

REPORT ON EXAMINATION

OF

**VANGUARD FIRE & CASUALTY
COMPANY**

MAITLAND, FLORIDA

AS OF

DECEMBER 31, 2004

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

August 26, 2005

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (FS), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2004, of the financial condition and corporate affairs of:

**VANGUARD FIRE & CASUALTY COMPANY
2450 MAITLAND CENTER PARKWAY
SUITE 300
MAITLAND, FLORIDA 32751**

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

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2002 through December 31, 2004. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2001. This examination commenced, with planning at the Office, on May 16, 2005, to May 20, 2005. The fieldwork commenced on May 23, 2005, and was concluded as of August 26, 2005. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This financial examination was a statutory financial examination conducted in accordance with the Financial Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code (FAC), with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2004. Transactions subsequent to year-end 2004 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

Based on the review of the Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPAs, after verifying the statutory requirements, for the following accounts:

- Federal income taxes
- Taxes, licenses and fees
- Reinsurance recoverable
- Ceded reinsurance payable

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2001, along with resulting action taken by the Company in connection therewith.

Expense of Parent

In 2001 and 2002 the Company paid \$446,622 in the form of premium payments on an asset protection policy, the beneficiary of which was Winter Park Insurance Investments, Inc.

Resolution: On October 21, 2002, Winter Park Insurance Investments, Inc. issued a check for \$446,622 to the Company to reimburse the Company for these premium payments.

Audit Committee

The audit committee did not document its audit findings, its interaction with the CPA nor its report to the board of any findings of adverse financial condition or significant deficiencies in internal controls noted by the accountant. **Resolution:** The audit committee met annually with the independent CPA following completion of the annual audit.

Corporate Records

The authorization of investments was not recorded in accordance with Section 625.304, FS. **Resolution:** On June 17, 2002, the Board of Directors approved the investment activity for 2002.

Written Premiums

The Company did not include the \$25 per policy managing general agent (MGA) fee charged to policyholders as direct written premiums in violation of Section 627.403, FS. **Resolution:** The Company currently includes the \$25 per policy MGA as written premium in accordance with Section 627.403, FS.

Custodial Agreement

The Company had a custodial agreement with TIB Bank of the Keys, which did not meet the requirements of Rule 69O-143.042, FAC. **Resolution:** The Company provided an amended custodial agreement with the TIB Bank of the Keys, which met the requirements of Rule 69O-143.042 FAC.

Agents' Balances

The Company reported \$923,788 of billed premiums in the course of collection. The Company did not correctly separate the premiums in course of collection of \$547,197 and premiums booked but deferred of \$376,591. The Company also did not calculate the amount of agent's balances to nonadmit due to the over 90 day balances. **Resolution:** The Company now records the "Premiums in course of collection" and "Premiums booked but deferred" in the proper annual statement line. The Company also non-admits "agents' balances" and "premiums in the course of collection" over 90 days past due.

Other Expenses

The Company improperly reported an amount of \$176,872 which was the amount of the FIGA assessment due. **Resolution:** The FIGA assessment was correctly reported on the "Taxes, licenses and fees" line in subsequent filings.

The Company improperly reported an amount of \$28,257, which was the amount of the ceded premiums payable- 1st excess of loss. **Resolution:** Ceded premiums payable has been properly classified on line "Ceded reinsurance premiums payable" on subsequent filings.

Amounts Withheld or Retained for Others

The Company did not report \$1,400,000 which was the amount of the liability established by Consent Order, Case No.4353-01 CO, for the return of unfiled recoupment surcharges of Florida Hurricane Catastrophe Fund (FHCF) assessments, as amounts withheld or retained for others.

Resolution: As of September 30, 2005, the Company had refunded the \$1.4 million in recoupment surcharges of Florida Hurricane Catastrophe Fund (FHCF) assessments to its policyholders.

HISTORY

General

The Company was incorporated on September 22, 1997, as a stock property and casualty insurer under the applicable provisions of the State of Florida and commenced business on December 27, 1998 with the name Professional Protective and Insurance Company. The name was subsequently changed to Vanguard Fire & Casualty Company in June 2000.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2004:

Fire	Allied Lines
Homeowners Multi Peril	Other Liability

The articles of incorporation were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2004, the Company's capitalization was as follows:

Number of authorized common capital shares	10,000
Number of shares issued and outstanding	10,000
Total common capital stock	\$10,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, Winter Park Insurance Investments, Inc. (WPPI) who owned 100 percent of the stock issued by the Company. WPPI, in turn was owned by the following individuals: Thomas R. Jones (22.33%), L. Alan Lund (22.33%), George Nenezian (22.33%) and 9 shareholders with less than 10% each (33.01%).

Profitability of Company

The following table shows the profitability trend (in dollars) as reported by the Company for the period of examination.

	2004	2003	2002
Premiums Earned	9,635,502	5,757,520	8,403,960
Net Underwriting Gain/(Loss)	(23,052,590)	(2,970,556)	(4,950,615)
Net Income/(Loss)	(16,384,421)	(2,432,031)	(1,674,479)
Total Assets	77,978,214	28,740,197	31,724,635
Total Liabilities	70,827,506	20,763,797	23,723,154
Surplus As Regards Policyholders	7,150,710	7,976,400	8,001,481

Dividends to Stockholders

No dividends were declared or paid to the stockholders during the period covered by this examination.

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. Directors serving as of December 31, 2004, were:

Directors

Name and Location

Principal Occupation

William T. Sanders
Maitland, Florida

President,
Vanguard Fire & Casualty Company

Thomas R. Jones Jr.
Homestead, Florida

Manager
T. R. Jones & Company of Broward LC

L. Alan Lund
Homestead, Florida

Managing Member
T.R. Jones & Company of Broward LC

George J. Nenezian
Miami Lakes, Florida

President
NSI Insurance Group, Inc.

Thomas L. Stinson
Maitland, Florida

COO/CFO
Vanguard Fire & Casualty Company

The Board of Directors in accordance with the Company's bylaws appointed the following senior officers:

Senior Officers

Name

Title

William T. Sanders
Thomas R. Jones, Jr.
Thomas L. Stinson
Sidney L. Bright

President
Treasurer / Secretary
Chief Financial Officer
VP of Product Development & Regulatory
Compliance

The Company's board appointed an audit committee in accordance with Section 624.424(8), FS.

The entire Board of Directors served on the Audit Committee.

Conflict of Interest Procedure

The Company had adopted a policy statement requiring disclosure of conflicts of interest, in accordance with Section 607.0832, FS.

Corporate Records

The recorded minutes of the shareholders and Board of Directors meetings were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

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

There were no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance during the period under examination.

Surplus Debentures

As of December 31, 2004, there were no outstanding surplus debentures of the Company.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the Office on July 15, 2004. The Company has not filed an updated holding company registration statement with the Office in violation of Section 628.801, FS and Rule 69O-143-046, FAC.

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

Tax Allocation Agreement

The Company, along with its parent filed a consolidated federal income tax return. On December 31, 2004, the method of allocation between the Company and its parent was based on separate tax liability as if the Company had filed a separate tax return.

Claims Services Agreement

The Company entered into an agreement effective January 1, 2000 whereby affiliate Winter Park Risk Services, Inc. (WPRS) will provide claim service for the Company's insurance business.

MGA Agreement

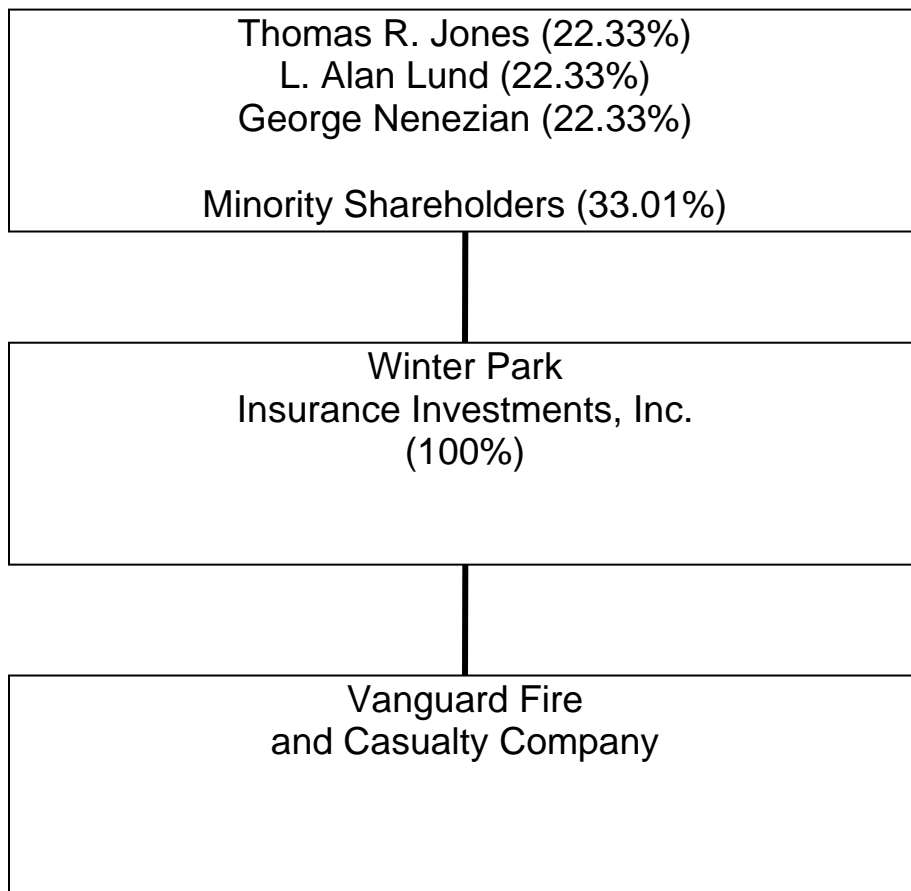
The Company entered into an MGA agreement with its affiliate, Southeast Insurance Solutions, Inc. (SISI) effective January 1, 2002 appointing SISI as its agent and representative for the production, servicing and acceptance of the classes and kinds of insurance written by the Company.

The Company also entered into another MGA agreement with affiliate Precision Underwriters, Inc. (PUI) effective January 1, 2002 appointing PUI as its agent and representative for the production, servicing and acceptance of the classes and kinds of insurance written by the Company.

The Company failed to file the MGA agreement with PUI with the Office in violation of the Consent Order No.26559-98-CO and Rule 69O-143.047, FAC.

A simplified organizational chart as of December 31, 2004, reflecting the holding company system, is shown below. Schedule Y of the Company's 2004 annual statement provided a list of all related companies of the holding company group.

**VANGUARD FIRE & CASUALTY COMPANY
ORGANIZATIONAL CHART
DECEMBER 31, 2004**



FIDELITY BOND AND OTHER INSURANCE

As of year-end 2004, WPIL, doing business as Vanguard Fire & Casualty maintained fidelity bond coverage of \$2,000,000 with a deductible of \$10,000 for a single loss. This insurance adequately covered the suggested minimum amount of coverage for the Company, as recommended by the NAIC in the NAIC's Financial Condition Examiner Handbook.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company sponsored a 401(k) plan covering substantially all employees. The funding policy was discretionary, matching a portion of contributions attributable to its employees.

STATUTORY DEPOSITS

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

FS:

State	Description	Par Value	Market Value
FL	CD, 1.83%, 11/03/05	\$300,000	\$300,000
Total Special Deposits		<u>\$300,000</u>	<u>\$300,000</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

The Company was authorized to transact insurance only in the state of Florida, in accordance with Section 624.401(2), FS.

Treatment of Policyholders

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1) (j), FS.

REINSURANCE

The reinsurance agreements reviewed were found to comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines. However, the Company had a verbal agreement with Renaissance Reinsurance Ltd for the first right of refusal on reinsuring the Company's business at market rates for the treaty years 2004 through 2006, in exchange for the forgiveness of the repayment of the balance of a bonus paid to the Company by Renaissance Reinsurance Ltd.

Assumed

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

Ceded

The Company ceded approximately 85% of its premiums on a quota share and excess of loss basis to authorized and unauthorized reinsurers. The primary ceding reinsurers were Everest Reinsurance Company, an authorized unaffiliated reinsurer (24%), Folksamerica Reinsurance Company, an authorized unaffiliated reinsurer (21%), Odyssey America Reinsurance Corp., an authorized unaffiliated reinsurer (17%), Florida Hurricane Catastrophe Fund (11%), and Renaissance Reinsurance Ltd, an unauthorized non-U.S. reinsurer (10%).

The letters of credit issued for the benefit of the Company did not comply with NAIC and/or the State of Florida statutory guidelines as follows:

Quanta Reinsurance Ltd. - The letter of credit was subject to and governed by the laws of the state of New York rather than Florida as required by Rule 69O-144.005 (6)(e), FAC. Further, the evergreen clause allowed for only 45 days notice rather than the 60 days notice as provided by Rule 69O-144.005 (6)(d)2, FAC.

Axis Specialty Ltd. - The letter of credit was subject to and governed by the laws of the state of New York rather than Florida as required by Rule 69O-144.005 (6)(e), FAC. Further, the evergreen clause allowed for only 30 days notice rather than the 60 days notice as provided by Rule 69O-144.005 (6)(d)2, FAC.

Montpelier Reinsurance Ltd. - The letter of credit was subject to and governed by the laws of the state of New York rather than Florida as required by Rule 69O-144.005 (6)(e), FAC. Further, the evergreen clause allowed for only 45 days notice rather than the 60 days notice as provided by Rule 69O-144.005 (6)(d)2, FAC.

Renaissance Reinsurance Ltd. - The letter of credit was a standby letter of credit issued on January 28, 2005 and expires January 31, 2005 which is less than one year in violation of NAIC guidelines and Rule 69O-144.005 (6)(d)1, FAC. Further, the letter of credit was subject to and governed by the laws of the state of New York rather than Florida as required by Rule 69O-144.005 (6)(e) FAC. Finally, the evergreen clause allowed for only 30 days notice rather than the 60 days notice as provided by Rule 69O-144.005 (6)(d)2, FAC.

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

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years 2002, 2003, and 2004, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, FAC.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office, with the exception of adjustments to line items as noted within this report.

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

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with TIB Bank of the Keys. The custodial agreement failed to indicate that the agreement must be terminable by the insurance company on not more than thirty (30) days' notice in violation of Rule 69O-143.042(o), FAC.

Policy Administration Services Agreement

The Company entered into a policy administration services agreement with Mynd Corporation (formerly the Policy Management System Corporation) effective April 1, 2002. The agreement provided that Mynd Corporation provide the Company with full business process outsourcing which included, but is not limited to, application receipt, policy issuance, premium billing and collection, and various other policyholder services.

Insurance Services Agreement

The Company entered into two agreements with Braishfield Associates, Inc. (BAI), effective July 1, 2000 and October 23, 2000, appointing BAI as its program manager and agent to solicit, market, and underwrite business. Both agreements were terminated effective February 25, 2004.

Independent Auditor Agreement

The Company engaged Thomas Howell Ferguson PA for the purpose of annually auditing and reporting on the statutory basis financial statements at year-end.

Risk-Based Capital

The Company reported its risk-based capital at an adequate level. However, as a result of all examination adjustments the risk-based capital has decreased to the mandatory control level.

Subsequent Event:

As of December 31, 2005, the Company reported its risk based capital had increased from the mandatory control level up to the company action level.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2004, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

VANGUARD FIRE & CASUALTY COMPANY
Assets

DECEMBER 31, 2004

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$680,982		\$680,982
Cash:			
On deposit	34,625,181	\$38,625,298	(4,000,117)
Short-term investments	50,737		50,737
Investment Income due & accrued	13,911		13,911
Agents' Balances:			
Uncollected premium	752,081		752,081
Deferred premium	481,770		481,770
Reinsurance			
Amounts recoverable	30,574,899	(587,743)	31,162,642
Other amounts receivable		(3,284,058)	3,284,058
Current federal income tax recoverable	2,663,320		2,663,320
Net deferred tax asset	627,337		627,337
Receivable from PSA	6,839,402	6,640,706	198,696
Aggregate write ins for other than invested assets	668,594		668,594
Totals	<u>\$77,978,214</u>	<u>\$41,394,203</u>	<u>\$36,584,011</u>

VANGUARD FIRE & CASUALTY COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2004

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$11,790,218	\$2,084,000	\$13,874,218
Loss adjustment expenses	2,337,647		2,337,647
Commissions payable	669,841		669,841
Other expenses	362,240		362,240
Taxes, licenses and fees	166,254		166,254
Unearned premium	2,838,066		2,838,066
Advance premium	1,468,424		1,468,424
Ceded reinsurance payable	4,218,753	587,727	4,806,480
Funds held by company under reinsurance treaties	7,793,350	3,284,058	11,077,408
Amounts withheld or retained for account of others	26,944		26,944
Remittances and items not allocated	154,710		154,710
Drafts outstanding	38,625,298	(38,625,298)	0
Payable to parent, subsidiaries and affiliates	0	393,998	393,998
Aggregate write-ins for liabilities	375,759		375,759
Total Liabilities	\$70,827,504	(\$32,275,515)	\$38,551,989
Common capital stock	\$10,000		10,000
Gross paid in and contributed surplus	25,740,000		25,740,000
Unassigned funds (surplus)	(18,599,290)	(9,118,688)	(27,717,978)
Surplus as regards policyholders	\$7,150,710	(9,118,688)	(\$1,967,978)
Total liabilities, capital and surplus	\$77,978,214	\$41,394,203	\$36,584,011

VANGUARD FIRE & CASUALTY COMPANY
Statement of Income

DECEMBER 31, 2004

Underwriting Income

Premiums earned	\$9,635,502
DEDUCTIONS:	
Losses incurred	24,437,352
Loss expenses incurred	7,353,583
Other underwriting expenses incurred	897,157
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$32,688,092</u>
Net underwriting gain or (loss)	(\$23,052,590)

Investment Income

Net investment income earned	\$290,809
Net realized capital gains or (losses)	(288,122)
Net investment gain or (loss)	<u>\$2,687</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$0
Aggregate write-ins for miscellaneous income	42,100
Total other income	<u>\$42,100</u>

Net income before dividends to policyholders and before federal & foreign income taxes	(\$23,007,803)
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$23,007,803)
Federal & foreign income taxes	<u>(6,623,382)</u>
Net Income	(\$16,384,421)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$7,976,401
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Gains and (Losses) in Surplus

Net Income	(\$16,384,421)
Net unrealized capital gains or losses	216,100
Change in net deferred income tax	1,366,721
Change in non-admitted assets	(1,599,091)
Surplus adjustments: Paid in	15,575,000
Aggregate write-ins for gains and losses in surplus	0
Examination adjustment	(9,118,688)
Change in surplus as regards policyholders for the year	<u>(\$9,944,379)</u>
Surplus as regards policyholders, December 31 current year	<u><u>(\$1,967,978)</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Cash (\$3,949,380)

The exam amount is \$38,625,298 less than the \$34,625,181 reported by the Company. The Company issued checks rather than drafts and erroneously reported the outstanding check balance of the claims account as drafts outstanding rather than as a reduction of cash as required by SSAP 2.

Reinsurance Recoverable \$31,162,642

The exam amount is \$587,743 greater than the \$30,574,899 reported by the Company. This amount was the adjustment to the general ledger and was included in the Company's audited financial statements.

Other Amounts Receivable under Reinsurance Contracts \$3,284,058

The above amount is \$3,284,058 greater than the \$0 reported by the Company. The Company improperly excluded "return premiums" from the amount reported as funds held by the Company under reinsurance treaties. This amount was included as a receivable since this amount would be returned to the Company if the treaties terminated at December 31, 2004.

Receivable from PSA \$198,696

The above amount is \$6,640,706 less than the \$6,839,402 reported by the Company. A valid right of setoff did not exist between multiple parties under multiple contracts. Therefore, the inter-company credit balances of \$393,988 were reclassified to "Payable to PSA". The remaining \$7,034,704 was a receivable due from affiliate WPRS for advances on claims service fees. These

amounts were not evidenced by secured loans. These amounts were prepayments to WPRS and are non-admitted assets pursuant to Section 625.031(7), FS. SSAP 25 provides for the admittance of loans or advances to an affiliate; however, certain items must be present for these amounts to be considered loans, which are not present in this situation. Loans are evidenced by loan documents and are required to be secured pursuant to Section 625.012(2), FS, neither of which are present in this situation. An advance is the same as a prepayment and Section 625.031(7), FS identifies prepayments as non-admitted assets, contradicting and overruling the language in SSAP 25.

Liabilities

Losses and Loss Adjustment Expenses \$16,211,865

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2004, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office's Actuary performed a reserve analysis to determine the adequacy of the Company's reserves. The results of this analysis determined that the Company's carried reserves of \$14,127,865 were approximately \$2,084,000 deficient.

Ceded Reinsurance Payable \$4,806,480

The above amount is \$587,727 greater than the \$4,218,753 reported by the Company. The confirmation received from the reinsurers reported a larger payable than reported by the Company,

and therefore the amounts were adjusted to reflect the amounts confirmed by the reinsurer. These adjustments were also made to the 2004 audited financial statements.

Funds held by Company under reinsurance treaties \$11,077,408

The above amount is \$3,284,058 greater than the \$7,793,350 reported by the Company. The Company improperly excluded “return premiums” from the amount reported as funds held by the Company under reinsurance treaties.

Drafts Outstanding \$-0-

The above amount is \$38,625,298 less than the \$38,625,298 reported by the Company. The Company issued checks rather than drafts and erroneously reported the outstanding check balance of the claims account as drafts outstanding rather than as a reduction of cash as required by SSAP No. 2. Therefore, the entire balance was reclassified to cash.

Additionally, the Company did not maintain an Escheat payable account and had not filed a report of abandoned property with the Department of Financial Services for year-end 2004 in violation of Section 717.117, FS.

Payable to parent, subsidiaries and affiliates \$393,998

The above amount is \$393,998 greater than the \$0 reported by the Company. A valid right of setoff did not exist between multiple parties under multiple contracts. Therefore, the inter-company credit balances of \$393,988 were reclassified to “Payable to PSA”.

Surplus as regards policyholders

(\$1,967,978)

The above amount is \$9,118,688 less than the \$7,150,710 reported by the Company. The Company's surplus, as adjusted by the examination findings, does not meet the minimum required surplus of \$4,000,000 in violation of Section 624.408, FS.

Subsequent Event:

As of December 31, 2005, the Company reported a surplus as regards policyholders of \$8,112,296 which exceeds the minimum required surplus in accordance with Section 624.408 Florida Statutes.

**VANGUARD FIRE & CASUALTY COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2004

The following is a reconciliation of surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders
per December 31, 2004, Annual Statement \$7,150,710

	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
Cash	\$34,625,181	(\$4,000,117)	(\$38,625,298)
Reinsurance recoverable	30,574,899	31,162,642	587,743
Receivable from PSA	6,839,402	198,696	(6,640,706)
Other amounts receivable from reinsurers	-	3,284,058	3,284,058
LIABILITIES:			
Loss reserves	\$11,790,218	\$13,874,218	\$2,084,000
Ceded reinsurance premiums payable	4,218,753	4,806,480	587,727
Funds held by Company	7,793,350	11,077,408	3,284,058
Drafts outstanding	38,625,298	-	(38,625,298)
Payable to PSA	-	393,998	393,998
Net Change in Surplus:			<u>(9,118,688)</u>
Surplus as Regards Policyholders December 31, 2004, Per Examination			<u><u>(\$1,967,978)</u></u>

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2001 examination report issued by the Office, with the exception of the custodial agreement.

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2004.

Affiliated Companies

The Company had not filed an updated holding company registration statement with the Office in violation of Section 628.801, FS and Rule 69O-143-046, FAC. **We recommend the Company comply with Section 628.801, FS and Rule 69O-143.046, FAC and file an updated holding company registration statement within 30 days of the issuance of this report.**

Subsequent Event:

The Company filed an amended Holding Company Registration Statement on September 1, 2005.

Managing General Agent

The Company failed to file the MGA agreement with PUI with the Office in violation of the Consent Order No. 26559-98-CO and Rule 69O-143.047, FAC. **We recommend the Company in the**

future comply with the Consent Order and Rule 69O-143.047, FAC, which provides that the insurer notify the Office in writing at least 30 days prior to entering into intercompany agreements.

Subsequent Event:

The MGA Agreement between the Company and Precision Underwriters Inc. was filed with the office on July 20, 2005.

Reinsurance

The Company had a verbal agreement with Renaissance Reinsurance Ltd. **We recommend that the Company enter into only written agreement with their reinsurers.**

The letters of credit issued for the benefit of the Company did not comply with NAIC and/or State of Florida statutory guidelines. **We recommend the Company replace the current letters of credit and ensure that all future letters of credit received from reinsurers comply with Rule 69O-144.005 (6), FAC; otherwise, credit in Schedule F of the Annual Statement will not be allowed.**

Subsequent Event:

The Quanta Reinsurance, Ltd Letter of Credit was amended on October 19, 2005 to comply with the provisions of Rule 69O-144.005 (6) Florida Administrative Code.

Custodial Agreement

The custodial agreement failed to indicate that the agreement must be terminable by the insurance company on not more than thirty (30) days' notice as required by Rule 69O-143.042(o), FAC. **We recommend the Company obtain a custodial agreement that**

complies with Rule 69O-143.042(o), FAC which states that the agreement shall be terminable by the insurance company on not more than thirty (30) days' notice; and provide a copy to the Office within 90 days of the issuance of this report.

Subsequent Event:

The Company provided an amended custodial agreement with the TIB Bank of the Keys, which met the requirements of Rule 69O-143.042 FAC.

Reinsurance Recoverable

The Company inadvertently understated funds recoverable from reinsurers on paid loss and loss adjustment expenses. **We recommend the Company maintain an accurate accounting of all reinsurance balances in all future filings with the Office.**

Other Amounts Receivable under Reinsurance Contracts

The Company offset the "Funds Held by Company under Reinsurance Treaties" account with the amount that would be returned to the Company if the treaties terminated at December 31, 2004. **We recommend the Company compute funds held balances in accordance with the respective reinsurance treaties in all future years.**

Receivable from PSA

The Company mistakenly offset the debit and credit balances due from various affiliates and reported one net amount in the 2004 annual statement. **We recommend the Company comply with SSAP No. 64 and offset assets with liabilities only when a right of offset exists for all future filings with the Office.**

The Company reported as an admitted asset a prepayment of funds to an affiliate. **We recommend the Company comply with Section 625.031(7), FS and non-admit prepayments in all future filings with the Office.**

Subsequent Event:

As of November 30, 2005, the full amount of the receivable had been collected by the Company.

Loss and Loss Adjustment Expense

The Company's reserves were materially deficient. **We recommend the Company record reserves in all future filings with the Office, sufficient to cover the value of its claims when ultimately settled in accordance with SSAP No. 55.**

Ceded Reinsurance Premiums Payable

The Company inadvertently underreported ceded premiums payable to reinsurers. **We recommend the Company maintain an accurate accounting of all reinsurance balances in all future filings with the Office.**

Drafts Outstanding

The Company issued checks rather than drafts and erroneously reported the outstanding check balance of the claims account as drafts outstanding. **We recommend the Company comply with SSAP No. 2 and record outstanding checks as a reduction of cash in all future filings with the Office.**

Subsequent Event:

Outstanding checks were properly included as negative cash balances rather than drafts outstanding in accordance with SSAP 2.

Unclaimed Funds

The Company did not maintain an Escheat payable account and had not filed a report of abandoned property with the Department of Financial Services for year-end 2004 as required by Section 717.117, FS. **We recommend the Company comply with Section 717.117, FS and escheat unclaimed funds.**

Subsequent Event:

The Company has identified uncashed checks issued and outstanding for more than 5 years and is in the process of issuing letters to the owners at their last known addresses. The report of unclaimed property will be filed with the Department not less than 60 days after the letters to the owners have been mailed.

Payable to PSA

The Company mistakenly offset the debit and credit balances due from various affiliates and reported one net amount in the 2004 annual statement. **We recommend the Company comply with SSAP No. 64 and offset assets with liabilities only when a right of offset exists in all future filings with the Office.**

SUBSEQUENT EVENTS

The Company cancelled the quota share reinsurance agreements that required the maintenance of the funds held account.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Vanguard Fire & Casualty Company** as of December 31, 2004, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was (\$1,967,978), which was in violation of Section 624.408, FS, and makes the Company insolvent. It is recommended that the Company infuse capital within 10 days of the issuance of this report to bring their surplus into compliance with Section 624.408, FS.

In addition to the undersigned, Jay C. Ambler, Financial Examiner/Analyst I; Michael F. Hampton, CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor, and Joseph Boor, FCAS, Actuary participated in the examination.

Respectfully submitted,

Kethessa Carpenter
Financial Specialist
Florida Office of Insurance Regulation