

**STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA**

REPORT ON EXAMINATION

OF

COASTAL INSURANCE RISK RETENTION GROUP, INC.

Montgomery, Alabama

AS OF

DECEMBER 31, 2007

Participation:

ALABAMA
Southeastern Zone, NAIC

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AFFIDAVIT

**STATE OF ALABAMA
COUNTY OF MONTGOMERY**

Blase Francis Abreo, being first duly sworn, upon his oath deposes and says:

THAT he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

THAT an examination was made of the affairs and financial condition of *COASTAL INSURANCE RISK RETENTION GROUP, INC.* for the period of April 3, 2003 through December 31, 2007;

THAT the following 52 pages constitute the report therein to the Commissioner of Insurance of the State of Alabama; and

THAT the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.

Francis Blase Abreo
Blase Francis Abreo, CFE

Subscribed and sworn to before the undersigned authority this 14th day of November 2008.

Kimberly D. Robinson
(Signature of Notary Public)

Kimberly D. Robinson Notary Public
(Print Name)

in and for the State of Alabama

My Commission expires 5-6-09

SCOPE OF EXAMINATION

A full scope financial and market conduct examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the *Alabama Insurance Code* and the regulations and bulletins of the State of Alabama Department of Insurance; and in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

An organizational examination of the Company as of April 3, 2003 was concluded on April 29, 2003. The current examination covers the intervening period from April 3, 2003, through December 31, 2007, and was conducted by examiners from the Alabama Department of Insurance. Where deemed appropriate, transactions subsequent to December 31, 2007, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2007. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the *Alabama Insurance Code* and the Insurance Department's rules and regulations, or other insurance laws or rules, or which were deemed by the examiner to require comments and/or recommendations.

Company office copies of the filed Annual Statements for the years 2003 through 2007 were compared with or reconciled to account balances with respect to ledger items.

The market conduct phase of the examination consisted of a review of the Company's territory, plan of operation, complaint handling, marketing and sales, producer licensing, policyholder service, underwriting and rating, claims payments and practices, and compliance with privacy policies and practices.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attests to have valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2007. A signed letter of representation was also obtained at the conclusion of the examination whereby management represented that, through the date of this examination report, complete

disclosure was made to the examiners regarding asset and liability valuation, the financial position of the Company, and contingent liabilities.

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. Articles of Incorporation, ARTICLE IV, states:

“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...”

The Company provides the following insurance coverages to hospitals and physicians in the state of Alabama:

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

The 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.”

At December 31, 2003, Common capital stock was \$505,170, Gross paid in and contributed surplus was \$9,664,660, and Unassigned funds (surplus) were \$(1,615,684). At December 31, 2007, the Common capital stock was \$507,235, Gross paid in and contributed surplus was \$11,728,094, and Unassigned funds (surplus) were \$2,637,181. Treasury stock was \$2,550,780.

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.”

The Common capital stock issued and outstanding at December 31, 2007:

<u>Class</u>	<u>Par Value</u>	<u>Shares authorized</u>	<u>Issued</u>	<u>Outstanding (O/S)</u>	<u>Treasury Stock (T/S)</u>	<u>O/S including T/S</u>
A	\$1.00	500,000	500,000	312,144	187,856	\$500,000
B	0.01	2,000,000	669,035	601,894	67,141	6,690
C	0.01	1,000,000	51,773	51,773	0	518
D	0.01	1,000,000	2,466	2,385	81	24
E	0.01	250,000	260	260	0	3
Common capital stock						\$507,235

Coastal Insurance Services, Inc. (CIS) is a wholly owned subsidiary of the Company. The Company has entered into a Management Services Agreement with CIS. The Company will provide CIS with management services for a fee. The Company provides management services to Healthcare Workers’ Compensation Self Insurance Funds (HWCF) for fees. HWCF is listed on Schedule Y – Part 1 and Part 2.

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, 2007, there were 194 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, 2007.

<u>Name and Residence</u>	<u>Principal Occupation</u>
Billy Albert Mason Spanish Fort, Alabama	President, Springhill Memorial Hospital Mobile, Alabama
Robert Curtis Chapman Cropwell, Alabama	Retired CEO of Eastern Health System, Inc. Birmingham, Alabama
Bryan Neal Kindred Tuscaloosa, Alabama	President & CEO, DCH Health System Tuscaloosa, Alabama
Frank Willard Harris Highlands, North Carolina	Retired CEO, Russell Medical Center Alexander City, Alabama
Jennie Rogers Rhinehart Tallasse, Alabama	Administrator, Community Hospital, Inc. Tallasse, Alabama
Lothar Ephraim Peace, III Jackson Gap, Alabama	CEO, Russell Medical Center Alexander City, Alabama
William Allen Foster Opp, Alabama	Administrator, Mizell Memorial Hospital Opp, Alabama
Louie Cecil Wilson, M.D. Mobile, Alabama	Retired - Cardio Thoracic & Vascular Surgery Assoc., P. C. Mobile, Alabama
William Hardin Coleman, M.D. PhD Scottsboro, Alabama	President of Family Practice Scottsboro, Alabama
Melvin Lamar Capell Montgomery, Alabama	President and CEO of the Company Montgomery, Alabama
James Michael Horsley Montgomery, Alabama	President, Alabama Hospital Association Montgomery, Alabama
Barry Smith Cochran Fayette, Alabama	Administrator, Fayette Medical Center Fayette, Alabama

The examination determined that the investment activities during the year 2007 were not authorized, approved or ratified by the Board of Directors as required by ALA. CODE §27-41-5 (1975), which states:

“An insurer shall not make any investment or loan, other than loans on policies or annuity contracts, unless the same be authorized, approved or ratified by the board of directors of the insurer or by such committee or person as the board of directors shall expressly authorize. The action of the board of directors, the committee or other persons so authorized shall be recorded and regular reports thereof shall be submitted to the board of directors....”

In a resolution adopted by the Board of Directors on July 30, 2008, the investment transactions during the year 2007 were approved and ratified by consent in writing in lieu of meeting.

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, 2007.

Officer	Title
Melvin Lamar Capell	President and Chief Executive Officer
Thorton Dudley Perry	General Counsel
John Mark Killingsworth	SVP - Treasurer and Chief Financial Officer
Frank Labbie Parsons	SVP – Claims
Ernest Wray Smith	SVP – Underwriting
Gaston Wayne Averrett	VP - Workers' Compensation
Donald Anthony Eagen	VP - Information Technology
Dawn Wilkes Adams	VP - Workers' Compensation Claims

Committees

The following committees were appointed by the Board of Directors and were serving at December 31, 2007:

<u>Executive Committee</u>	
Robert Curtis Chapman, Chairman	Bryan Neal Kindred
Frank Willard Harris	Billy Albert Mason
Louie Cecil Wilson, M.D.	
<u>Compliance and Audit Committee</u>	
Frank Willard Harris, Chairman	Robert Curtis Chapman
Lother Ephraim Peace, III	Jennie Rogers Rhinehart
James Michael Horsley	Barry Smith Cochran
<u>Nominating & Corporate Governance Committee</u>	
Bryan Neal Kindred, Chairman	Robert Curtis Chapman
Billy Albert Mason	William Hardin Coleman, M.D. PhD
William Allen Foster	

Conflict of Interest

The conflicts of interest statements filed by the officers and directors of the Company were reviewed for the period covered by this examination. Disclosures were made by a director and an officer of the Company; however, it did not appear that the disclosures represented conflict of interest.

CORPORATE RECORDS

The Articles of Incorporation, and *By-Laws*, as amended were inspected and found to provide for the operations of the Company in accordance with usual corporate and applicable statutes and regulations. One amendment was made to the Articles of Incorporation during the period covered by the examination.

Minutes of the Annual Membership, Board of Directors and committees of the Company, from April 3, 2003, through the most recent meetings recorded at the time of examination, were reviewed. Other than the item previously noted in the caption MANAGEMENT AND CONTROL, the minutes appeared to be complete with regard to recorded actions taken on matters before the respective bodies for deliberation and action.

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).

A review of the Company's filings from April 3, 2003, through most recent filings indicated that all required disclosures were included in the Company's filings.

The examiners determined that the Company had not completed Part 1 - Common Interrogatories - General, note 1.1 appropriately when the Company indicated that it was not a member of the holding Company System.

The Insurance Holding Company System as defined in ALA. CODE § 27-29-1 (1975), states:

“(4) INSURANCE HOLDING COMPANY SYSTEM. A system which consists of two or more affiliated persons, one or more of which is an insurer.”

Affiliated as defined in ALA. CODE § 27-29-1 (1975), states:

“(1) AFFILIATE. The term shall include an “Affiliate” of, or person “affiliated” with, a specific person, and shall mean a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by... (3) Control. Control shall be presumed to exist if any person, directly or indirectly owns, controls, holds with the power to vote, or holds proxies representing five percent or more of the voting securities of any other person....”

Investment in the Company's stock is a prerequisite to obtain insurance from the Company. As of December 31, 2007, the following hospitals had five percent or more of the voting rights:

- DCH Health Care Authority - 23.7% CLASS A & B stock as of December 31, 2007.
- Southern Medical Health Systems - 10.5009% CLASS A & B stock as of December 31, 2007.

The Company had 100% ownership in Coastal Insurance Services Inc., and has a contractual relationship (services) with Healthcare Workers' Compensation fund.

Dividend to Stockholders

No dividends to stockholders were paid during the examination period.

Organizational Chart

The following Chart presents the identities and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2006:

Statement as of December 31, 2007 of the Coastal Insurance Risk Retention Group, Inc.

SCHEDULE Y - INFORMATION CONCERNING ACTIVITIES OF INSURER MEMBERS OF A HOLDING COMPANY
PART 1 - ORGANIZATIONAL CHART

Coastal Insurance Risk Retention Group, Inc.
Alabama Corporation
FEIN No. 61-1443708

Subsidiary

Coastal Insurance Services, Inc.
Alabama Corporation
FEIN No. 14-1893967

Service Agreement

**Healthcare Workers' Compensation Self
Insurance Fund**
Alabama Corporation
FEIN No. 87-0693453

The organizational chart in the Company's 2007 Annual Statement reported Coastal Insurance Services Inc., as a wholly owned subsidiary of the Company, and Healthcare Workers Compensation Fund (HWCF), a trust, contracted with the Company to obtain management services. The organization chart did not include the NAIC Company Code and the two-character state abbreviation for Coastal Insurance Risk Retention Group, Inc., which is required by the guidance provided by NAIC Annual Statement Instructions, which states:

“...The NAIC company code and two-character state abbreviation of the state of domicile should be included for all domestic insurers...”

The Company did not include the name of the policyholders, with over 5% of the voting rights, on the Organization Chart as required by the NAIC Annual Statement Instructions, which states:

“However, any persons(s) (that includes natural person) deemed to be an ultimate controlling person, must be included in the organizational chart.”

ALA. CODE § 27-29-1 (1975), states in pertinent part:

“(3) Control. The term shall include “controlling,” “controlled by,” or “under common control with” and shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than....Control shall be presumed to exist if any person, directly or indirectly owns, controls, holds with the power to vote, or holds proxies representing five percent or more of the voting securities of any other person....”

Transactions and Agreements with Affiliates

The Schedule Y – Part 2 of the 2007 Annual Statement indicated that the Company received \$1,833,896 for providing professional management services, including office space and equipment to Coastal Insurance Services, Inc., an affiliated company and Healthcare Workers' Compensation Self Insurance Fund, a trust managed by the Company.

Management Agreement with Coastal Insurance Services, Inc:

The Company entered into a management agreement with Coastal Insurance Services, Inc., (CIS) an affiliated Company. The agreement has been in effect since September 1, 2003, with the initial term of the agreement thirty-six months, which automatically

renewed for an additional term of thirty-six 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:

- CIS retains the Company to 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 (1975), which states:

“(a) 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 agreement between the affiliated companies 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”

Management agreement with Healthcare Workers' Compensation Self-Insurance Fund:

The Company entered into a Management Agreement with Healthcare Workers' Compensation Self-Insurance Fund (HWCF), effective May 1, 2003 through December 31, 2003. The agreement was renewed for an additional period of twenty-four months beginning January 1, 2004 through December 31, 2006.

According to the agreement the Company is responsible for the day to day operations of HWCF including the following obligations imposed by the agreement:

- A. Collection of all sums due the HWCF from its members
- B. Pay all approved items of expense as directed by the Board of Trustees
- C. 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 Trustees. The budget may be amended from time to time and approved by the Trustees to meet changing obligations
- D. Open the books and records of the Fund maintained by Coastal to inspection by the Board of Trustees or third duly authorized and appointed agent.
- E. The President/CEO of Coastal and such other employees of Coastal as the president/CEO designates shall attend all Board of Trustee meetings. They shall make such reports as required to keep the Board of Trustees advised of current operations and the financial situation of HWCF
- F. Process any and all claims filed against Members of HWCF. Coastal shall only pay employees' claims to the extent allowed by the Alabama Workers' Compensation Law
- G. Retain an attorney, when necessary, for the proper administration of HWCF and for the disputing of claims filed by employees of Members

- H. Assure that an audited financial statement of a fiduciary, as defined in the Medicare Medical Provider Manual be forwarded to each member no later than ninety (90) days after the end of each year
- I. Upon the termination of any Member from the Medicare program, obtain a determination of the adequacy of HWCF balance as of the date of that member's termination, pursuant to the Medicare Medical Provider Manual § 2162/8 (A)(4). Such determinations shall be made by an independent actuary, insurance company or broker
- J. Perform any and all other duties imposed upon the Company by the rules and regulations of the Director of the Alabama Department of Industrial Relations and all applicable laws.

The Company and Healthcare Workers, Compensation Self Insurance Funds (HWCF) continued to operate under the agreement which expired on December 31, 2006. The examiners determined that the Company continued to record the transactions with HWCF on Schedule Y – Part 2 on the same basis as recorded during the years January 1, 2005 to December 31, 2006. The Company should comply with ALA. CODE §27-29-5 (b) (1975), which states:

“The following transactions involving a domestic insurer and any persons in its holding company system may not be entered into unless the insurer has notified the commissioner in writing on its intention to enter into such transaction at least 30 days prior thereto...

(4) All management agreements, service contracts, and all cost sharing arrangements...”

On September 3, 2008, the Company and HWCF entered into a management service agreement on the same terms and conditions as the original contract. The agreement was made retroactive as of January 1, 2007.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2007, the Company was insured by a financial institution bond issued by Hartford Casualty Insurance Company of Hartford, Connecticut. The single loss limit of the bond was less than the NAIC suggested minimum requirements for fidelity coverage.

In addition to the fidelity bond, the financial institution bond provided the following coverages:

- Business Liability

- Medical Expense
 - Liability and Medical Expense
 - Fire Legal Liability
 - General Aggregate
 - Products/Completed Ops Aggregate
 - Personal and Advertising Injury
 - Employee Benefits Liability
 - Computer and Media
 - Business Income and Extra Expense
 - Identity Recovery
- Professional Liability
 - Directors and Officers Liability including Employment Practice Liability
 - Umbrella Liability
 - Business Auto
 - Workers' Compensation

The type of coverages and the maximum limits indicated for each occurrence appears to have been sufficient to cover the Company against hazards to which it might be exposed.

EMPLOYEES' AND AGENTS' WELFARE

Employees Benefits

As of December 31, 2007, the Company provided the following benefits to its employees and agents:

- military leave
- maternity leave
- jury duty
- paid vacation
- paid illness
- paid personal days
- bereavement
- doctor appointments
- paid holidays
- short term disability
- long term disability
- retirement savings 401(k) plan
- flexible spending accounts

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

The Company was asked how it determined if prospective and current employees and agents were not in conflict with Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which prohibits certain persons from participating in the business of insurance.

Company management indicated that it had no policy in place to ensure those authorized to act on its behalf meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

“...Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred...”

MARKET CONDUCT ACTIVITIES

Territory

At December 31, 2007, 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

At December 31, 2007, the Company offered medical malpractice and other liability products, on a direct basis, through captive agents. There were six licensed agents, two of the six agents were producing agents and the rest were performing underwriting duties at the Company's home office.

The Company did not have a formal written plan for the acquisition of new business; except, that their producing agents would target few new hospitals and physicians, each year, in rural areas as prospective customers.

Policy Forms and Underwriting Practices

The Company's policy forms and endorsements filed with the Alabama Department of Insurance during the period under examination were reviewed. The policy forms filed were determined to be approved by the Alabama Department of Insurance; although, the Company could not produce evidence showing the approval stamp on eight of the seventy-four forms 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 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.”

As of December 31, 2007, the Company was issuing medical professional liability insurance. The Company's rates and underwriting guidelines were filed and approved by the Alabama Department of Insurance.

A sample of fifty application files was reviewed to determine if the rates charged for policy coverage were in accordance with the filed rates. The examiners determined that the rates charged were in accordance with the filed rates; except minor differences were noted in two policies where manual calculations were involved. The application files, which were reviewed, had all information necessary to issue the policy and had the policyholder's signature. Four out of the fifty files could not be located, which 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 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.”

Compliance with Agents' Licensing Requirements

In order to verify compliance with agents' licensing requirements of the Alabama Department of Insurance (ALDOI), the agents listing from the Alabama Department of Insurance was compared with the listing maintained by the Company. It was determined that twelve agents were appointed by the Company during the period covered by the examination. All agents except one was licensed for the Company by the Alabama Department of Insurance. As of December 31, 2007, six agents were not with the Company, due to termination, retirement, resignation, or being laid off from the Company. Company management indicated that an application would be

processed to have the agent appointed for the Company; the agent's name appears on the ALDOI website of licensed agents.

A sample of fifty new application files were reviewed to established that the agents were properly licensed and appointed to transact business on behalf of the Company when the policies were written. There were no discrepancies found; however, four files could not be located by the Company, which 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 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.”

Advertising and Marketing

The Company's advertising materials were reviewed for the period covered by the examination. The advertisements consisted of brochures, newsletters and letters.

The Company's web page (www.coastalins.org) was reviewed and found to include the following links: Underwriting, Claims, Risk Management, Allied Health Care, Helpful Links and Downloads, Client Login and Contact Us.

Company management indicated that producers are not allowed to create their own advertising and sales material, including internet sites.

Claims Payments Practices

Paid Claims

A sample of fifty paid claims was selected from the 2003 - 2007 paid claims listing. The population from which the sample was taken included both hospital and physician paid claims. The paid claims sample was reviewed with regards to compliance with policy provisions, timeliness of payments, and adequacy of documentation. There were no noteworthy discrepancies found within the sample of paid claims.

Denied and Closed without Payment Claims

A sample of fifty claims was selected from the denied and closed without payment claims, including declined/rejected and rescinded claims.

It was determined that the Company was in compliance with ALA. ADMIN. CODE 482-1-125-.04 (a) which states:

“The insurer shall maintain claim files that are accessible and retrievable for examination. An insurer shall be able to provide the claim number, line of coverage, date of loss, and date and amount of payment. They shall also be able to provide the same information (except date and amount of payment) for all claims closed without payment. This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer's activities relative to each claim.”

Policyholders' Complaints

The Company did not have any complaints logged in their register and no complaints were filed with the Alabama Department of Insurance during the examination period. As of December 31, 2007, the Company did not have a complaint handling policy or procedure.

The Alabama Department of Insurance adopted the NAIC Market Regulation Handbook, effective May 7, 2007, via ALA. ADMIN. CODE 482-1-097-.07 (2007). According to the handbook, regulated entities should maintain a complete record of all the complaints it received since the date of its last examination. This record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint, and the time it took to process each complaint. A “complaint” shall mean any written communication primarily expressing a grievance.

During the examination, the Company's General Counsel developed complaint handling guidelines, which were approved by the Board of Directors.

Privacy Policies and Practices

The Company's privacy policy 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 information provided is not sold or used for promotional purposes to third parties. A Privacy Notice is issued with each physician medical professional policy that is issued by Coastal Insurance Risk Retention Group. The notice is issued automatically by the computer and it is issued on new and renewal policies. The Company complied with the privacy requirements of ALA. ADMIN. CODE 482-1-122 (2001).

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, 2007.

<u>Description</u>	<u>Book Value</u>	<u>Fair Value</u>
United States Treasury	\$109,930	\$111,753
Total	\$109,930	\$111,753

FINANCIAL CONDITION/GROWTH OF THE COMPANY

<u>Year</u>	<u>Gross Premiums Written</u>	<u>Premiums Earned</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Policyholders' Surplus</u>
2003	\$ 9,020,375	\$3,866,790	\$12,804,805	\$ 4,250,659	\$ 8,554,146
2004	14,192,442	8,834,560	20,690,144	10,931,576	9,758,568
2005	15,076,146	8,842,875	27,004,405	15,395,864	11,608,541
2006	15,460,645	9,526,559	34,635,437	20,958,814	13,676,623
2007*	14,238,528	7,159,536	40,097,084	27,931,821	12,165,263

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

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 reinsurance treaties in-force at December 31, 2007, were negotiated through John B. Collins Associates, with a number of authorized and unauthorized reinsurers including Lloyd's Syndicates participating in the treaties. The participating reinsurers are listed below:

<u>Reinsurers</u>	<u>Reinsurers Participation</u>	
	<u>Excess Casualty</u>	<u>Excess Umbrella</u>
<u>United States</u>		
Odyssey Reinsurance	10.0%	10.0%
Total – United States	10.0%	10.0%
<u>Europe and Bermuda</u>		
Aspen Insurance UK Limited	17.0%	17.0%
Hannover Ruckversicherung Ag	7.5%	5.0%
Montpelier Reinsurance Ltd	7.0%	5.0%
Catlin Insurance Company Ltd.	7.5%	5.0%
AXA Re	16.0%	14.0%
Total – Europe and Bermuda	55.0%	46.0%
<u>Lloyd's Underwriters</u>		
FDY Syndicate #435	6.5%	5.0%
HMA Syndicate #1200	3.5%	3.0%
HAR Syndicate #2000	4.0%	4.0%
SJC Syndicate #2003	11.0%	10.0%
MAP Syndicate #2791	10.0%	14.0%
LIB Syndicate #4472	0.0%	5.5%
Total – Lloyd's Underwriters	35.0%	41.5%
TOTAL	100.0%	97.5%

First Excess Casualty Reinsurance Contract

The reinsurance contract was effective July 1, 2007, and remained in-force until July 1, 2008. 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, 2007, and remained in-force until July 1, 2008. 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.

ACCOUNTS AND RECORDS

The Company's accounting records were maintained on electronic data processing equipment and manually on personal computers. The Company provides management services to Coastal Services, Inc. (CIS), a subsidiary of the Company and Healthcare Workers' Compensation Self-Insurance Fund (Trust) under management agreements entered separately with the CIS and the Trust. For further review of the agreements, see the heading HOLDING COMPANY AND AFFILIATES section of this report.

The examiners reviewed the accounts and records maintained by the Company for cash disbursements of \$25.00 or more. The review indicated the Company's documentation did not include all necessary receipts for items of \$25.00 or more. The Company provided copies of the cancelled checks, and vouchers which included the amount of transfer, the payor, and payee. The documentation did not include all description of the consideration for the payment, a description of the services provided, itemization of the expenditures, or a receipt. The documentation is required by ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

External Audit and Actuarial

The Company was audited annually by the certified public accounting firm of Faulkner Mackie & Cochran, P.C., Nashville, Tennessee. Mr. Jerry W. Faulkner, CPA, was the engagement partner during the years under examination.

The reserve calculation was certified by Mr. John F. Gibson, MAAA, FCAS, with PricewaterhouseCoopers, Atlanta, Georgia during the period under examination.

Record Retention Policy

The Company did not have a formal record retention policy and procedure. The company should develop a record retention policy and procedure which ensure compliance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer, foreign insurer, health care services corporation, health maintenance organization, prepaid dental plan, managing general agent or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer's financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

Disaster Recovery Plan

Company management indicated that a disaster recovery plan/contingency plan (Plan) is in place to handle significant contingency that might affect the Company's operation; however, the Plan was not tested.

The Company's Plan must be current, based on business impact analysis, contingency plan which had been tested and addresses all significant business activities, including financial functions, telecommunication services, data processing, network services, and clearly describing senior management roles and responsibilities associated with the declaration of emergency in accordance with ALA. ADMIN. CODE 482-1-126-.05(2003), which states:

“**Objectives of Information Security Program.** A licensee's information security program shall be designed to do all of the following:

- (a) Ensure the security and confidentiality of customer information.
- (b) Protect against any anticipated threats or hazards to the security or integrity of the information.
- (c) Protect against unauthorized access to or use of the information that could result in substantial harm or inconvenience to any customer.”

Consideration of Fraud

The examiners utilized Exhibit G – Consideration of Fraud from the NAIC Financial Condition Examiners Handbook, to identify fraud risk factors and obtain a reasonable assurance that the financial statements were free from material misstatement due to fraud. The CPA documentation on the fraud risk factors was reviewed and procedures were included to test the fraud risk factors identified during the planning stage of the examination.

Company management was interviewed to understand corporate governance, and its commitment to ethics, risk management and knowledge of fraud risk factors. Company management indicated that they had not identified any fraudulent activities perpetrated within or against the Company.

FINANCIAL STATEMENTS

The Financial Statements included in this report were prepared based on the Company's records, and the valuations and determinations made during the examination for the year ended December 31, 2007. Amounts shown in the comparative statements for the years 2003, 2004, 2005, 2006 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus	28 and 29
Summary of Operations	30
Capital and Surplus	31

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

COASTAL INSURANCE RISK RETENTION GROUP, INC.
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER
FUNDS

For the Year Ended December 31, 2007

	Assets	Non- admitted Assets	Net Admitted Assets
<u>ASSETS</u>			
Bonds (Note 1)	\$28,068,028	\$ 0	\$28,068,028
Common Stock	6,494,905	19,594	6,475,311
Cash, cash equivalents, and short-term investments (Note 2)	<u>3,152,828</u>	<u>0</u>	<u>3,152,828</u>
Subtotals, cash and invested assets	\$37,715,761	\$ 19,594	\$37,696,167
Investment income due and accrued	336,992	0	336,992
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	13,301	0	13,301
Deferred premiums, agents' balances an installments booked but deferred and not yet due (Note 3)	929,591	0	929,591
Reinsurance: Amounts recoverable from reinsurers			
Current federal and foreign income tax recoverable and interest thereon	228,238	0	228,238
Net deferred tax asset	1,128,378	670,398	457,980
Electronic data processing equipment and software	293,195	243,323	49,872
Furniture and equipment, including health care delivery assets	19,418	19,418	0
Receivables from parent, subsidiaries and affiliates	155,073	0	155,073
Aggregate write-ins for other than invested assets (Note 4)	622,920	393,050	229,870
Total Assets	<u>\$41,442,867</u>	<u>\$1,345,783</u>	<u>\$40,097,084</u>

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

**COASTAL INSURANCE RISK RETENTION GROUP, INC.
STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER
FUNDS**

For the Year Ended December 31, 2007

Liabilities:	
Losses (Note 5)	\$12,522,550
Loss adjustment expenses (Note 5)	7,738,133
Other expenses (excluding taxes, licenses, and fees)	922,930
Taxes, licenses and fees (excluding federal and foreign income taxes) (Note 6)	
Unearned premiums	1,085,611
Advance premium	31,763
Ceded reinsurance premiums payable (net of ceding commissions)	3,301,934
Amounts withheld or retained by the Company for the account of others	50,000
Remittances and items not allocated (Note 3)	0
Aggregate write-ins for liabilities	<u>2,278,900</u>
Total Liabilities	<u>\$27,931,821</u>
Capital and Surplus:	
Common capital stock	507,235
Gross paid in and contributed surplus	11,728,094
Unassigned funds (Note 7)	2,480,714
Less treasury stock, at cost	
255,078 shares common (value included in Line 28 \$188,528)	<u>2,550,780</u>
Total Capital and Surplus	<u>\$12,165,263</u>
Total Liabilities and Stockholders' Equity	<u>\$40,097,084</u>

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

COASTAL INSURANCE RISK RETENTION GROUP, INC.
SUMMARY OF OPERATIONS

For the Years Ended December 31, 2007, 2006, 2005, 2004, and 2003

	2007	2006	2005	2004	2003
Underwriting Income					
Premiums earned	\$7,159,536	\$9,526,559	\$8,842,875	\$8,834,560	\$3,866,790
<i>Deductions:</i>					
Losses incurred	4,024,310	3,226,916	2,712,839	2,958,944	1,669,682
Loss expenses incurred	1,922,235	2,415,532	3,399,989	3,445,312	1,636,597
Other underwriting expenses Incurred	1,977,950	2,206,789	1,714,619	2,246,781	2,393,859
Total underwriting deductions	<u>\$7,924,495</u>	<u>\$7,849,237</u>	<u>\$7,827,447</u>	<u>\$8,651,037</u>	<u>\$5,700,138</u>
Net underwriting gain / (loss)	<u>\$(764,959)</u>	<u>\$1,677,322</u>	<u>\$1,015,428</u>	<u>\$183,523</u>	<u>\$(1,833,348)</u>
Investment Income					
Net investment income earned	1,449,283	1,013,627	655,601	174,928	27,748
Net realized capital gains(loss)	<u>476,707</u>	<u>(59,427)</u>	<u>(18,424)</u>	<u>5,499</u>	<u>0</u>
Net investment gain/(loss)	<u>\$1,925,990</u>	<u>\$954,200</u>	<u>\$637,177</u>	<u>\$180,427</u>	<u>\$27,748</u>
Other Income					
Aggregate write-ins for miscellaneous income	<u>12,032</u>	<u>2,825</u>	<u>100</u>	<u>0</u>	<u>848,247</u>
Total other income	<u>\$12,032</u>	<u>\$2,825</u>	<u>\$100</u>	<u>\$0</u>	<u>\$848,247</u>
Net income, after dividends to policyholders, after capital gains tax and before all federal and foreign income tax	1,173,063	2,634,347	1,652,705	363,950	(957,353)
Federal and foreign income taxes incurred	<u>360,205</u>	<u>1,051,105</u>	<u>755,115</u>	<u>361,446</u>	<u>-</u>
Net Income	<u>\$812,858</u>	<u>\$1,583,242</u>	<u>\$897,590</u>	<u>\$2,504</u>	<u>\$(957,353)</u>

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

**COASTAL INSURANCE RISK RETENTION GROUP, INC.
CAPITAL AND SURPLUS ACCOUNT**

For the Years Ended December 31, 2007, 2006, 2005, 2004, and 2003

	2007	2006	2005	2004	2003
Surplus as regards policyholders, December 31 prior year	\$13,676,623	\$11,608,541	\$9,758,568	\$8,554,146	\$0
Net income	812,858	1,583,242	897,590	2,504	(957,353)
Change in net unrealized capital gains or (losses)	(299,742)	189,606	37,801	110,143	(1,000)
Change in net deferred income tax	78,471	248,843	177,272	155,389	430,624
Change in non-admitted assets	(166,722)	(318,502)	11,300	143,096	(1,014,955)
Change in provision for reinsurance				49,000	(49,000)
Capital changes: Paid in	47	548	726	744	505,170
Surplus adjustments: Paid in	47,163	547,442	725,284	743,546	9,664,660
Change in treasury stock	(2,227,510)	(323,270)			
Aggregate write-ins for gains and losses in surplus	<u>244,075</u>	<u>140,173</u>			<u>(24,000)</u>
Change in surplus as regards policyholders for the year	<u>\$(1,511,360)</u>	<u>\$2,068,082</u>	<u>\$1,849,973</u>	<u>\$1,204,422</u>	<u>\$8,554,146</u>
Surplus as regards policyholders, December 31 current year	<u>\$12,165,263</u>	<u>\$13,676,623</u>	<u>\$11,608,541</u>	<u>\$9,758,568</u>	<u>\$8,554,146</u>

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

NOTES TO FINANCIAL STATEMENTS

Note 1 - Bonds

\$28,068,028

The captioned amount is the same as reported by the Company in its 2007 Annual Statement.

The examiners reviewed a sample of securities from Schedule D - Parts 3, Schedule D - Part 4 and Schedule D - Part 5 of the 2007 and 2006 Annual Statements to determine that securities acquired and disposed during the aforementioned period were appropriately recorded on the trade date, and not the settlement date.

Documentation supporting the acquisition and disposal of eight of the thirty-two transactions in the sample were not provided. Hence, the Company did not comply with ALA. CODE §27-27-29-(a) (1975), which states:

“(a) 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.”

The examiners selected a sample of bonds from Schedule D - Part 1 to test the amortization of premiums or discounts on bonds to determine the appropriateness of the amortization method used by the Company and to verify compliance with SSAP No. 26, paragraph 6, of the NAIC Accounting Practices and Procedures Manual, which states:

“Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer’s discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).”

The documentation supporting the amortization was not available for the examiners review. Hence, the Company is not in compliance with the aforementioned statute ALA. CODE §27-27-29 (a) (1975).

The examiners determined that sixteen U.S. Government NRSRO Rated Issuer Filing Exemption securities in the Company's portfolio were listed with the "FE" symbol after the "1" designation. PART FIVE, Section 3(e)(ii)(B) Purposes and Procedures Manual of the NAIC Securities Valuation Office, states:

"A single entry will appear in the VOS publication in its normal CUSIP sequence, followed by the description "All Issues" for the specific securities listed in the U.S. Government Securities Filing Exemption List which is Section 16, 17, and 18 of the Appendix of this Manual...The NAIC Designation for these securities should be NAIC 1."

The Company should report the U.S. Government securities that are listed in Section 16, 17 and 18 of the Purposed and Procedures Manual of the NAIC Securities Valuation Office without the "FE" symbol after the "1" designation.

Effective October 1, 2003, the Company entered into an Investment Consulting Agreement with Highland & Associates (Highland), Birmingham, Alabama. According to the agreement, the annual fee payable to Highland would be assessed upon the combination of the Company's invested assets, held under custody agreement, and Workers Compensation Self Insurance Fund (HWCF) investment account assets. The annual consulting fee charged by Highland would be billed monthly and was based on a schedule with the minimum fee payable would be \$60,000 and the maximum fee payable would be \$240,000. The agreement specifies that the fee would be split on a 50/50 basis between the Company and HWCF.

Company management indicated that after the signing of the agreement, the Company renegotiated the annual fee for services to a flat \$50,000. However, the Company could not provide the renegotiated Investment Consulting Agreement with Highland. Hence, the Company is not in compliance with the aforementioned statute ALA. CODE §27-27-29 (a) (1975).

Note 2 - Cash, cash equivalents and short - term investments \$ 3,152,828

The captioned \$3,152,828 is the same as reported by the Company in its 2007 Annual Statement, but \$19,800 less than that determined by the examination. Due to immateriality no changes were made to the financial statements.

At December 31, 2007, the Company had \$990,000 on deposit, under a repurchase agreement, with Regions Bank. The collateral transferred securities received by the Company amounted to \$990,000, which was \$19,800 less than the \$1,009,800 required

by SSAP No. 91, paragraph 71 (a) of the NAIC Accounting Practices and Procedures Manual, which states:

“The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at any time the fair value collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transactions, at least equals 102 percent of the purchase price.”

Since the total fair value of the collateral transferred securities was \$19,800 less than that required by the SSAP No. 91, paragraph 71 (a), the Company should have not admitted the amount as required by SSAP No. 91, paragraph 68 of the NAIC Accounting Practices and Procedures Manual, which states:

“Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.”

A review of the 2007 Annual Statement indicated that the Company reported its investment under repurchase agreement on Schedule E – Part 1 – Cash instead of Schedule DA – Part 1 – Short-Term Investments. SSAP No. 91, paragraph 67 of the NAIC Accounting Practices and Procedures Manual, states:

"For repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 64 of this statement, the underlying securities shall not be accounted for as investment owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income..."

In addition, the NAIC Annual Statement Instructions, Schedule DA - Part 1, states:

“Include all investments whose maturities (or repurchase dates under repurchase agreements) at the time of acquisition were one year or less except those defined as cash in accordance with SSAP No. 2, Cash, Drafts, and Short - Term Investments...”

SSAP No. 2, paragraph 10 of the NAIC Accounting Practices and Procedures Manual states:

“All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding those investments classified as cash equivalents as defined in paragraph 3) shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans which meet the above criteria. Short-term investments shall not include certificate of deposit.”

The examination established that the Company did not disclose the repurchase agreement in Note 5 (e) of the NOTES TO FINANCIAL STATEMENTS of the 2007 Annual Statement, which was in conflict with the guidance provided by SSAP 91, paragraph 88, of the NAIC Accounting Practices and Procedures Manual, which states:

- “h. Descriptions of any loaned securities, including the amount, a description of and the policy for, requiring collateral, and whether or not the collateral is restricted;
- i. A description of the securities underlying repurchase and reverse repurchase agreements, dollar repurchase and dollar reverse repurchase agreements, including book values and fair value, maturities, and weighted average interest rates for the following categories: (i) securities subject to reverse repurchase agreement; (ii) securities subject to repurchase agreements...”

Note 3 - Deferred premiums, agents' balances and installments

<u>booked but deferred and not yet due</u>	<u>\$929,591</u>
<u>Remittances and items not allocated</u>	<u>\$ -0-</u>

The captioned \$929,591 is the same as reported by the Company in its 2007 Annual Statement, but \$57,273 less than that determined by the examination. The captioned \$0 is the same as reported by the Company in its 2007 Annual Statement, but \$57,273 more 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 premiums received in the amount of \$57,273 were not applied to particular policies at December 31, 2007. 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 NAIC Annual Statement Instructions, 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.”

Note 4 - Aggregate write-ins for other than invested assets **\$229,870**

The captioned \$229,870 is \$156,467 less than the \$386,337 reported by the Company in its 2007 Annual Statement and consisted of amounts recoverable from policyholders on account of policy deductibles paid by the Company to settle claims against the policyholders.

The examination determined that in medical mal-practice insurance, claims resulting in loss payments, the Company will pay off the liability and subsequently collect the policy deductible from the policyholder in the contracted amount. At December 31, 2007, the Company recorded the \$156,467 amount recoverable from the policyholders and admitted the amount, instead of not admitting the same as required by SSAP No. 87, paragraph 3, of the NAIC Accounting Practices and Procedures Manual, which states:

“...Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interest should not be recognized on the balance sheet, and are, therefore, considered nonadmitted. For the purpose of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.”

Note 5 - Losses	\$12,522,550
<u>Loss adjustment expenses</u>	<u>\$7,738,133</u>

The captioned amounts are the same as reported by the Company in its 2007 Annual Statement.

The review of paid losses included the testing of *Schedule P - Part 1 - Summary, Schedule P - Part 1F - Section 2, and Schedule P - Part 1H - Section 2*, and comparing the paid losses to the *Underwriting and Investment Exhibit Part 2 - Losses Paid and Incurred* (Exhibit - Part 2). The Schedule P's mentioned above indicated that the Company recovered reinsurance on losses paid during the years 2005, 2006 and 2007. However, the Exhibit - Part 2 did not correctly report direct, assumed and recovered losses paid on the 2005 - 2007 Annual Statement. The Company's Exhibit - Part 2 included paid losses net or reinsurance in the "Direct Business," column 1 and left the "Reinsurance Recovered," column 3 as \$0. The "Net Payments," column 4 is correct and equals the misstated "Direct Business," column. The Exhibit - Part 2 was not completed in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Column 1 - Losses Paid Less Salvage - Direct Business Line 34 should agree with Schedule T, Line 59, Column 5....Column 3 - Reinsurance Recovered Include: Amount receivable from reinsurance on losses paid during the current calendar year.”

The Company provided a spreadsheet showing what the Company should have recorded in the "Direct Business," column of Exhibit -Part 2. The examination determined that the gross Current Year (CY) paid losses on Schedule P were not consistent with Exhibit - Part 2. The difference is that Schedule P does not reflect deductibles that have been billed to insureds, whereas Exhibit - Part 2 does.

(000's omitted)				
Year	Gross Loss Payments During Year Per Corrected Exhibit - Part 2	Gross Loss Payments During Year Per Schedule P	Difference in Gross Loss Payments	Billed Deductibles Per Company
2005	\$ 815	\$ 855	\$ -40	\$ 40
2006	2,414	2,624	-210	210
2007	1,269	1,046	223	224

The examination determined that the paid losses in Schedule P should include all deductibles that have been billed to insureds and are in the process of being collected, except, if the Company determines that the amount is uncollectible. The CY paid losses in Schedule P's must reconcile to Exhibit – Part 2 as required by the aforementioned NAIC Annual Statement Instructions.

The examination also determined that the Current Year (CY) incurred net expenses on Schedule P did not agree with the Statement of Income, line 3. The following table will explain the difference:

Year	Current Year Net Incurred LAE (000's omitted)		
	Statement of Income	Schedule P	Difference
2007	\$1,922	\$1,876	\$ 46
2006	2,416	2,592	-176
2005	3,400	3,823	-423
2004	3,445	3,477	-32
2003	1,637	1,636	1

The Statement of Income, line 3, should reconcile to CY Loss Adjustment Expenses in Schedule P to be consistent with the NAIC Annual Statement Instructions.

The examination utilized Audit Command Language (ACL) to reconcile the Paid Losses and Defense and Cost Containment (DCC) expenses, to Schedule P. The following table will explain the differences:

Current Year Losses and DCC (000's omitted)

Year	Losses*			DCC		
	ACL	Sch P	Difference	ACL	Sch P	Difference
2007	\$1,295	\$1,046	\$ 240	\$1,185	\$ 982	\$ 203
2006	2,410	2,624	-214	1,114	1,337	-223
2005	820	855	-35	782	724	58
2004	11	11	0	428	461	-33

*Before credit for billed deductibles

After adjusting the amounts, in the above table, for unbilled deductibles, the differences during each of the years were determined to be immaterial for further review. Hence, no changes were made to the financial statements.

Note 6 – Taxes, licenses and fees

\$ -0-

The captioned amount is the same as reported by the Company in its 2007 Annual Statement, but \$21,885 less than that determined by the examination. Due to immateriality no adjustments were made to the financial statements.

A review of the accounts and records indicated that the credit and deduction for franchise and privilege taxes applied by the Company on the premium tax returns (2003 – 2007) was not in accordance with that allowed by ALA. CODE § 27-4A-3 (1975) states:

“(c) 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....

(6) Sixty percent of the franchise or privilege taxes paid by the insurer to the State of Alabama for the calendar year.”

The following table summarizes the difference:

<u>Year</u>	<u>Privilege Taxes Paid</u>	<u>Credit/Deduction Applied (100%)</u>	<u>Credit allowed is 60%</u>	<u>Difference</u>
2003	\$ 100	\$ -0-	\$ 60	\$ (60)
2004	1,671	\$2,500	1,003	1,497
2005	10,915	10,106	6,549	3,557
2006	17,617	17,470	10,570	6,900
2007	24,953	24,963	14,972	9,991
				<u>\$21,885</u>

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.

Note 7 – Unassigned funds (surplus)**\$2,480,714**

The unassigned fund (surplus), as determined by this examination is \$156,467 less than the \$2,637,181 amount reported by the Company in its 2007 Annual Statement.

The following schedule presents a reconciliation of the unassigned funds per the Company's filed statement to that developed by this examination:

Unassigned funds per Company		\$2,637,181
Examination increase / (decrease) to assets:		
• Aggregate write-ins for other than invested assets	\$(156,467)	
Examination (increase) / decrease to liabilities:	\$-0-	
Net increase / (decrease)		\$ 156,467
Unassigned funds (surplus) per examination		\$2,480,714

CONTINGENT LIABILITIES AND PENDING LITIGATION

The examination for contingent liabilities and pending litigation included review of the Company's Annual Statement disclosures, minutes of the corporate governing bodies, pending claims, and the usual examination of the accounts for unrecorded items. No material unreported contingencies were noted, and all litigation pending against the Company, at December 31, 2007, appeared to be within the ordinary course of its business.

The Company's Chief Executive Officer and its Chief Financial Officer executed a letter of representation, attesting to the non-existence of unreported liabilities as of December 31, 2007.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

The review was conducted during the examination with regards to the Company's compliance with recommendation made in the organizational examination report. This review indicated that the Company had satisfactorily complied with the recommendations contained in the Report of Examination.

COMMENTS AND RECOMMENDATIONS

Board of Directors – Page 5

It is recommended that the all investment transactions be authorized, approved or ratified by the Board of Directors as required by ALA. CODE §27-41-5 (1975), which states:

“An insurer shall not make any investment or loan, other than loans on policies or annuity contract, unless the same be authorized, approved or ratified by the board of directors of the insurer or by such committee or person as the board of directors shall expressly authorize. The action of the board of directors, the committee or other persons so authorized shall be recorded and regular reports thereof shall be submitted to the board of directors....”

Holding Company Registration and Reporting - Page 8

It is recommended that the Company complete the Common Interrogatories - General appropriately by indicating “Yes” to the question; Is the Company a member of the Holding Company System? The Company is a member of the Holding Company System as defined in ALA. CODE § 27-29-1 (4) (1975), which states:

“INSURANCE HOLDING COMPANY SYSTEM. A system which consists of two or more affiliated persons, one or more of which is and insurer.”

Affiliated as defined in ALA. CODE § 27-29-1 (1975), states:

“(1) AFFILIATE. The term shall include an “affiliate” of, or person “affiliated” with, a specific person, and shall mean a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by... (3) Control shall be presumed to exist if any person, directly or indirectly owns controls, holds with the power to vote, or holds proxies representing five percent or more of the voting securities of any other persons...”

Organizational Chart – Page 9

It is recommended that the Company include the NAIC Company code and two-character state abbreviation of the state of domicile in the organization chart as required by NAIC Annual Statement Instructions, which states:

“...The NAIC company code and two-character state abbreviation of the state of domicile should be included for all domestic insurers...”

It is recommended that the Company include the name of the ultimate controlling person in the organization chart as a footnote with the voting right preference and comply with the NAIC Annual Statement Instructions, which states:

“However, any persons(s) (that includes natural person) deemed to be an ultimate controlling person, must be included in the organization chart.”

ALA. CODE § 27-29-1 (1975) which states in pertinent parts:

“The term shall include “controlling,” “controlled by,” or “under common control with” and shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than...Control shall be presumed to exist if any person, directly or indirectly owns, controls, holds with the power to vote, or holds proxies representing five percent or more of the voting securities of any other person...”

Management agreement – Page 11

It is recommended that the Company maintain complete records of all actions taken by the Board of Directors, including the approval of the affiliated party contracts as required by ALA. CODE § 10-2B-16.01 (1975), which states:

“(a) 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 agreement provides for the 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.”

It is recommended that the Company not enter into any transaction with affiliated parties without a valid contract as required by ALA. CODE §27-29-5 (b) (1975), which states:

“The following transactions involving a domestic insurer and any persons in its holding company system may not be entered into unless the insurer has notified the commissioner in writing on its intention to enter into such transaction at least 30 days prior thereto...

(4) All management agreements, service contracts, and all cost sharing arrangements...”

Fidelity bond and other insurance – Page 15

It is recommended that the Company obtain fidelity bond coverage in an amount adequate to cover the Company and all companies named in the fidelity bond as named insured. Exhibit R of the NAIC Financial Condition Examiners Handbook indicates the exposure index amount with the recommended fidelity bond amount.

Section 1033 of Title 18 of the U.S. Code – Page 17

It is recommended that the Company create a policy that ensures those authorized to act on its behalf meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

“Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred...”

Policy Forms and Underwriting – Page 18

It is recommended that the Company maintain complete records of its policy forms and/or endorsement approvals and 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.”

Policy Forms and Underwriting – Page 18

Compliance with Agents’ Licensing Requirements – Page 18

It is recommended that the Company maintain complete records, including the application files and 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.”

Policyholders Complaints – Page 20

It is recommended that the Company implement the complaint handling policy in order to be compliant with the NAIC Market Regulation Handbook which was adopted by the Alabama Department of Insurance effective May 7, 2007, via ALA.ADMIN. CODE 482-1-097-.07 (2007).

Accounts and Records – Page 24

It is recommended that the Company maintain the required supporting documentation for all disbursements exceeding \$25.00 in accordance with ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

It is recommended that the Company establish and maintain a record retention policy that complies with ALA.ADMIN. CODE §482-1-118-.03.

“Every insurer, which term shall include every domestic insurer . . . or any other legal entity regulated by the Insurance Code and licensed to do business in this

state shall maintain its books, records, documents and other business records in order that the insurer's financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years."

It is recommended that the Company implement a written contingency plan that clearly describes senior management roles and responsibilities associated with the declaration of emergency in accordance with the guidance provided by ALA. ADMIN. CODE 482-1-126-.05(2003), which states:

“Objectives of Information Security Program. A licensee's information security program shall be designed to do all of the following:

- (a) Ensure the security and confidentiality of customer information.
- (b) Protect against any anticipated threats or hazards to the security or integrity of the information.
- (c) Protect against unauthorized access to or use of the information that could result in substantial harm or inconvenience to any customer.”

Bonds – Page 32

It is recommended that the Company maintain complete records of acquisition and disposal of bond, and amortization of premium and discount and 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.”

It is recommended that the amortization of bond premium or discount be calculated in accordance with the guidance provided by SSAP No. 26, paragraph 6, of the NAIC Accounting Practices and Procedures Manual, which states:

“Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).”

It is recommended that the documentation supporting the amortization of bond premium be maintained and made available for the examiners review in accordance with the guidance provided 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 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.”

It is recommended that when completing Schedule D, Part 1, Column 6, NAIC Designations, that the Company follow the instructions of the Purposes and Procedures Manual of the NAIC Securities Valuation Office, NAIC Designations for U.S. Government Securities Exempt From Filing the Company, PART FIVE, Section 3(e)(ii)(B) which states:

“A single entry will appear in the VOS publication in its normal CUSIP sequence, followed by the description “All Issues” for the specific securities listed in the U.S. Government Securities Filing Exemption List which is Section 16, 17, and 18 of the Appendix of this Manual...The NAIC Designation for these securities should be NAIC 1.”

It is recommended that the Company obtain an Investment Consulting Agreement showing the renegotiated annual fee of \$50,000. The agreement should be made available for the examiners review as required by ALA. CODE §27-27-29 (a) (1975).

Cash and short-term investments – Page 33

It is recommended that the Company obtain the collateral transferred securities having a fair value at least equal to 102 percent for investments made under repurchase agreement as required by SSAP No. 91, paragraph 71 (a) of the NAIC Accounting Practices and Procedures Manual, which states:

“The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at any time the fair value collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transactions, at least equals 102 percent of the purchase price.”

It is recommended that the Company determine the current value of the collateral and if the collateral is less than 102 percent of the purchase price, not admit the difference as required by SSAP No. 91, paragraph 68 of the NAIC Accounting Practices and Procedures Manual, which states:

“Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.”

It is recommended that the Company reports its investment under repurchase agreement on Schedule DA – Part 1 – Short-term Investment instead of Schedule E – Part 1 – Cash, as required by SSAP No. 91, paragraph 67 of the NAIC Accounting Practices and Procedures Manual, states:

“For repurchase agreements that are accounted for as collateralized lendings in accordance with paragraph 64 of this statement, the underlying securities shall not be accounted for as investment owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income...”

In addition, the NAIC Annual Statement Instructions, Schedule DA - Part 1, states:

“Include all investments whose maturities (or repurchase dates under repurchase agreements) at the time of acquisition were one year or less except those defined as cash in accordance with SSAP No. 2, Cash, Drafts, and Short - Term Investments...”

SSAP No. 2, paragraph 10 of the NAIC Accounting Practices and Procedures Manual states:

“All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding those investments classified as cash equivalents as defined in paragraph 3) shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans which meet the above criteria.”

It is recommended that the Company complete the Note 5 (e) of the NOTES TO FINANCIAL STATEMENTS in accordance with the guidance provided by SSAP 91, paragraph 88, of the NAIC Accounting Practices and Procedures Manual, which states:

- “h. Descriptions of any loaned securities, including the amount, a description of and the policy for, requiring collateral, and whether or not the collateral is restricted;
- i. A description of the securities underlying repurchase and reverse repurchase agreements, dollar repurchase agreements, including book values and fair value, maturities, and weighted average interest rates for the following categories: (i) securities subject to reverse repurchase agreement; (ii) securities subject to repurchase agreements...”

Deferred premiums, agents' balances and installments booked but deferred and not yet due – Page 35
Remittances and items not allocated – Page 35

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 NAIC Annual Statement Instructions, 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 uncollected deductible on paid claims should not be admitted in accordance with the guidance provided by SSAP No. 87, paragraph 3, of the NAIC Accounting Practices and Procedures Manual, which states:

“...Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interest should not be recognized on the balance sheet, and are, therefore, considered nonadmitted. For the purpose of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which is accorded limited or no value in statutory reporting, and is one which is:

- c. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or
- d. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.”

Losses – Page 37

Loss adjustment expenses – Page 37

It is recommended that the *Underwriting and Investment Exhibit Part 2 - Losses Paid and Incurred* should be completed in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Column 1 - Losses Paid Less Salvage - Direct Business, Line 34 should agree with Schedule T, line 59, column 5....Column 3 - Reinsurance Recovered Include: Amount receivable from reinsurance on losses paid during the current calendar year.”

It is recommended that the Company Current Year losses paid recorded on Schedule P agree to the *Underwriting and Investment Exhibit Part 2 - Losses Paid and Incurred* as generally required by the NAIC Annual Statement Instructions. The Company should include deductible billed not collected at year-end on Schedule P, except the amount is uncollectible.

It is recommended that the Company agree Current Year Loss Adjustment Expenses on Schedule P to the Statement of Income, line 3 as generally required by the NAIC Annual Statement Instructions.

Taxes, licenses and Fees – Page 38

It is recommended that credit and deduction for franchise or privilege taxes on the premium tax return is not greater than sixty percent as required by ALA. CODE § 27-4A-3 (1975), which states:

“(c) 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....

(6) Sixty percent of the franchise or privilege taxes paid by the insurer to the State of Alabama for the calendar year.”

SUBSEQUENT EVENTS

The examiners reviewed the cash receipts and disbursements transactions occurring subsequent to the balance sheet date. In addition, the examiners inquired of management regarding any significant events. The significant events are listed below:

Registration:

Company management indicated the following:

- The Company met the requirements under Tenn. Code Ann. § 56-45-104 and was granted approval to function as a Risk Retention Group in the state of Tennessee in October 2008
- The Company filed a Risk Retention Group – Notice of Registration with the Office of Insurance and Safety Fire Commissioner in the state of Georgia seeking approval to engage in activities as a risk retention group on October 13, 2008. As of November 14, 2008, the registration was pending approval.
- The Company filed a Risk Retention Group – Notice of Registration with the Mississippi Commissioner of Insurance to engage in activities as a risk retention group on November 3, 2008. As of November 14, 2008, the registration was pending approval.

Reorganization:

The Company has a proposed plan of reorganization. The reorganization's purpose is to centralize administrative functions and property in one service company that would service the Company and Healthcare Workers' Compensation Self Insurance Fund (HWCF) in order to achieve better business practices by creating cost center segregation, that could be periodically reviewed, which would facilitate marketing and expansion strategies.

The Company has proposed the formation of two new companies; Coastal Insurance Management Company, Inc. and Coastal Contract Services, Inc.

The proposed Articles of Incorporation of Coastal Insurance Management Company, Inc. state that the purposes of the Corporation:

- To provide general and administrative support services to the Company, HWCF, and other affiliated entities.
- To provide management, marketing and insurance agency services to the Company, and other affiliated entities.
- The transaction of any lawful business for which the corporations may be organized under the Alabama Business Corporation Act.

The proposed Articles of Incorporation of Coastal Contract Services, Inc. states the purposes of the Corporation:

- To negotiate and enter into service contracts to provide third-party administrator services, insurance agency services, and other contract services
- The transaction of any lawful business for which the corporations may be organized under the Alabama Business Corporation Act.

CONCLUSION

In concluding this Report on Examination, as of December 31, 2007, of *COASTAL INSURANCE RISK RETENTION GROUP, INC.*, acknowledgment is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

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

In addition to the undersigned, Jerry Hyche, Mora Perkins, Charles Turner, Jennifer Haskell, Examiners, and Suejeudi Buehler, FCAS, MAAA and Matthew Merlino, FCAS, MAAA, FCA, Consulting Actuarial Examiners, both with Merlino & Associates, Inc.; all representing the Alabama Department of Insurance, participated in this examination of Coastal Insurance Risk Retention Group, Inc.
Respectfully submitted,

Francis Blase Abreo

Blase Francis Abreo, CFE
Examiner-in-Charge
State of Alabama
Department of Insurance