

**STATE OF NORTH DAKOTA
BISMARCK, NORTH DAKOTA**

REPORT OF EXAMINATION

OF

**ADRIATIC INSURANCE COMPANY
METAIRIE, LOUISIANA**

**AS OF
DECEMBER 31, 2006**

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Adriatic Insurance Company

Metairie, Louisiana

as of December 31, 2006, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official seal at my
office in the City of Bismarck, this 1st day of
July, 2008.




Adam W. Hamm
Commissioner of Insurance

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Metairie, Louisiana
June 17, 2008

Honorable Alfred W. Gross
Chairman, Financial Condition (E) Committee NAIC
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
P.O. Box 1157
Richmond, VA 23218

Honorable Merle D. Scheiber
Secretary, Midwestern Zone (III), NAIC
South Dakota Division of Insurance
Department of Revenue and Regulation
445 East Capitol Avenue
Pierre, SD 57501-3185

Honorable Adam W. Hamm
Commissioner of Insurance
State of North Dakota
600 East Boulevard Avenue
Bismarck, ND 58505

Dear Commissioners:

Pursuant to your instructions and statutory requirements, a financial examination has been made of the books, records and financial condition of

**Adriatic Insurance Company
Metairie, Louisiana**

as of December 31, 2006.

Adriatic Insurance Company, hereinafter referred to as the "Company", was last examined as of December 31, 2001, by the North Dakota Insurance Department.

The present examination was conducted at the Company's home office in Metairie, Louisiana, by Examiners from Eide Bailly, LLP representing the North Dakota Insurance Department and the Midwestern Zone.

SCOPE OF EXAMINATION

This examination was a financial condition examination conducted in accordance with N.D.C.C. § 26.1-03-19.3 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. This statutory examination covers the period from January 1, 2002, through

December 31, 2006, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

Work papers provided by the Company's independent auditor were reviewed and where deemed appropriate certain procedures and conclusions documented in those work papers have been relied upon and copied for inclusion into the working papers of this examination.

All recommendations made in the prior report of statutory examination have been adequately addressed by the Company with the following exceptions:

| <u>Recommendation</u> | <u>Action by the Company</u> |
|---|--|
| It is recommended that the Company develop and maintain sufficient documentation, including program file definitions, flow charts, and narratives for each financially significant computer application and program. | The Company did not document financially significant computer applications and programs |
| It is recommended that the Company enter into a written tax allocation agreement with its parent company describing the tax allocation method between the two companies and providing for settlement of intercompany balances. | The Company did not enter into a written agreement describing a method of allocation of the federal tax recoverable or payable resulting from the consolidated return. The Company advised that a separate agreement is being adopted in 2008. |
| It is recommended that the Company obtain insurance coverage protecting itself from losses resulting from dishonest acts committed by Company employees. | The Company did not obtain insurance coverage as recommended. |
| It is recommended that the Company classify federal income taxes receivables from its parent as a separate line item under the caption "Aggregate Write-Ins For Other Than Invested Assets" on page 2 of the Annual Statement, until such time as a tax allocation agreement is executed which meets the conditions of the Annual Statement Instructions for line 16, page 2. | The Company did not comply with this recommendation. |

HISTORY

General

The Company was incorporated on July 16, 1992, in accordance with the North Dakota Business Corporation Act, N.D.C.C. Chapter 10-19.1, and the state insurance statutes, N.D.C.C. Chapter 26.1-05. Effective October 1, 1992, the Company was the surviving entity in a merger with Adriatic Insurance Company, a Delaware corporation that was originally organized on June 12, 1979, under the laws of the State of Delaware.

The Company's primary purpose is to engage in the business of property and casualty insurance. The Company is authorized to operate on the stock plan and is a wholly owned subsidiary of the Anglesey Corporation, A Delaware insurance holding company.

Capital Stock

The Company's Articles of Incorporation authorize the Company to issue 1,500,000 shares of single class (common), no par value capital stock.

At December 31, 2006, the Company had issued all 1,500,000 shares to its parent, Anglesey Corporation. The ownership of Anglesey Corporation is primarily held by the ultimate controlling person, Anthony Ciervo, Jr., who controlled 53.39% of Anglesey's Class A, no par common stock as December 31, 2006.

On April 27, 1994, the Company's stockholder voted to change the par value of common stock from \$1 par value per share to no par. The amendment to the Articles was filed with an approval by the North Dakota Insurance Department effective August 17, 1994.

The stockholder also approved a transfer of \$2,000,000 of unassigned surplus funds to capital stock on April 27, 1994.

Dividends to Stockholders

There were no dividends declared or paid in 2002, 2003, 2004, 2005 or 2006.

Management

The Bylaws provide that an annual meeting of the stockholders shall be held on the fourth Wednesday of April of each year, beginning with the year 1993 at the hour of 2:00 p.m.

The Bylaws also provide that the number of directors of the corporation shall be three and each director holds office until the next annual meeting of stockholders and until his successor has been elected and qualified. Regular meetings of the Board of Directors are held after the annual stockholders meeting.

Board of Directors

Directors serving as of December 31, 2006, were as follows:

| <u>Name and Address</u> | <u>Principal Occupation</u> |
|--|---|
| Joseph Edmond Taylor Metairie, Louisiana | President Adriatic Insurance Company |
| Anthony Vandegrift Ciervo Metairie, Louisiana | Secretary Adriatic Insurance Company |

Steven Michael Harris
Mandeville, Louisiana

Treasurer
Adriatic Insurance Company

Officers

The Bylaws provide that the officers of the corporation shall be a President, a Vice President, a Secretary, and a Treasurer. The Board of Directors may also appoint other or additional officers as may be reasonably necessary for the conduct of the Company's business.

Officers of the Company serving as of December 31, 2006, were as follows:

| <u>Name</u> | <u>Position</u> |
|--------------------------|------------------------------|
| Joseph Edmond Taylor | President |
| Anthony Vandegrif Ciervo | Secretary and Vice President |
| Steven Michael Harris | Treasurer |

Conflict of Interest

The Company has a procedure requiring all directors, officers, and key employees to sign an annual statement entitled "Prohibited Pecuniary Interest of Officials and Employees."

The Examiners' review of the conflict of interest questionnaire disclosed no reporting conflicts.

Corporate Records

The minutes of the Board of Directors and stockholders for the period under examination were read.

The minutes of the various meetings indicated that meeting was well attended and held in accordance with the Bylaws.

The Company did not adopt any amendments to the Articles of Incorporation or Bylaws during the period under examination.

AFFILIATED COMPANIES

Anglesey Corporation, a Delaware insurance holding company, owned 100% of the Company's outstanding stock at December 31, 2006. The ultimate controlling person in the holding company system is Anthony Ciervo, Jr., who owned 4,605 or 53.39% of Anglesey Corporation Class A, no par common stock at December 31, 2006.

A consolidated federal income tax return is filed for Adriatic Insurance Company and its parent Anglesey Corporation. The return is in the parent's name. There is no written agreement describing a method of allocating the federal income tax recoverable or payable. There should be a written agreement approved by the Board of Directors describing the method of allocation and the manner in which intercompany balances will be settled. The agreement should require

that any intercompany balance would be settled within a reasonable time following the filing of the consolidated tax return. The agreement would comply with regulations promulgated by the IRS.

It is again recommended that the Company enter into a written tax allocation agreement with its parent, Anglesey Corporation, describing the tax allocation method between the two companies and providing for settlement of intercompany balances.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2006, the Company did not have insurance coverage protecting it from losses resulting from dishonest acts committed by any of the Company's employees. At December 31, 2006, the minimum amount of coverage suggested by NAIC guidance was \$400,000.

It is recommended that the Company obtain insurance coverage protecting itself from losses resulting from dishonest acts committed by Company employees

The Company had in force insurance policies providing coverage for business personal property, general liability, loss of income, workers compensation, and employers liability.

PENSION, STOCK OWNERSHIP, AND OTHER INSURANCE PLANS

During the period under examination, the Company provided a health plan to employees and in 2001 the Company established a savings incentive match plan with deferred employee compensation and up to 3% matching.

STATUTORY DEPOSITS

Deposits held by or pledged to regulatory agencies at December 31, 2006, are as follows:

| <u>State</u> | <u>Type of Asset</u> | <u>Fair Value</u> | <u>Statement Value</u> |
|----------------|----------------------|-------------------|------------------------|
| Arkansas | CD | \$250,000 | \$250,000 |
| Louisiana | CD | \$100,000 | \$100,000 |
| New Mexico | Treasury Bill | \$341,719 | \$341,719 |
| New York | CD | \$2,561,000 | \$2,561,000 |
| North Dakota | CD | \$2,500,000 | \$2,500,000 |
| Oklahoma | CD | \$100,000 | \$100,000 |
| South Carolina | CD | \$200,000 | \$200,000 |

The deposits held by the States of North Dakota and New York are for the benefit of all policyholders, claimants, and creditors of the Company.

GROWTH OF THE COMPANY

Amounts reflected below were taken from annual statements with the exceptions of years 2001 and 2006. Financial examination reports were used for those years.

| | Net Premiums Written | Admitted Assets | Liabilities | Surplus as Regards Policyholders | Net Income |
|-------------------|----------------------------|--------------------|--------------|--|-------------|
| December 31, 2001 | \$21,770,654 | \$44,476,368 | \$17,808,535 | \$26,667,833 | \$1,733,920 |
| December 31, 2002 | 27,594,841 | 51,944,102 | 20,858,587 | 31,085,515 | 3,750,682 |
| December 31, 2003 | 22,364,407 | 54,877,719 | 20,349,476 | 34,528,243 | 3,442,728 |
| December 31, 2004 | 20,783,760 | 57,632,280 | 19,278,337 | 38,353,943 | 3,825,700 |
| December 31, 2005 | 20,874,971 | 62,532,081 | 20,189,161 | 42,342,920 | 3,988,977 |
| December 31, 2006 | 16,805,375 | 64,172,747 | 15,951,879 | 48,220,868 | 5,877,948 |

TERRITORY AND PLAN OF OPERATION

The Company is licensed in the states of North Dakota, Delaware, Nevada, and New Mexico but writes no business in those states. It operates in the District of Columbia and 24 states on an excess and surplus lines basis.

During the period under examination, the Company wrote inland marine and auto physical damage lines of business.

The Company specialized in writing automobile physical damage coverage for commercial vehicles, including local and long-haul trucking, taxicabs and special automobile risks.

At December 31, 2006, the Company had 50 agents or agencies.

REINSURANCE

The Company ceded reinsurance premiums totaling \$3,746,074 during 2006. All of the 2006 reinsurance premiums were ceded to off-shore unauthorized reinsurers. As of December 31, 2006, loss, loss adjustment expense, and unearned premium reinsurance credits from unauthorized reinsurers totaled \$2,648,000 and funds held by the Company under reinsurance treaties totaled \$3,785,000.

At December 31, 2006, the Company had the following principal reinsurance treaty in force:

Ceded Reinsurance

Type: Multiple Line Excess of Loss

Reinsurer: Aquitaine Insurance Company

Scope: Property business shall mean Automobile Bodily Injury and Property Damage Liability, Personal Injury Protection, Bodily Injury Other Than

Automobile, Property Damage Other than Auto, Employer's Liability, Fire, Allied Lines, Commercial Multiple, Marine Hull, Marine Liability, Inland Marine, Commercial Automobile Physical Damage, Burglary-Theft, Private Passenger Automobile, Mobile Homeowners, Building Contents Liability, Catastrophe Cover covering all lines written.

Coverage:

| Class of Business | Company Retention | Reinsurer's Limit | Comments |
|--|--------------------------|--------------------------|-----------------|
| Auto Bodily Injury and Property Damage Liability | \$25,000 | \$50,000 | Per Occurrence |
| Personal Injury Protection | \$25,000 | \$50,000 | Per Occurrence |
| Bodily Injury Protection, Other Than Auto | \$25,000 | \$50,000 | Per Occurrence |
| Property Damage, Other Than Auto | \$30,000 | \$55,000 | Per Occurrence |
| Employer's Liability | \$25,000 | \$50,000 | Per Occurrence |
| Commercial General Liability | \$50,000 | \$250,000 | Per Occurrence |
| Fire | \$30,000 | \$55,000 | Per Risk |
| Allied Lines | \$30,000 | \$55,000 | Per Risk |
| Commercial Multi-Peril | \$30,000 | \$60,000 | Per Risk |
| Marine Hull | \$30,000 | \$60,000 | Per Risk |
| Marine Liability | \$30,000 | \$60,000 | Per Risk |
| Inland Marine | \$35,000 | \$75,000 | Per Risk |
| Mobile Homeowners | \$30,000 | \$65,000 | Per Risk |
| Building Contents Liability | \$30,000 | \$60,000 | Per Risk |
| Commercial Auto Physical Damage | \$30,000 | \$55,000 | Per Risk |
| Burglary-Theft | \$30,000 | \$55,000 | Per Risk |
| Private Passenger Auto Physical Damage | \$12,000 | \$50,000 | Per Risk |

Catastrophe Cover: All lines 100% of \$1,000,000 excess of \$150,000 per occurrence not to exceed \$1,200,000 aggregate per risk. Additionally, reinsurer shall be liable for 100% of the amount by which the Company's net losses incurred during each calendar year exceed 120% of Company's net earned premium.

Premium: 18% of Company Written Premium

Commissions: 32% of ceded reinsurance premium.

Effective Date: May 1, 1992

Termination: Either party may cancel by providing not less than 90 days written notice.

The reinsurance agreements contain the insolvency clause required by N.D.C.C. § 26.1-02-21.

ACCOUNTS AND RECORDS

The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the course of the examination and its trial balance of the general ledger for the year 2006 was traced to the statutory annual statement.

The Company is audited annually by the independent certified public accountant firm of Rebowe & Company. The work papers of this CPA were made available to the Examiners and were used to the extent deemed appropriate for this examination.

FINANCIAL STATEMENTS

The financial statements of the Company are presented on the following pages in the sequence listed below:

Statement of Assets, Liabilities, Surplus and Other Funds, December 31, 2006

Underwriting and Investment Exhibit, Year 2006

Reconciliation of Capital and Surplus, January 1, 2002 through December 31, 2006

Adriatic Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31, 2006

| | Assets | Nonadmitted Assets | Net Admitted Assets |
|---|---------------------|-------------------------------|--------------------------------|
| Cash | \$11,078,435 | | 11,078,435 |
| Short-Term Investments | 50,405,128 | | 50,405,128 |
| Investment Income Due and Accrued | 579,747 | | 579,747 |
| Premiums and Agents Balances in Course of Collection | 1,920,587 | | 1,920,587 |
| Amounts Recoverable from Reinsurers | 128,879 | | 128,879 |
| Federal and Foreign Income Tax Recoverable | 59,893 | | 59,893 |
| Receivable from Parent, Subsidiary and Affiliate | 78 | | 78 |
| Totals | <u>\$64,172,747</u> | | <u>\$64,172,747</u> |

Adriatic Insurance Company
Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31, 2006

| | | |
|---|-------------------|---------------------|
| Losses | | \$ 5,231,710 |
| Loss Adjustment Expenses | | 547,400 |
| Other Expenses | | 298,773 |
| Taxes, Licenses and Fees | | 851 |
| Unearned Premiums | | 6,058,362 |
| Funds Held by the Company Under Reinsurance Treaties | | 3,784,575 |
| Amounts Withheld or Retained by Company for Account of Others | | 30,208 |
| Total Liabilities | | <u>\$15,951,879</u> |
| Common Capital Stock | \$3,500,000 | |
| Gross Paid In and Contributed Surplus | 1,100,042 | |
| Unassigned Funds (Surplus) | <u>43,620,826</u> | |
| Surplus as Regards Policyholders | | <u>48,220,868</u> |
| Total | | <u>\$64,172,747</u> |

**Adriatic Insurance Company
Underwriting and Investment Exhibit
for the year Ended December 31, 2006**

UNDERWRITING INCOME

| | | |
|--------------------------------------|-------------|-------------------|
| Premiums Earned | | \$18,355,455 |
| Deductions: | | |
| Losses Incurred | \$7,299,228 | |
| Loss Expense Incurred | 970,837 | |
| Other Underwriting Expenses Incurred | 4,062,714 | |
| | | |
| Total Underwriting Deductions | | <u>12,332,779</u> |
| Net Underwriting Gain or (Loss) | | \$ 6,022,676 |

INVESTMENT INCOME

| | | |
|--------------------------------------|-------------|-----------|
| Net Investment Income Earned | \$2,703,118 | |
| Net Realized Capital Gains or Losses | 0 | |
| | | |
| Net Investment Gain or (Loss) | | 2,703,118 |

OTHER INCOME

| | | |
|--|--|---------------------|
| Total Other Income | | <u>21,531</u> |
| Net Income Before Federal Income Taxes | | \$ 8,747,325 |
| Federal Income Taxes Incurred | | <u>2,869,377</u> |
| Net Income | | <u>\$ 5,877,948</u> |

Adriatic Insurance Company
Reconciliation of Capital and Surplus Accounts
January 1, 2002 Through December 31, 2006

| | Year Ended December 31, | | | | |
|---|-------------------------|--------------|--------------|--------------|--------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| Capital and Surplus, December 31, Previous Year | \$27,334,833 | \$31,085,515 | \$34,528,243 | \$38,353,943 | \$42,342,920 |
| Net Income | \$3,750,682 | \$3,442,728 | \$3,825,700 | \$3,988,977 | \$5,877,948 |
| Net Unrealized Capital Gains or (Losses) | \$0 | \$0 | \$0 | \$0 | \$0 |
| Net Change in Capital and Surplus for the Year | \$3,750,682 | \$3,442,728 | \$3,825,700 | \$3,988,977 | \$5,877,948 |
| Capital and Surplus, December 31, Current Year | \$31,085,515 | \$34,528,243 | \$38,353,943 | \$42,342,920 | \$48,220,868 |

NOTES TO FINANCIAL STATEMENTS

Financial statement balances at December 31, 2006, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

CONCLUSION

The financial condition of the Company as of December 31, 2006, as determined by this examination is summarized as follows:

| | | |
|--------------------------------------|-------------------|---------------------|
| Admitted Assets: | | <u>\$64,172,747</u> |
| Total Liabilities | \$15,951,879 | |
| Surplus as Regards Policyholders | <u>48,220,868</u> | |
| Liabilities, Surplus and Other Funds | | <u>\$64,172,747</u> |

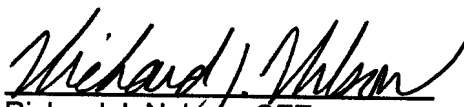
No adjustment of the balance sheet amounts reported by the Company in its 2006 Annual Statement was made by this examination.

Since the last examination of the Company conducted as of December 31, 2001, the Company's admitted assets have increased \$19,696,379, its total liabilities have decreased \$1,856,656, and its surplus as regards policyholders has increased \$21,553,035.

The courteous cooperation extended by the officers and employees of the Company during the course of this examination is gratefully acknowledged.

In addition to the undersigned, Ryan Havick, CFE, of Eide Bailly and Mike Andring, ACAS of the North Dakota Insurance Department participated in this examination.

Respectfully submitted,


Richard J. Nelson, CFE

COMMENTS AND RECOMMENDATIONS

It is again recommended that the Company develop and maintain sufficient documentation, including program file definitions, flow charts, and narratives for each financially significant computer application and program.

It is again recommended that the Company enter into a written tax allocation agreement with its parent, Anglesey Corporation, describing the tax allocation method between the two companies and providing for settlement of intercompany balances. The Company advised that a new agreement is being adopted in 2008.

It is again recommended that the Company obtain insurance coverage protecting itself from losses resulting from dishonest acts committed by Company employees.

It is again recommended that the Company classify federal income tax receivables from its parent, as a separate line item under the caption "Aggregate Write-ins for Other Than Invested Assets" on line 23, page 2 of the Annual Statement, until such time as a tax allocation agreement is executed which meets the conditions of the Annual Statement Instructions for line 16.1, page 2.