# REPORT ON EXAMINATION

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Dept. Of Commerce & Insurance
Company Examinations

OF

NORTH AMERICAN INDEMNITY COMPANY

Nashville, Tennessee

as of

December 31, 2003

THE DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

Nashville, Tennessee

PENGAD-Bayonne, N. J.
EXHIBIT
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Nashville, Tennessee
March 21, 2005

Commissioner Paula A. Flowers
Tennessee Department of Commerce and Insurance
Davy Crockett Tower, Fifth Floor
500 James Robertson Parkway
Nashville, Tennessee 37243-0565

Commissioner:

Pursuant to your instructions and in accordance with Tennessee Insurance Laws and Regulations, and Resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial examination and market conduct review was made of the condition and affairs of:

**NORTH AMERICAN INDEMNITY COMPANY**
3401 West End Avenue, Suite 600
Nashville, Tennessee 37203

(hereinafter referred to as the Company) as of December 31, 2003, and a report thereon is hereby respectfully submitted.

## INTRODUCTION

This examination was called by the Commissioner of Commerce and Insurance of the State of Tennessee and commenced on May 17, 2004. The examination was conducted under the association plan of the NAIC by duly authorized representatives of "The Department of Commerce and Insurance", State of Tennessee.

## SCOPE OF EXAMINATION

The period covered hereunder is from December 31, 1999, the date of the last examination, to the close of business on December 31, 2003, the date of this examination.

**Location of Books and Records**

The majority of the Company's original books and records are located in Marietta, GA and were provided to examiners at the Company's primary administrative home office in Nashville, TN. The location of the Company's books and records were determined to be in compliance with Tenn. Code Ann. 56-2-104.

The examination of the financial condition was conducted in accordance with guidelines and procedures contained in the National Association of Insurance Commissioners (NAIC) Examiners Handbook. During the course of the examination, assets were verified and valued and liabilities were determined and estimated as of December 31, 2003. The financial condition of the Company and its amount of solvency were thereby established. Test checks were made of income and disbursement items for selected periods, and a general review was made of the Company's operations, practices, and compliance with applicable statutes and regulations. All asset and liability items contained in the financial statement of this report were examiner and verified with relative emphasis according to their amount and potential impact on capital and surplus.

Also an examination was also made into the following matters:

Company History
Charter and Bylaws
Management and Control
Corporate Records
Fidelity Bonds and Other Insurance
Territory
Plan of Operation
Market Conduct Activities
Reinsurance
Retirement Plan and Other Employee Benefits
Loss Experience
Accounts and Records
Statutory Deposits
Agreements with Parent, Subsidiaries and Affiliates
Litigation
Financial Statement

**Previous Examination Recommendations**

A recommendation included in the previous report on examination was as follows:

- Section 56-1-407(a)(2), Tennessee Code Annotated allows bonds to be valued as follows:

  "If purchased above or below par, on the basis of the purchase price adjusted so as to bring the value to par at maturity and so as to yield in the meantime the effective rate of interest at which the purchase was made."

  The Company has elected not to amortize acquisition premiums and discounts since this amount has historically been of such an immaterial amount. It is suggested that the Company begin such amortization on future annual statements to better comply with the above statute and NAIC Accounting Practices. This is due to the increased amount of discount which is available for amortization and would produce an increase to the statutory surplus. No change to the present financial statement is suggested due to the amount in question falling well below the tolerable error and planning materiality for this examination.

Procedures for this examination included a test of year-end amortized book values for compliance with Statutory Accounting Principles and Tennessee Statues. Corrective action taken by the Company for the above recommendation was as follows:

- The Company has chosen to amortize premiums and discounts on bonds using the straight-line method. The Company understands that this is not the prescribed method for amortization but has determined that the overall difference between the two methods is immaterial. The Company plans to file its tax return using the straight-line method and is aware of the potential exposure. Considering this, the Company will note the method used in the Annual Statement notes (as in the prior year), but will not recalculate using the effective interest method for all bonds. Thus, the Company is in violation of Tenn. Code Ann. § 56-13-113 which states that each statement filed by a captive insurance company shall be in such form as approved by the Commissioner.

## COMPANY HISTORY

The Company was incorporated on July 23, 1986 as a for profit pure captive insurance company under the provisions of the Tennessee General Corporation Act and the Tennessee Captive Insurance Act. On July 28, 1986, the Board of Directors of the Company approved the issuance of four thousand (4,000) shares of authorized common capital stock to MATSCO, Incorporated, a Georgia corporation located at 1600 Kenview Drive, Marietta, Georgia. As consideration for the issuance of such common stock, the Company was provided an irrevocable letter of credit issued by Commerce Union Bank, Nashville, Tennessee, on behalf of the Company in favor of the Commissioner of Commerce and Insurance, State of Tennessee, as its designated beneficiary. Such irrevocable letter of credit was issued on August 1, 1986, and is automatically renewable in periods, each of one (1) year, for a maximum amount of seven-hundred fifty thousand dollars ($750,000); of which, the Board of Directors designated four-hundred thousand dollars ($400,000) as capital paid in and three-hundred fifty thousand dollars ($350,000) as gross paid in and contributed surplus pursuant to the provisions of Sections 56-13-116 and 119, Tennessee Code Annotated. On August 29, 1986, the Company was issued a Certificate of Authority by the Department of Commerce and Insurance, State of Tennessee, effective August 25, 1986, to transact the business of Professional Liability, Property, Casualty, Errors and Omissions, and Comprehensive General Liability Insurance.

Effective January 2, 1990, MATSCO, Incorporated transferred all outstanding shares of the Company's authorized common capital stock to Corporate Investments, INC. (a Delaware Corporation) which is a wholly owned corporate subsidiary. On December 19, 1994, an order was signed by the Commissioner of Commerce and Insurance, State of Tennessee which allowed the transfer of all outstanding shares of the Company's authorized common capital stock to Robert E. Matthews and ordered this transfer exempt from the provisions of 56-11-203, Tennessee Code Annotated. This acquisition did not change or influence the control of the Company since Mr. Matthews was the majority shareholder of the corporate affiliate which previously owned all outstanding shares.

At December 31, 2003, the Company was licensed in one state, Tennessee. The common capital stock had a balance of $400,000 and gross paid in and contributed surplus of $660,828. There were 400 shares of common stock outstanding.

**Dividends**

The Company paid no dividends during the period under examination.

**Growth of Company**

The following exhibit depicts certain aspects of the growth and financial history of the Company since the previous examination, according to annual statements filed with the Department of Commerce and Insurance, State of Tennessee.

| Date | Earned Premiums | Incurred Losses & LAE | Admitted Assets | Liabilities | Capital and Surplus |
|---|---|---|---|---|---|
| 12/31/00 | $404,000 | $ 242,400 | $ 8,705,229 | $2,969,699 | $5,735,530 |
| 12/31/01 | 401,333 | 240,800 | 9,162,229 | 3,768,735 | 5,393,494 |
| 12/31/02 | 400,000 | 1,105,899 | 9,142,704 | 4,618,255 | 4,524,449 |
| 12/31/03 | 445,000 | (1,675,446) | 10,611,538 | 3,176,251 | 7,435,287 |

## CHARTER AND BYLAWS

**Charter:**

The Charter was filed and recorded with the Tennessee Secretary of State on July 23, 1986, and recorded with the Davidson County Clerk on July 30, 1986. The principal purposes of the Company are "To engage in the insurance business in the State of Tennessee and elsewhere as a captive insurance company; to make insurance and reinsurance, both in the State of Tennessee and elsewhere, to protect against professional liability, property, casualty, errors and omissions and comprehensive general liability pursuant to the Tennessee Captive Insurance Company Act." The Charter authorizes a maximum number of four thousand (4,000) shares of common capital stock with a par value of one hundred dollars ($100) per share.

Articles of Amendment to the Charter were filed with the Secretary of State's office on April 14, 1988 and the Davidson County Clerk on April 15, 1988 to change the address of the principal and home office and to add the language of the Tennessee Business Corporation Act concerning director liability for breach of fiduciary liability.

The corporation's existence is perpetual and its principal and home office is established at 3401 West End Avenue, Suite 600, Nashville, Tennessee.

There were no charter amendments during the period under examination.

**Bylaws:**

The Bylaws of the Company in effect at December 31, 2003 were adopted by the unanimous consent of the Board on July 28, 1986 and have not been amended or changed during the period covered by this examination.

An annual meeting of the shareholders of the Company shall be held on such date as may be determined by the Board of Directors. The business to be transacted at such meeting shall be the election of directors and such other business as shall be properly brought before the meeting. Special meetings of the stockholders, for any purpose, may be called by the Board of Directors or the President or Secretary at the request of the holders of at least 10% of all issued and outstanding shares of the Company entitled to vote at such meeting. Represented either in person or by proxy, a majority of the issued and outstanding shares of the Company constitute a quorum necessary to transact business. Each issued and outstanding share of common stock entitled to vote at any meeting of the shareholders shall be entitled to one vote. Any action which may be taken at a meeting of the stockholders may be taken without a meeting by informal action upon written consent executed by all of the stockholders entitled to vote thereon.

A Board of Directors of at least three (3) members nor more than seven (7) members shall be elected to manage the business and affairs of the Company by the stockholders entitled to vote at the annual meeting to serve for a term not to exceed three (3) years and until his successor is elected and qualified. Regular meetings of the Board shall be held at such times as are fixed from time to time by resolution of the Board, and may be held without notice of the time or place thereof. A majority of the number of directors is necessary to constitute a quorum for the transaction of business at any meeting. Special meetings may be held at any time upon call of the President, a Vice President or any two (2) Directors. Notice of the time and place each special meeting shall be given to each Director at either his business or residence address, as shown by the records of the Company.

The officers for the corporation shall be a President, a Secretary and such other officers as may be elected from time to time by the Board of Directors. One person may hold more than one

office except the President may not hold the office of Secretary. Each officer shall serve at the pleasure of the Board of Directors for such time as the Board may set and until his successor shall have been elected and qualified, or until his death, resignation or removal.

The fiscal year of the Corporation shall be determined by the Board of Directors, and in the absence of such determination, shall be the calendar year.

The Bylaws may be altered, amended or repealed, and new Bylaws may be adopted only by the affirmative vote of a majority of all the issued and outstanding common stock of the corporation.

## MANAGEMENT AND CONTROL

**Management:**

The Bylaws vest the management of the business and affairs of the Company in a Board of Directors of at least three (3) and not more than seven (7) persons. According to the bylaws of the Company, each director shall serve for a term not to exceed three (3) years and until his successor shall be elected and qualified. Since its incorporation, the Company has had the same directors. As of December 31, 2003, the Board of Directors of the Company was composed of the following:

Quinton William Hammack, Jr.
John Hansford Ross
James Clyde Scott, Jr.

As of December 31, 2003, the following persons held office in the Company:

Quinton William Hammack, Jr., President
James Clyde Scott, Jr., Secretary/Treasurer
John Hansford Ross, Vice President

As of December 31, 2003, the Investment Committee was composed of the following:

Quinton William Hammack, Jr.
John Hansford Ross
James Clyde Scott, Jr.

The administrative and executive functions of the Company are performed by staff employed through C. W. Matthews Contracting Company, Inc., an affiliated corporation. The Company

additionally contracts with Polk & Sullivan Group, Inc., a Tennessee Corporation located in Nashville, Tennessee for certain professional and administrative insurance services. The current street and zip code of the principal office of the corporation has changed since the amendment to its charter in 1988. The change has not been filed or updated with the department as of December 31, 2003. The Company is in the process of making these necessary changes.

**Management Agreements**

The Company has an Insurance Management Agreement with Polk & Sullivan Group, Inc., made as of March 31st and renewed each year.

Under the agreement Polk & Sullivan provides the Company with management and related professional and administrative services. Polk & Sullivan provides policyholder service, billing collection advisory service and management. Under the agreement, the Company is provided accounting services, financial reports, and all reports and applications required by the Tennessee Captive Insurance Act.

**Pecuniary Interest**

A check for compliance with Tenn. Code Ann. § 56-3-103 found that no director or officer of the Company had a pecuniary interest in the investment or disposition of Company funds.

**Conflict of Interest Policy**

The Company has established a conflict of interest policy for its directors and officers. The affected persons file annual statements. The statements were reviewed and found to be in compliance with Section 56-13-107 (c), Tennessee Code Annotated.

**Control:**

The Company is wholly-owned by Robert E. Matthews, a Georgia resident. Mr. Matthews is the majority stockholder of MATSCO, Incorporated which owns 100% of C. W. Matthews Contracting Company, Inc., a large highway and bridge construction firm located in Marietta, Georgia.

## CORPORATE RECORDS

Minutes of the meetings of the shareholders of the Company were reviewed for the period under examination. In general, such minutes appear to be in proper order and accurately report the proceedings of each respective meeting.

## HOLDING COMPANY STRUCTURE

An organizational chart of the Company and its parent is located on the last page of this examination report. The following agreement was in effect at December 31, 2003:

The Company has a service agreement with C. W. Matthews Contracting Company, Inc. an affiliated company. The agreement was executed January 3, 1995, and shall continue until such time as either party shall give written notice to the other that such party desires to terminate the agreement. Such written notice of termination shall provide for an effective date of such termination not less than thirty (30) days from the date of such written notice. The terms of the agreement are fair to both parties.

Under the agreement C.W. Matthews Contracting Company Co., Inc provides the Company with certain general and administrative functions and services. The functions and services provided include complete and timely financial and managerial accounting reports, data processing services and reports and preparation and filing of all tax returns and reports. Other services include general corporate services, strategic planning and management and licensing and registration services.

## FIDELITY BOND AND OTHER INSURANCE

As of December 31, 2003, and the date of this examination report, the Company is not a named insured under the fidelity bond and other insurance issued to MATSCO, Incorporated and/or C.W. Matthews Contracting Company, Inc. Minimum fidelity coverage suggested in the National Association of Insurance Commissioners' Examiners Handbook for a company of the Company's size and premium volume is not less than $100,000.

## TERRITORY

As of December 31, 2003, and as of the date of this examination report, the Company was licensed to transact business only in the State of Tennessee. The Certificate of Authority for that jurisdiction was reviewed.

## SCHEDULE T –EXHIBIT OF PREMIUMS WRITTEN

| Direct Premiums Written | Direct Premiums Earned | Direct Losses Paid | Direct Losses Incurred | Direct Losses Unpaid |
|---|---|---|---|---|
| | | | | |
| $460,000 | $445,000 | $0 | ($1,675,446) | $2,415,271 |

## PLAN OF OPERATION

The Company is a pure captive insurance company with one policyholder, C. W. Matthews Contracting Company, Inc. The Company presently writes an excess policy of $1,000,000 above C. W. Matthews Contracting Company, Inc.'s initial self insured layer of $1,000,000. MATSCO, Incorporated (the parent of C. W. Matthews Contracting Company, Inc.) and Kenview Corporation (a corporate affiliate) are also named insureds under the policy. The coverage is for auto liability and general liability. As needed, railroad protective coverage is provided.

C. W. Matthews Contracting Company, Inc. files the "Report of Person(s) Procuring Insurance From Unauthorized Insurers" in the State of Georgia and pays the appropriate premium tax as provided under Section 33-5-33, Georgia Insurance Code.

## MARKET CONDUCT ACTIVITIES

In accordance with the policy of the Department of Commerce and Insurance, State of Tennessee, a market conduct review was made of the Company as of December 31, 2003 in conjunction with this examination. The following items were addressed:

**Policy Forms, Rating and Underwriting:**

Under Section 56-13-125, Tennessee Code Annotated, rates are filed with the Department only if the Commissioner deems necessary. The policy written to C. W. Matthews Contracting Company, Inc. was reviewed.

**Advertising:**

The Company does no advertising.

**Claims Review:**

The Company carries a $200,000 case reserve on an auto accident claim from the 1995 accident year which was litigated and has now been dismissed in court.

The Company continues to carry an Incurred But Not Reported (IBNR) reserve in the amount of approximately $2,321,000 for conservatism which cover years 1994 thru 2003.

The Company adopts the above reserving policy even though they have not paid a claim for the period under review.

**Policyholder Complaints:**

During the period under examination there appeared to be no unusual practices or items warranting criticism of the Company.

**Privacy**

The Company is not subject to Tenn. Comp. R. & Reg. §0780-1-72 since it does not insure or transact business with any individuals.

**Anti-Fraud Plans**

The Company is exempt from Tenn. Code Ann. § 56-53-111 because it does not have direct written premiums exceeding ten million dollars ($10,000,000).

## REINSURANCE

For the entire period under review and as of the date of this examination, the Company has not reinsured any of its insured risks.

## RETIREMENT PLAN AND OTHER EMPLOYEE BENEFITS

As of December 31, 2003, the Company had no employees.

## LOSS EXPERIENCE

| Year | Losses Incurred | LAE Incurred | Premiums Earned | Loss Ratio |
|---|---|---|---|---|
| 2000 | $ 242,400 | $-0- | $ 404,000 | 60.0% |
| 2001 | 240,800 | -0- | 401,333 | 60.0% |
| 2002 | 1,105,899 | -0- | 400,000 | 276.5% |
| 2003 | (1,675,446) | -0- | 445,000 | (376.5%) |

## ACCOUNTS AND RECORDS

During the course of examination, such tests and audit procedures were made as were considered necessary, including substantial verification of postings, extensions and footings and reconciliation of subsidiary ledgers to control accounts where necessary. General ledger trial balances were reconciled with copies of annual statements for the years 2000, 2001, 2002, and 2003. The company could not provide a detailed general ledger for 2003.

Accounting records conform to generally accepted insurance accounting practices and appear to properly reflect the operations during the period under examination and the status of the Company at the date of examination.

The Company does not have a data processing system as all work is done by their corporate affiliate, C. W. Matthews Contracting Company, Inc.

The Company's Risk Based Capital Report was reviewed and found to be in compliance with requirements.

The Company retains the independent certified accounting services of Faulkner, Mackie &

Cochran for financial statement reporting purposes. This firm has been performing such services for over ten (10) years. The Company qualified for the small company audited financial statement exemption filing. As stated in the Property and Casualty Annual Statement Instructions, an insurer that has less than $1,000,000 total direct plus assumed written premiums during a calendar year, and less than $1,000,000 total direct plus assumed loss and loss adjustment expense reserves at year-end, in lieu of the Actuarial Opinion required for the calendar year, may submit an affidavit under oath of an officer of the insurer that specifies the amounts of direct plus assumed written premiums and direct plus assumed loss and loss adjustment reserves. An exemption request was made by the Company and approved by "The Department of Commerce and Insurance." Thus, there appears to be no violation as respect to Tenn. Comp. R. & Reg. §0780-1-65.07(3).

## STATUTORY DEPOSITS

In compliance with statutory requirements, the Company maintained the following deposits at December 31, 2003.

| Where Deposited and Description | Par Value | Statement Value | Market Value |
|---|---|---|---|
| **Tennessee** | | | |
| Letter of Credit | $750,000 | $750,000 | $750,000 |
| **Total special deposits held for the benefit of all policyholders of the Company** | 750,000 | 750,000 | 750,000 |
| **Total** | $750,000 | $750,000 | $750,000 |

## LITIGATION

As of December 31, 2003, the Company had no pending litigation, other than that arising out of the normal course of business, which would adversely affect the financial condition of the Company.

## FINANCIAL STATEMENT

There follows a statement of assets, liabilities and statement of income at December 31, 2003, together with a reconciliation of capital and surplus for the period under review, as established by this examination:

### ASSETS

| | Ledger Assets | Assets Not Admitted | Net Admitted Assets |
|---|---|---|---|
| Bonds | $ 4,265,293 | $ 4,265,293 | $ 0 |
| Preferred stocks | 1,168,210 | 1,168,210 | 0 |
| Common stocks | 3,616,030 | 3,616,030 | 0 |
| Cash and short-term investments | 734,672 | 726,868 | 7,804 |
| Investment income due and accrued | 62,941 | 62,941 | 0 |
| Prepaid expenses | 12,904 | 12,904 | 0 |
| Irrevocable letter of credit | 750,000 | | 750,000 |
| Commission income receivable | 14,392 | | 14,392 |
| **Totals** | **$ 10,624,442** | **$ 9,852,246** | **$ 772,196** |

### LIABILITIES, SURPLUS, AND OTHER FUNDS

| | | |
|---|---|---|
| Losses | | $ 2,520,692 |
| Current federal and foreign income taxes | | 13,990 |
| Net deferred tax liability | | 526,569 |
| Unearned premiums | | 115,000 |
| **Total Liabilities** | | **3,176,251** |
| Common capital stock | $ 400,000 | |
| Gross paid in and contributed surplus | 660,828 | |
| Unassigned funds (surplus) | (3,464,883) | |
| Total capital and surplus | | (2,404,055) |
| **Totals** | | **$ 772,196** |

## STATEMENT OF INCOME

### UNDERWRITING INCOME

| | | |
|---|---|---|
| Premiums earned | | $ 445,000 |
| Deductions: Losses incurred | ($1,675,446) | |
| Other underwriting expenses incurred | 80,037 | |
| Total underwriting deductions | | (1,595,409) |
| Net underwriting gain | | 2,040,409 |

### INVESTMENT INCOME

| | | |
|---|---|---|
| Net investment income earned | 342,380 | |
| Net realized capital gains | 222,612 | |
| Net investment gain | | 564,992 |

### OTHER INCOME

| | |
|---|---|
| Aggregate write-ins for miscellaneous income | 14,392 |
| Net income before federal income taxes | 2,619,793 |
| Federal income taxes incurred | 126,685 |
| **Net income** | $ 2,493,108 |

### CAPITAL AND SURPLUS

| | | |
|---|---|---|
| Surplus as regards policyholders, December 31, prior year | | $ 4,524,449 |
| Net income | $2,493,108 | |
| Change in net unrealized capital gains or (losses) | 396,091 | |
| Change in deferred income tax | (406) | |
| Change in non-admitted assets | (9,817,297) | |
| Change in surplus as regards policyholders for the year | | ( 6,928,504) |
| **Surplus as regards policyholders, December 31, current year** | | **($2,404,055)** |

**RECONCILIATION OF CAPITAL AND SURPLUS**
**FOR THE PERIOD UNDER EXAMINATION**

| **Surplus as regards policyholders December 31** | **2000** | **2001** | **2002** | **2003** |
|---|---|---|---|---|
| Previous Year | $5,258,963 | $5,735,530 | $5,393,494 | $4,524,449 |
| Net Income (loss) | 407,511 | 417,584 | (356,466) | 2,493,108 |
| Net unrealized capital gains or (losses) | 65,964 | (120,178) | (490,114) | 396,091 |
| Change in nonadmitted assets | 3,092 | (3,257) | (22,140) | (9,817,297) |
| Change in net deferred income tax | | (300) | (325) | (406) |
| Cumulative effect of changes in accounting principles | | (635,885) | | |
| **Surplus as regards to policyholders December 31 Current Year** | **$5,735,530** | **$5,393,494** | **$4,524,449** | **$(2,404,055)** |

## ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION

**Bonds** **$-0-**

The value of bonds is $4,265,293 less than the annual statement value of $4,281,293 less the reclassification of $16,000 to preferred stock.

The $16,000 reclassification is the result of the Company listing and reporting a preferred stock as a bond.

The total value of bonds is being nonadmitted because the Company was not in compliance with Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company's custodial agreement was in the name of an affiliate, not the Company. Also, the securities were held in a joint account with another affiliate.

**Preferred Stocks** **$-0-**

The value of preferred stocks is $1,168,210 less than the annual statement value of $1,152,210 plus the reclassification of $16,000 from bonds.

The total value of preferred stocks is being nonadmitted because the Company was not in compliance with Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company's custodial agreement was in the name of an affiliate, not the Company. Also, the securities were held in a joint account with another affiliate.

**Common Stocks** **$-0-**

The value of common stocks is $3,616,030 less than the amount stated in the 2003 annual statement.

The total value of common stocks is being nonadmitted because the Company was not in compliance with Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company's custodial agreement was in the name of an affiliate, not the Company. Also, the securities were held in a joint account with another affiliate.

**Short-term Investments** **$-0-**

The value of short-term investments is $726,868 less than the amount stated in the 2003 annual statement.

The total value of short-term investments is being nonadmitted because the Company was not in compliance with Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company's custodial agreement was in the name of an affiliate, not the Company. Also, the securities were held in a joint account with another affiliate.

**Investment Income Due and Accrued** **$-0-**

The value of investment income due and accrued is $62,941 less than the amount stated in the 2003 annual statement.

The total value of investment income due and accrued is being nonadmitted because the Company was not in compliance with Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company's custodial agreement was in the name of an affiliate, not the Company. Also, the securities were held in a joint account with another affiliate.

**Unassigned Funds (Surplus)** **($3,464,883)**

The value of unassigned funds is $(9,839,342) less than the amount stated in the 2003 annual statement. Said difference is outlined in the following "Summary Schedule".

## SUMMARY SCHEDULE FOR "ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM EXAMINATION" AS THEY AFFECT SURPLUS

The following depicts the change in surplus as outlined in the previous section of the report.

| ITEM | SURPLUS INCREASE | SURPLUS DECREASE |
|---|---|---|
| Bonds | | $4,265,293 |
| Preferred Stocks | | 1,168,210 |
| Common Stocks | | 3,616,030 |
| Short-term Investments | | 726,868 |
| Investment Income Due and Accrued | | 62,941 |
| Totals | | $9,839,342 |

Prior to the completion of the examination, the Company executed a newly amended custodial agreement dated November 11, 2004 that met the standards set forth by Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company's securities were placed in its name only versus being held jointly with an affiliate. If this custodial agreement had been in place at December 31, 2003, the Company would have had admitted assets of $10,611,538 and liabilities, exclusive of capital, of $3,176,251. Thus, there would have existed for the additional protection of policyholders, the amount of $7,435,287 in the form of paid-up capital, gross paid-in and contributed surplus and unassigned funds (surplus).

## COMMENTS AND RECOMMENDATIONS

The following list presents a summary of comments and recommendations noted in this report:

### Comments:

**Management and Control** – Page 7

According to the bylaws of the Company, each director shall serve for a term not to exceed three (3) years and until his successor shall be elected and qualified. Since its incorporation, the Company has had the same directors.

The current street and zip code of the principal office of the corporation has changed since the amendment to its charter in 1988. This change has not been filed or updated with the department as of December 31, 2003. The Company is in the process of making these necessary changes.

**Fidelity Bond and Other Insurance** - Page 9

The company does not maintain a fidelity bond. Minimum fidelity coverage suggested in the National Association of Insurance Commissioners' Examiners Handbook for a company of the Company's size and premium volume is not less than $100,000.

### Recommendations:

- It is recommended that all charter amendments be approved by "The Tennessee Department of Commerce and Insurance" as set forth by Tenn. Code Ann. § 56-2-103(6) before submitting to the Secretary of State. Under Tenn. Code Ann. § 48-15-102 a corporation may change its registered office by delivering to the secretary of state for filing a statement of change.

- The Company's custodial agreement with Delaware Trust Capital Management in effect as of the date of examination did not meet the requirements set forth by Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company, Delaware Trust Company, National Association

and certain representatives of the Tennessee Department of Commerce and Insurance worked to resolve the problem prior to the completion of the examination and created a newly amended agreement dated November 11, 2004 that met the standards.

- Tenn. Code Ann. § 56-13-113 states that each annual statement filed by a captive insurance company shall be in such form as approved by the commissioner.

  The Company has chosen to amortize premiums and discounts on bonds using the straight-line method. The Company understands that this is not the prescribed method for amortization but has determined that the overall difference between the two methods is immaterial. The Company plans to file its tax return using the straight-line method and is aware of the potential exposure. Considering this, the Company will note the method used in the Annual Statement notes (as in the prior year), but will not recalculate using the effective interest method for all bonds. It is recommended that the Company use the preferred method of amortization on future annual statements to better comply with the above statute and NAIC Accounting Practices.

  During the examination review, it was noted that the Company did not include in the Annual Statement Schedule D the rates used to obtain the fair value of bonds. It is recommended that the Company report the rate used to obtain fair value for each security listed in Schedule D in the future.

## CONCLUSION

The customary examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of North American Indemnity Company of Nashville, Tennessee.

In such manner, it was determined that, as of December 31, 2003, the Company had admitted assets of $772,196 and liabilities, exclusive of capital, of $3,176,251. Thus, the capital and surplus were ($2,404,055). Since the Company was required to maintain capital and surplus of $750,000 per Tenn. Code Ann. § 56-13-116, the Company was insolvent in the amount of $3,154,055.

Respectfully submitted,

Stephanie D. Higgins

Stephanie D. Higgins, CFE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC

**AFFIDAVIT**

The undersigned deposes and says that she has duly executed the attached examination report of North American Indemnity Company dated March 21, 2005, and made as of December 31, 2003, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says she is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of her knowledge, information and belief.

Stephanie D. Higgins

Stephanie D. Higgins, CFE
Examiner-in-Charge
State of Tennessee
Southeastern Zone, NAIC

Subscribed and sworn to before me

this 21st day of

March, 2005

Notary Helen H. Dorsey

County Davidson

State Tennessee

Commission Expires 03/25/2006

## ORGANIZATIONAL CHART

Robert E. Matthews

100% 49.8%

North American Indemnity Company MATSCO, Incorporated

100% 100%

Kenview Corporation C.W. Matthews Contracting Company, Inc.

## ADDENDUM

Prior to the completion of the examination, the Company executed a newly amended custodial agreement dated November 11, 2004 that met the standards set forth by Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company's securities were placed in its name only versus being held jointly with an affiliate. If this custodial agreement had been in place at December 31, 2003, the Company would have had admitted assets of $10,611,538 and liabilities, exclusive of capital, of $3,176,251. Thus, there would have existed for the additional protection of policyholders, the amount of $7,435,287 in the form of paid-up capital, gross paid-in and contributed surplus and unassigned funds (surplus).

SYNAXIS
POLK & SULLIVAN
A subsidiary of First Tennessee Bank National Association

*Risk Management, Insurance, Bonds & Employee Benefits*

March 31, 2005

RECEIVED
APR 1 1 2005
Dept Of Commerce & Insurance
Company Examinations

Mr. Don Spann, CFE
Insurance Examination Director
State of TN Dept of Commerce & Insurance
500 James Robertson Pkwy
Nashville, TN 37243

Re: Financial Condition Examination of North American Indemnity Company
Made as of December 31, 2003

Dear Mr. Spann:

Pursuant to Tenn. Code Ann. 56-1-411(d)(1), this letter will serve as written submission with respect to the matters contained within the referenced report for North American Indemnity Company.

Management and Control –Page 20: The bylaws do limit the term for a director to three (3) years; however, they do not stipulate that a director can not succeed themselves. Therefore, an amendment to the bylaws is not deemed necessary.

The only other issue with respect to this report is the length of time and cost associated with the process. As you are aware, we have appealed this and are waiting for a disposition on our request for reimbursement.

If you have any questions after reviewing this information please contact me.

Sincerely,

Daniel D. Hite
Executive Vice President

Cc: Kathy Fussel
Larry Knight

PENGAD-Bayonne, N. J.
EXHIBIT
B

3401 West End Avenue, Suite 600
Nashville, TN 37203
Telephone 615.385.2860
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The Council of Insurance Agents & Brokers