment. Prepaid expenses generally meet the definition of assets in SSAP No. 4 – Assets and Nonadmitted Assets (SSAP No. 4). Such expenditures also meet the criteria defining nonadmitted assets as specified in SSAP No. 4 and SSAP No. 87 – Capitalization Policy, an Amendment to SSAP Nos. 4, 19, 29, and 73, (SSAP No. 87), (i.e., the assets are not readily available to satisfy policyholder obligations). Prepaid expenses shall be reported as nonadmitted assets and charged against unassigned funds (surplus).

Note 4 – Other expenses	\$ 1,671,432
<u>Aggregate write-ins for liabilities</u>	\$ 1,625,010
<u>Electronic data processing equipment & Software</u>	\$ 26,959

The captioned amounts are the same as reported by the Company in its 2012 Annual Statement, but the \$1,671,432 liability is \$92,569 less than the \$1,764,001, and the \$1,625,010 liability is \$32,431 less than the \$1,657,441, and the \$26,959 asset are the same as determined by the examination. See the following table:

Account Description	Other Expenses	Aggregate Write-ins for liabilities	Assets - EDP
Account balances per 2012 A/S	\$ 1,671,432	\$ 1,625,010	\$26,959
Uncashed Checks	-32,431	32,431	
Payable for non-operating system software	125,000	-0-	125,000
Non-operating software (nonadmit asset)	<u>-0-</u>	<u>-0-</u>	<u>-125,000</u>
Account balance per examination	\$ 1,764,001	\$ 1,657,441	\$ 26,959

The review of the Company's accounting records was performed to search for unrecorded expense accruals as of December 31, 2012. The examination determined that a payment for \$125,000 for purchases related to non-operating system software was not recorded on the books as of December 31, 2012. The Company was not in compliance with SSAP No. 5R, paragraph 3, of the NAIC Accounting Practices and Procedures Manual, which states:

A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statement when incurred.

The cost of computer software is reported as an asset under Electronic data processing equipment and software. Non-operating system software are nonadmitted assets in accordance with the guidance provided by SSAP No. 16R, paragraph 2 of the NAIC Accounting Practices and Procedures Manual, which states:

EDP equipment and software generally meet the definition of assets established in SSAP No. 4- Assets and Nonadmitted Assets. EDP equipment and operating system software are admitted assets to the extent they conform to the requirements of this statement. Nonoperating system software are nonadmitted assets.

Since the nonoperating system software is a nonadmitted asset, there will be an impact on the surplus in the amount of \$125,000. However, due to immateriality no changes will be made to the financial statements.

The examination determined that the Company included \$32,431 amount in uncashed checks pending escheatment to a state under *Other expenses* instead of *Aggregate write-ins for liabilities*.

The Company did not comply with the NAIC Annual Statement Instructions, which states:

Details of Write-ins Aggregated at Line 25 for Liabilities...

This schedule is for other liability items not specifically provided for.

Include: Uncashed drafts and checks that are pending escheatment to a state...

Note 5 - Dividends declared and unpaid: Stockholders**\$ 4,903,103**

The captioned amount is the same as reported by the Company in its 2012 Annual Statement, but \$158,080 less than that determined by the examination. Due to immateriality, no changes were made to the 2012 Annual Statement.

The review of the accounts and records indicated that the liability for Dividends declared and unpaid to stockholders was understated by \$158,080. The Class B shareholders records indicated that the Company calculated the dividends on 90,659 shares when the number of shares held by Class B shareholders (physicians) as of January 10, 2013, equaled 117,227 for a difference of 26,568 shares. The 26,568 shares multiplied by the dividend declared by the Board of Directors of \$5.95 per share totaled \$158,080. Based on the information available to the Company before the issuance of the statutory financial statements the liability for Dividends declared and unpaid to stockholders should have been \$5,061,183. The Company did not comply with the guidance provided by SSAP No. 5, paragraph 7, of the NAIC Accounting Practices and Procedures Manual, which states:

An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

- a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
- b. The amount of loss can be reasonably estimated.

Note 6 – Unassigned funds (surplus)**\$ 9,272,063**

The captioned amount is the same as reported by the Company in its 2012 Annual Statement. No changes were made to the Company's financial statements in this report.

CONTINGENT LIABILITIES AND PENDING LITIGATION

The examination of contingent liabilities and pending litigation included the review of the Company's statutory financial statement disclosures, minutes of the Board of Directors meetings, pending claims and the Letter of Representation. There were no material unreported contingencies that would have an impact on the Company's financials.

The legal confirmations obtained by the external auditor from law firms representing the Company were reviewed by the examiners. This review did not disclose items that would have a material effect on the Company's financial position in the event of an adverse outcome.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

Transactions and Agreements with Affiliates – Page 11

It is again recommended that the Company maintain complete records of all actions taken by the Board of Directors, including documenting the approval of the management service agreements by the Board of Directors in the minutes of the Board of Directors meetings as required by ALA. CODE § 10-2B-16.01(a) (1975), which states:

A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.

Deferred premiums, agents' balances and installments booked but deferred and not yet due - Page 36

Remittances and items not allocated - Page 36

It is again recommended that the Company report premium receipts which are not applied to a particular policy or receipts that cannot be identified with any particular policy under *Remittances and items not allocated* in accordance with the guidance provided by SSAP No. 67, paragraph 9, of the NAIC Accounting Practices and Procedures Manual, which states:

Remittances and Items Not Allocated: Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts....

and as required by NAIC Annual Statement Instructions, which states:

Line 15 - Remittances and Items Not allocated

Report a liability for cash receipts that the insurer cannot identify for a specific purpose or, for other reasons, the insurer cannot apply to a specific account when received. Refer to SSAP No. 67, Other Liabilities, for accounting guidance.

Include: items in suspense.

COMMENTS AND RECOMMENDATIONS

Conflict of Interest – Page 7

It is recommended that the Company maintain evidence of its conflict of interest statements signed by its officers, directors, and responsible employees as required by its own Conflict of Interest policy in order to comply with ALA. CODE § 27-27-29 (a) (1975), which states:

Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep in this state complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.

Transactions and Agreements with Affiliates – Page 11

It is recommended that the Company not enter into any transactions with affiliated parties without prior approval of the management services agreement by the Alabama Department of Insurance as required by ALA. CODE § 27-29-5 (b) (1975), which states:

The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period....

(4) All management agreements, service contracts, and all cost-sharing arrangements;

It is recommended that the Company maintain complete records of all actions taken by the Board of Directors, including documenting the approval of the management service agreements by the Board of Directors in the minutes of the Board of Directors meetings as required by ALA. CODE § 10-2B-16.01(a) (1975), which states:

A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.

It is recommended that the management service agreements between the Company and CIS and the Company and HIPSO provide for timely settlement of amount owed, with a specified due date to consider the receivable as admitted asset as required by SSAP No. 96, paragraph 2, of the NAIC Accounting Practices and Procedures Manual, which states:

Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted, except to the extent this is specifically addressed by other statements of statutory accounting principles (SSAPs). If the due date is not addressed by the written agreement, any uncollected receivable is nonadmitted

Section 1033 of Title 18 of the U.S. CODE – Page 18

It is recommended that the Company establish an internal procedure to perform background checks on employees on an ongoing basis as required by ALA. ADMIN. CODE 482-1-146-.11(2009), which states:

Responsibilities of Section § 1033 of Title 18 of the U.S. CODE; Insurers.

(1) A Section 1033 insurer subject to the Commissioner's examination authority shall have and apply the following:

(a) An internal procedure for determining, by means of background checks or investigations or otherwise, whether applicants for employment or individuals with whom the insurer intends to contract for activities in the business of insurance, whether or not in a capacity requiring a license, have a felony conviction for a Section 1033 offense.

(b) An internal procedure after initial employment or contracting, applied on a periodic basis, to ascertain the existence of a felony conviction for a Section 1033 offense.

(c) An internal procedure for assuring that affected employees or individual contractors have obtained and hold any required Section 1033 consent during the period of employment or contracting.

(2) Such procedures shall be maintained in a format capable of being furnished to the Department as part of the examination process or otherwise as requested by the Department.

(3) As part of an examination or otherwise, the Department may determine the existence of such procedures, whether and how they are being followed, and the effectiveness of the procedures.

It is recommended that the Company maintain the copies of the background checks performed on its directors, officers and employees and provide the same to the examiners as required by ALA. CODE § 27-27-29 (a) (1975), which states:

Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep in this state complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.

Compliance with Agents' Licensing Requirements - Page 22

It is recommended that the Company notify the Alabama Department of insurance within thirty days following the effective date of termination of the producer as required by ALA. CODE § 27-7-30 (e) (1975), which states:

Subject to the producer's contract rights, if any, an insurer or authorized representative of the insurer may terminate a producer's appointment at any time. An insurer or authorized representative of the insurer that terminates the appointment, employment, or contract with a producer for any reason shall within 30 days following the effective date of the termination, using a format prescribed by the commissioner, give notice of the termination to the commissioner.

It is recommended that the Company provide the terminated producers with the termination notice as required by ALA. CODE § 27-7-30.1(a) (1975), which states:

- (a) Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to

the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier.

Premium Taxes – Page 26

It is recommended that the Company review the Statute to confirm the kinds of deductions allowed by ALA. CODE § 27-4A-3 (c) (1975), which states:

The tax imposed by this section shall be subject to credit and deduction of the full amount, with 25 percent of the full amount paid, or estimated to be paid, being credited or deducted on each quarterly payment date, for all of the following:

- (1) Ad valorem property taxes paid by an insurer on any building and real estate in this state which is owned and occupied, in whole or in part, by the insurer for the full period of the tax year as its principal office in the state of Alabama.
- (2) All ad valorem taxes paid by an insurer during the calendar year on any other real estate and improvements thereon in this state which is owned and at least 50 percent occupied by the insurer for the full period of the tax year.
- (3) Ad valorem property taxes paid by an insurer on the insurer's offices in this state during the calendar year, but with respect to the office apportioned to the square foot area occupied by the insured, whether the ad valorem taxes are paid directly by the insurer or in the form of rent to a third-party landlord.
- (4) All license fees and taxes paid to any county in this state during the calendar year for the privilege of engaging in the business of insurance within the county.
- (5) All expenses of examination of the insurer by the commissioner paid during the calendar year.
- (6) Sixty percent of the franchise or privilege taxes paid by the insurer to the State of Alabama for the calendar year....

Reinsurance Ceded – Page 27

It is recommended that the Company not list unauthorized reinsurers under authorized reinsurers in Schedule F- Part 3 of its Annual Statement.

Bonds – Page 35

It is recommended that long-term certificate of deposits from a bank which is greater than the maximum FDIC deposit insurance limit when rated by an NAIC ARO should follow the filing exempt conversion process as required by Part Two Section 4(f) of the Purposes and Procedures Manual of the NAIC Securities Valuation Office, which states:

(i) A Certificate of Deposit that meets the definition of a bond in SSAP No. 26 is exempt from filing with the SVO if it is issued by a bank whose deposits are fully insured by the FDIC and is for an amount: (A) Equal to or less than the maximum FDIC deposit insurance, provided however, that the insurer's aggregate deposits with the bank are equal to or less than the maximum FDIC insurance limit or, (B) Greater than the maximum FDIC deposit insurance provided the issuing bank is rated and monitored by an NAIC ARO, (ii) The NAIC Designation for Certificates of Deposit described in (f) (i) (A) above shall be NAIC 1. The NAIC Designation for Certificates of Deposit described in (f) (i) (B) above shall be derived by application of the filing exempt conversion process discussed in Section 4(d) (i)(A) of this Part above and in Part One, Section 3 (e) of this Manual.

It is recommended that the Company follow the filing exempt conversion process for bonds which are rated by an NAIC ARO and comply with Part Two, Section 4(d)(i)(A) of the Purposes and Procedures Manual of the NAIC Securities Valuation Office, which states:

Rated and monitored by one NAIC CRP will be assigned the equivalent NAIC Designation. If rated and monitored by two NAIC CRPs, then the lowest rating will be assigned. In case of a security rated and monitored by three or more NAIC CRPs, the NAIC CRP's ratings for a security will be ordered according to their NAIC equivalents and the rating falling second lowest will be selected, even if that rating is equal to that of the first lowest.

Deferred premiums, agents' balances and installments booked but deferred and not yet due - Page 36

Remittances and items not allocated - Page 36

It is recommended that premium receipts which are not applied to a particular policy or receipts that cannot be identified with any particular policy should be

recorded under *Remittances and items not allocated* in accordance with the guidance provided by SSAP No. 67, paragraph 9, of the NAIC Accounting Practices and Procedures Manual, which states:

Remittances and Items Not Allocated: Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts....

The guidance provided by the NAIC Annual Statement Instructions, which states:

Line 15 - Remittances and Items Not allocated

Report a liability for cash receipts that the insurer cannot identify for a specific purpose or, for other reasons, the insurer cannot apply to a specific account when received. Refer to SSAP No. 67, Other Liabilities, for accounting guidance.

Include: items in suspense.

Aggregate write-ins for other than invested assets – Page 36

It is recommended that the Company nonadmit prepaid expenses not readily available to satisfy policyholder obligations and comply with SSAP No. 29, paragraph 2 of the NAIC Accounting Practices and Procedures Manual, which states:

A prepaid expense is an amount which has been paid in advance of receiving future economic benefits anticipated by the payment. Prepaid expenses generally meet the definition of assets in SSAP No. 4 – Assets and Nonadmitted Assets (SSAP No. 4). Such expenditure also meet the criteria defining nonadmitted assets as specified in SSAP No. 4 and SSAP No. 87 – Capitalization Policy, an Amendment to SSAP Nos. 4, 19, 29, and 73, (SSAP No. 87), (i.e., the assets are not readily available to satisfy policyholder obligations). Prepaid expenses shall be reported as nonadmitted assets and charged against unassigned funds (surplus).

Other expenses – Page 37

Aggregate write-ins for liabilities – Page 37

Electronic data processing equipment and software – Page 37

It is recommended that the Company include all expenses in accordance with the guidance provided by SSAP No. 5R, paragraph 3, of the NAIC Accounting Practices and Procedures Manual, which states:

A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statement when incurred.

It is recommended that the Company report uncashed checks that are pending escheatment to states and deferred compensation for officers on *Aggregate write-ins for liabilities* line item on page 3 of the Annual Statement in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

Details of Write-ins Aggregated at Line 25 for Liabilities...
This schedule is for other liability items not specifically provided for.
Include: Uncashed drafts and checks that are pending escheatment to a state...

Dividends declared and unpaid: Stockholders – Page 39

It is recommended that the Company establish a liability for dividend to stockholders based on the resolution passed by the Board of Directors and comply with the guidance provided by SSAP No. 5, paragraph 7, of the NAIC Accounting Practices and Procedures Manual, which states:

An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

- a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
- b. The amount of loss can be reasonably estimated.

SUBSEQUENT EVENTS

The Articles of Incorporation was amended effective March 21, 2013. The changes to the Articles of Incorporation included but were not limited to the following:

Name of the Company

The name of the Company was changed to Coastal Insurance Company Inc.

Number of Authorized Shares

Article II was deleted in its entirety and the following was substituted:

A. Number of Authorized Shares. The total number of shares of common stock authorized to be issued is 26,250,000 (the “Common Stock”) of which 20,000,000 shares shall be designated as Base Common Stock (the “Base Common Stock”), and 5,000,000 shares shall be designated as Class A Common Stock (the Class a Common Stock”), 1,000,000 shares shall be designated as Class D Shares (the “Class D Shares”) and 250,000 shares shall be designated as Class E Shares (the “Class E Shares”). The total number of preferred stock authorized to be issued is 5,000,000 which shall be designated as Class A Preferred Stock (the “Class A Preferred Stock”).

B. Common Stock. The authorized Common Stock shall comprise four classes of Common Stock designated respectively: Base Common Stock, Class A Common Stock, Class D Common Stock and Class E Common Stock. The par value of all shares of Common Stock is \$0.1 per share. Subject to the prior rights of holders of all other classes of stock, at the time outstanding, having superior rights to dividends, the holders of Common Stock shall be entitled to receive, out of any assets of the Corporation legally available therefore, such dividends as may be declared from time to time by the Board of Directors. All classes of Common Stock Shall vote as one voting group except as required by law. Except as otherwise provided below in this paragraph, all shares of Common Stock will be identical and will entitle the holders thereof to the same rights and privileges....

Management Agreement with Healthcare Improvement Patient Safety Organization, Inc. (HIPSO).

The Company entered into a Management Agreement with Healthcare Improvement Patient Safety Organization Inc. (HIPSO), a 100% owned affiliated Company, on January 1, 2013. The following was determined - See caption Transaction and Agreements with Affiliates – Page 11:

1. The Form D filing was not made in a timely manner.
2. The minutes of the Board of Directors meeting did not document the approval of the management services agreement between the Company and HIPSO.
3. The management services agreement did not provide for timely settlement of amount owed to the Company as required by SSAP No. 96, paragraph 2, of the NAIC Accounting Practices and Procedures Manual.

CONCLUSION

Acknowledgment is hereby made of the courteous cooperation extended by the officers and employees of the Company during the course of this examination.

The customary insurance examination procedures, as recommended by the NAIC have been followed to the extent appropriate in connection with the verification and valuation of assets and determination of liabilities set forth in this report.

In addition to the undersigned, Charles Turner, CISA; Jerry Hyche, AIE, FLMI and Sheliah Jones and Mr. Brent Sallay, FCAS, MAAA, consulting actuary with Taylor-Walker & Associates, Inc. represented the Alabama Department of Insurance and participated in the examination of the Company.

Respectfully submitted,

Francis Blase Abreo

Blase Abreo, CFE
Examiner-in-charge
Alabama Department of Insurance