

**AequiCap Insurance Company in Liquidation
Insolvency Report
May 17, 2017**

Receivership Information/Reference:

| | |
|-----------------------------|---|
| Name of Receivership | AequiCap Insurance Company (“AIC”) |
| Receivership Number | 531 |
| Date of Conservation | N/A |
| Date of Rehabilitation | February 28, 2011 |
| Date of Liquidation | March 7, 2011 |

Scope:

As provided in that Provider Contract between the “Receiver of the AequiCap Insurance Company (AIC)” (the Receiver being the Florida Department of Financial Services, Division of Rehabilitation and Liquidation), hereinafter referred to as (“Receiver”) and Dixon Hughes Goodman LLP (“Provider”), effective October 26, 2012, under Section 5, SCOPE OF WORK, states in part:

5.3.6 Prepare an insolvency summary report (“Insolvency Report”) for AIC in accordance with *Chapter 631.398 (3), Florida Statutes*.

The document review of the files in the Provider’s possession was conducted at various dates from October 26, 2012 through the date of this report, inclusive, by approved Provider staff at the Provider’s offices.

The authority under which this insolvency report is written is Section 631.398, Florida Statutes, which states as follows:

Title XXXVII Chapter 631
INSURER INSOLVENCY; GUARANTY OF INSURANCE PAYMENT

631.398

Prevention of insolvencies.

To aid in the detection and prevention of insurer insolvencies or impairments:

(1) Any member insurer; agent, employee, or member of the board of directors; or representative of any insurance guaranty association may make reports and recommendations to the department or office upon any matter germane to the solvency, liquidation, rehabilitation, or conservation of any member insurer or germane to the solvency of any company seeking to do an insurance business in this state. Such reports and recommendations are confidential and exempt from the provisions of s. 119.07(1) until the termination of a delinquency proceeding.

(2) The office shall:

(a) Report to the board of directors of the appropriate insurance guaranty association when it has reasonable cause to believe from any examination, whether completed or in process, of any member insurer that such insurer may be an impaired or insolvent insurer.

(b) Seek the advice and recommendations of the board of directors of the appropriate insurance guaranty association concerning any matter affecting the duties and responsibilities of the office in relation to the financial condition of member companies and companies seeking admission to transact insurance business in this state.

(3) The department shall, no later than the conclusion of any domestic insurer insolvency proceeding, prepare a summary report containing such information as is in its possession relating to the history and causes of such insolvency, including a statement of the business practices of such insurer which led to such insolvency.

History. ss. 28, 39, ch. 83-38; ss. 187, 188, ch. 91-108; s. 4, ch. 91-429; ss. 2, 6, ch. 93-118; s. 385, ch. 96-406; s. 1351, ch. 2003-261.

Business:

Historical information regarding AIC is as follows:

- **Date and Location of Incorporation:** AIC originally incorporated in Florida on November 13, 1985¹.
- **Date the Company Began Doing Business in Florida:** AIC was licensed to begin doing business in Florida as a property and casualty insurance company in December 1985² and continued to do so through March 7, 2011.
- **Lines of Business:** AIC was licensed in several states but wrote workers compensation and commercial auto liability in Florida, Georgia, South Carolina, and Oklahoma. During the year-ended December 31, 2010, AIC had a total of \$19,385,801 in direct written premium ("DWP"). Approximately 55% of DWP was related to commercial auto liability coverage, and the remaining 45% was related to workers' compensation coverage. Approximately 91% of DWP was related to policies written in Florida, 5% of DWP was related to policies written in Georgia, 4% of DWP was related to policies written in South Carolina, and less than .5% of DWP was related to policies written in Oklahoma³.
- **Certificates of Authority:** At the time of insolvency, AIC was operating under certificates of authority issued by the states of Florida, Georgia, South Carolina, Oklahoma, and Texas⁴.
- **Geographic Areas:** At the time of insolvency, AIC's area of insurance coverage was Florida, Georgia, South Carolina, and Oklahoma⁵.

¹ AIC Audited Financial Statements for the Years Ended December 31, 2009 and 2008, amended, Footnote 1.

² Florida Department of Financial Services

³ AIC Annual Statement Filing for the Year Ended December 31, 2010 (Unfiled) - Schedule T

⁴ AIC Annual Statement Filing for the Year Ended December 31, 2010 (Unfiled) - Schedule T

⁵ AIC Annual Statement Filing for the Year Ended December 31, 2010 (Unfiled) - Schedule T

- **Consent Order:** On August 13, 2008, the Company signed a consent order with an effective date of August 22, 2008, with the Florida Office of Insurance Regulation (“OIR”) through which AIC was directed to address the following items:
 - By August 15, 2008, replace assets totaling \$3,819,000 consisting of Equipment Trust Certificates and an interest in Cry Baby Broadway, Ltd. With assets that were acceptable to the OIR.
 - Increase loss and LAE reserves (carried reserves) to an amount within \$5,000,000 of the mid-point or best estimate of the opining actuary by December 31, 2008, and increase carried reserves to an amount equal to or higher than the opining actuary’s mid-point or best estimate by December 31, 2009.
- **Operating Results:** As reported in the AIC Annual Statement Filing for the Year Ended December 31, 2010 (Unfiled) - Statement of Income:
 - Premiums earned were \$14,872,431 and \$26,910,551 in 2010 and 2009, respectively.
 - Underwriting loss for the year ended was \$21,389,450 and \$6,558,837 in 2010 and 2009, respectively.
 - Net loss for the year ended was \$22,216,524 and \$3,923,211 in 2010 and 2009, respectively.
- **Ownership:** AIC’s 2010 NAIC Annual Statement identified AequiCap Inc., a wholly owned subsidiary of AequiCap Financial Group Inc., as the owner of AIC⁶. AIC’s 2010 Annual Report was not filed with the Florida Secretary of State and listed the following officers and directors at December 31, 2010.
 - Phillip Edward Morgaman, Chairman of the Board of Directors
 - Mark Stephenson, CEO and Director
 - Matthew Thomas Jones, President
 - Elvis R. Rivera, Controller & Financial Officer
 - Marilyn Johnson Peterson, Vice President
 - Charles King, Director
 - Neal Clark Nichols, Director
 - Deborah Sarvis Gardner, Director
- **Affiliates:** AIC’s 2010 NAIC Annual Statement identified the following affiliates:
 - AequiCap Financial Group Inc. (“AFG”), which owns 100% of the AIC’s parent, AequiCap Inc.

AIC also had the following wholly-owned subsidiaries;

- Viceroy Underwriters, Inc.
 - Insurance Services, Inc. (a wholly-owned subsidiary of Viceroy Underwriters, Inc.)
- AequiCap Finance Partners, Inc.

⁶ AIC Audited Financial Statements for the Years Ended December 31, 2010 and 2009

The following companies are affiliated by common ownership;

- AequiCap Employer Services, Inc.
- AequiCap Insurance Agency, Inc.
- AES I, Inc.
- AES II, Inc.
- AES III, Inc.

AIC had transactions with these additional affiliates;

- AequiCap Claims Services, Inc. (“ACS”)
- AequiCap Program Administrators, Inc. (“APA”)

AIC paid managing general agent (“MGA”) commissions to APA per audited financial statements:

- 2008 - \$9,458,000
- 2009 - \$11,448,000

AIC paid claims administration fees to ACS, per audited financial statements:

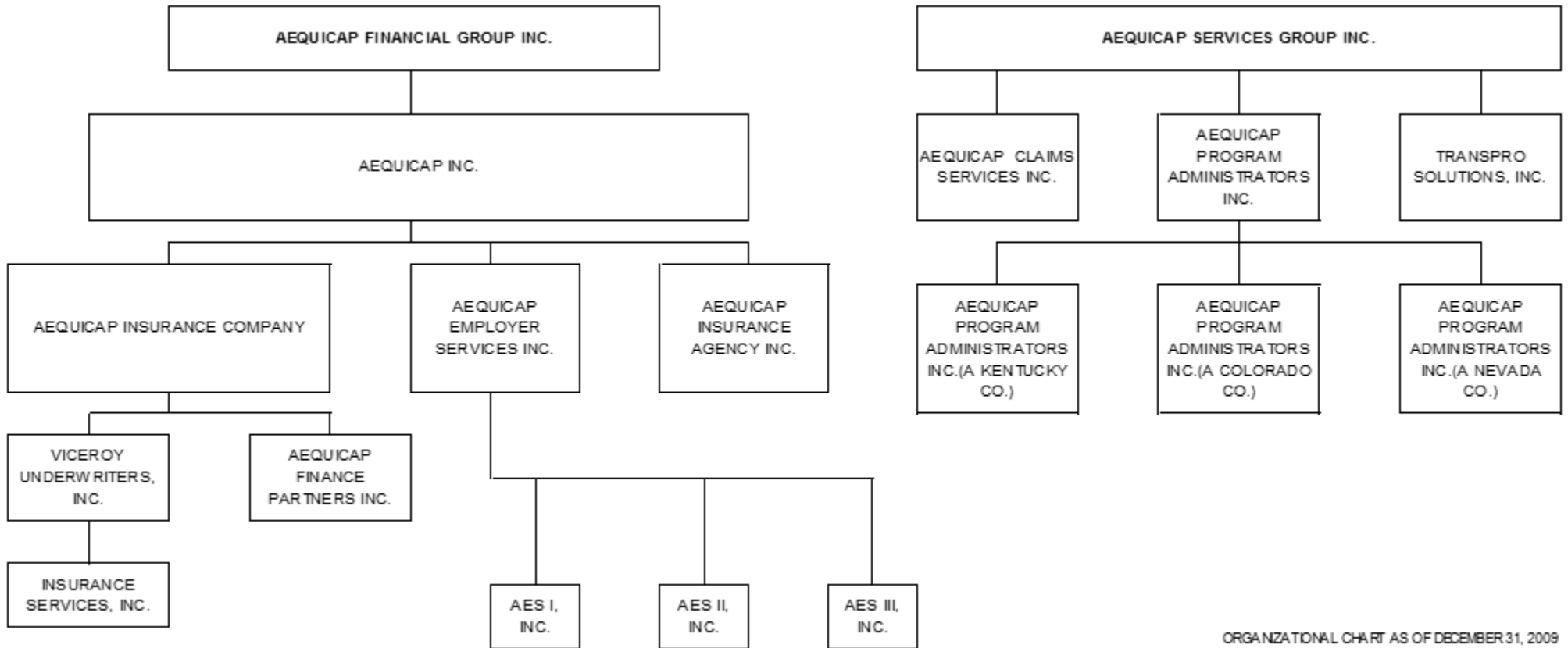
- 2007 - \$4,937,250
- 2008 - \$3,993,000
- 2009 - \$3,993,000

AIC paid management fees to AFG, per audited financial statements:

- 2007 - \$846,000
- 2008 - \$1,578,000
- 2009 - \$461,000

- **Organization Chart:** The following Organizational Chart was taken from the AIC Annual Statement Filing for the Year Ended December 31, 2009:

Organizational Chart - AequiCap Insurance Company



ORGANIZATIONAL CHART AS OF DECEMBER 31, 2009

Management:

The management of AequiCap Insurance Company was comprised of the following officers and directors⁷:

- James E Roberts served as President and COO during 2007 and 2008.
- Matthew Thomas Jones served as Vice President and Secretary during 2007 and 2008. He also served as President during 2009 and 2010.
- Elvis R Rivera served as the Controller and Financial Officer in 2010.
- Deborah Sarvis Gardner served as a member of the Board of Directors from 2007 through 2010. She also served as Senior Vice President and CFO from 2007 through 2009.
- Philip Edward Morgaman served as a Chairman of the Board of Directors from 2007 through 2010.
- Nicole Boodram served as Senior Vice President from 2007 through 2009. She also served as Secretary during 2009.
- Norman Baker served as Vice President from 2007 through 2009.
- Mark Stephenson served as a member of the Board of Directors and CEO from 2007 through 2010.
- Bradford St. Pierre served as Vice President and Chief Actuary from 2008 through 2009.
- Chris Parkinson served as Senior Vice President from 2007 through 2008.
- Marilyn Johnson Peterson served as Vice President 2007 through 2010.
- John Pecoraro served as Vice President 2009.
- Charles King served as a member of the Board of Directors from 2007 through 2010.
- William Dana Spruce served as a member of the Board of Directors during 2007.
- Justin Daniel Morgaman served as a member of the Board of Directors from 2007 through 2008.
- Neal Clark Nichols served as a member of the Board of Directors 2007 through 2010.

AIC was a wholly-owned subsidiary of Aequicap, Inc. during the entire period beginning January 1, 2007 through December 31, 2010⁸.

Background/Event of Impact:

AIC was licensed as a property & casualty insurer in 1985 to write workers' compensation and commercial automobile insurance in the State of Florida. The Company was licensed in various other, but primarily wrote business in Florida, Georgia, South Carolina, and Oklahoma.

Effective February 28, 2011, AIC was ordered into receivership for the purposes of rehabilitation by the Second Judicial Circuit Court in Leon County, Florida. On March 7, 2011, the Second Judicial Circuit Court ordered the liquidation of AIC. The Florida Department of Financial Services, Division of Rehabilitation and Liquidation ("DFS") is the court appointed Receiver of AIC.

⁷ AIC Annual Statement Filing for the Years Ended December 31, 2007 through December 31, 2010 (Unfiled)

⁸ AIC Annual Statement Filing for the Years Ended December 31, 2007 through December 31, 2010 (Unfiled)

AIC's primary lines of business were workers' compensation and commercial automobile coverages. These lines of business represented approximately, 56.2% and 43.8% of direct written premiums for 2007 through 2010, respectively⁹.

AIC reported net losses from 2007 to 2010 of \$(37,987,323). Its total capital and surplus decreased from \$20,162,689 at January 1, 2007 to \$(9,693,571) at December 31, 2010¹⁰.

As of December 31, 2010 the Company reported a negative surplus of (\$9,693,571) and a net loss of (\$22,216,524) for the year-ended 2010¹¹. The 2010 loss was due largely to a change in actuarial estimates of ultimate claims losses and negative claims development for prior years and 2010 claims. Adverse development on prior to 2010 accident years \$12.8 million. Based on its 2010 annual filing, a determination was made by the OIR that AIC was insolvent and did not maintain the statutorily required level of surplus for a P&C insurer as required by Section 62.408, Florida Statutes. As a result AIC's certification of authority was suspended effective March 7, 2011¹².

Loss reserves appear to have been understated in years prior to 2010. AIC had significant losses dating back to 2006. Instances of deficient reserves became apparent during the analysis of loss and LAE reserves. IBNR as a percentage of total reserves dropped significantly from year-end 2007 to year-end 2008 due to the expectation new claims handling procedures would lower ultimate losses. The expected decrease didn't occur and IBNR as a percentage of total reserves increased dramatically by the end of 2010¹³.

Additionally, according to Company records and data received from the Florida Insurance Guarantee Association ("FIGA"), reserves were increased more than 300% once FIGA assessed the open claims. Per data provided by FIGA during 2014, the adverse development continued and was at almost 500% of reserves at December 31, 2010 for claims incurred prior to that date¹⁴.

⁹ AIC Annual Statement Filing for the Years Ended December 31, 2007 through December 31, 2010 (Unfiled)

¹⁰ AIC Audited Financial Statements for the Years Ended December 31, 2007 through December 31, 2010, Statutory Statements of Changes in Surplus.

¹¹ AIC Audited Financial Statements for the Years Ended December 31, 2010 and 2009, Statutory Statements of Changes in Surplus.

¹² Florida Department of Financial Services website, *AequiCap Insurance Company Ordered into Liquidation*

¹³ DHG report to Florida Department of Financial Services dated October 10, 2014

¹⁴ DHG report to Florida Department of Financial Services dated October 10, 2014

Underwriting Results:

Underwriting results for AIC's years ended December 31, 2007, 2008, 2009 and 2010, as reported in its annual statement were as follows¹⁵:

| | 2007 | 2008 | 2009 | 2010 |
|-------------------------------------|--------------|-------------|-------------|--------------|
| Underwriting Income | 45,518,887 | 25,766,384 | 26,910,551 | 14,872,431 |
| Underwriting Expenses: | | | | |
| Losses and LAE Incurred | 29,853,998 | 13,122,502 | 13,004,562 | 19,326,201 |
| Loss Ratio | 66% | 51% | 48% | 130% |
| Other Underwriting Expenses: | | | | |
| Claim adjustment services | | | | |
| Direct | 12,808,535 | 1,324,327 | 4,917,915 | 12,378,149 |
| Reinsurance | (5,080,233) | (1,503,586) | 45,157 | (6,567,117) |
| Commissions & Brokerage | | | | |
| Direct | 6,347,807 | 1,147,871 | 4,139,000 | 2,813,632 |
| Reinsurance | (10,375,272) | (3,577,953) | (4,557,223) | 193,428 |
| Advertising | - | - | - | 300 |
| Boards & Bureaus | 328,077 | 343,121 | 328,367 | 174,723 |
| Surveys and Underwriting reports | 4,348,155 | 1,041,623 | 938,120 | 1,014,049 |
| Salary and related items | 16,066,677 | 13,563,836 | 11,275,603 | 6,305,974 |
| Insurance | 7,140 | - | - | - |
| Travel and Travel items | - | 23 | 30,000 | 1,951 |
| Rent and rent items | - | - | 4,072 | 3,603 |
| Equipment | 137,015 | 108,121 | 39,687 | 56,434 |
| Cost or depreciation of EDP | 333,476 | 183,717 | 126,334 | 265,662 |
| Printing and stationary | 82,817 | 38,527 | 71,707 | 98,738 |
| Postage | - | - | - | 38,434 |
| Legal and auditing | 827,993 | 599,340 | 607,465 | 431,864 |
| Taxes and Licenses | 2,828,478 | 1,475,285 | 1,890,329 | 804,677 |
| Real Estate | 892,868 | 676,100 | 551,038 | 770,384 |
| Other | (1,351,876) | (104,234) | (1,017,434) | (1,230,427) |
| Current year unpaid | 4,544,156 | 5,397,748 | 4,598,361 | 5,217,139 |
| Prior year unpaid | 6,183,708 | 4,544,156 | 5,673,050 | 4,598,361 |
| Total expenses paid | 29,841,209 | 14,462,526 | 20,464,826 | 16,935,680 |
| Net underwriting gain (loss) | (14,176,320) | (1,818,644) | (6,558,837) | (21,389,450) |

The above analysis reveals a continuing deterioration in underwriting results of operation with increasing yearly underwriting losses from 2008 to 2010. This deterioration is primarily the result of increasing losses and LAE ratios. Loss ratios increased from 51% in 2008 to 130% in 2010.

¹⁵ Statement of Income & Underwriting and Investment Exhibit Part 3 of NAIC Annual Reports for 2007 to 2010

During 2008, the Company introduced a new actuarial method based on the expectation that the claims handling procedures would result in faster claim resolution times and lower total loss. This resulted in an underestimate of loss, LAE, and associated reserves.

Increasing loss ratios as reflected on AIC's annual statement are attributed in part to negative development of loss reserves for earlier years and higher losses for 2009 and 2010 in relation to premiums earned.

AIC experienced cumulative underwriting losses from 2007 through 2010 in excess of \$43 million. The underwriting loss in 2010 alone was in excess of \$21 million, accounting for nearly half of the cumulative underwriting losses for the 2007 to 2010 timeframe.

Reinsurance:

AIC has been party to various reinsurance agreements since its inception.

We were unable to determine the reinsurance in force at the time of liquidation, however, the reinsurance in force through 2010 was as follows:

- (a) 2007: AIC assumed risks from unaffiliated insurers. The type of treaties entered into are unclear, but it appears AIC had an obligation of approximately \$3,940,000 under these treaties for paid loss and loss adjustment expenses and had a net receivable of approximately \$767,000 related to known case losses and loss adjustment expenses¹⁶. AIC ceded a portion of its risks to unrelated domestic and foreign reinsurers, and an affiliated foreign reinsurer, through quota share, excess of loss, and facultative reinsurance agreements. The reinsurance treaty with the affiliate was on a retroactive basis, covering losses incurred prior to November 2005. At December 31, 2007, AIC had net recoverables from the following group of insurers¹⁷:

- Authorized Unaffiliated Reinsurers: \$ 65,922,000
- Unauthorized Affiliated Reinsurer: \$ 190,000
- Unauthorized Unaffiliated Reinsurers: \$ 4,821,000

- (b) 2008: AIC assumed risk from unaffiliated insurers. The type of treaties entered into are unclear, but it appears AIC had an obligation of approximately \$476,000 under these treaties for paid loss and loss adjustment expenses and had a net receivable of approximately \$859,000 related to known case losses and loss adjustment expenses¹⁸. AIC ceded a portion of its risks to unrelated domestic and foreign reinsurers, and an affiliated foreign reinsurer, through quota share, excess of loss, and facultative reinsurance agreements. The treaty with the affiliate was on a retroactive basis, covering losses incurred prior to November 2005. At December 31, 2008, AIC had net recoverables from the following group of reinsurers¹⁹:

- Authorized Unaffiliated Reinsurers: \$ 45,246,000
- Unauthorized Affiliated Reinsurer: \$ -
- Unauthorized Unaffiliated Reinsurers: \$ 6,440,000

¹⁶ AIC Annual Statement Filing for the Year Ended December 31, 2007 - Schedule F, Part 1

¹⁷ AIC Annual Statement Filing for the Year Ended December 31, 2007 - Schedule F, Part 3

¹⁸ AIC Annual Statement Filing for the Year Ended December 31, 2008 - Schedule F, Part 1

¹⁹ AIC Annual Statement Filing for the Year Ended December 31, 2008 - Schedule F, Part 3

(c) 2009: AIC assumed risk from unaffiliated insurers. The type of treaties entered into are unclear, but it appears AIC had an obligation of approximately \$545,000 under these treaties for paid loss and loss adjustment expenses and had a net receivable of approximately \$1,085,000 related to known case losses and loss adjustment expenses²⁰. AIC ceded a portion of its risks to unrelated domestic and foreign reinsurers through quota share, excess of loss, and facultative reinsurance agreements. At December 31, 2009, AIC had net recoverables from the following group of reinsurers²¹.

- Authorized Unaffiliated Reinsurers: \$29,221,000
- Unauthorized Unaffiliated Reinsurers: \$18,240,000

(d) 2010: AIC assumed risk from unaffiliated insurers. The type of treaties entered into are unclear, but it appears AIC had an obligation of approximately \$450,000 under these treaties for paid loss and loss adjustment expenses and had a net receivable of approximately \$522,000 related to known case losses and loss adjustment expenses²². AIC ceded a portion of its risks to unrelated domestic and foreign reinsurers through quota share, excess of loss, and facultative reinsurance agreements. At December 31, 2010, AIC had net recoverables from the following group of reinsurers²³.

- Authorized Unaffiliated Reinsurers: \$30,176,000
- Unauthorized Unaffiliated Reinsurers: \$4,437,000

The following page shows information related to reinsurance excerpted from AIC 2007, 2008, 2009 and 2010 NAIC annual statements.

| | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> |
|--|-------------------|-------------------|-------------------|-------------------|
| Balance Sheet | | | | |
| Amounts recoverable from reinsurers | 1,337,007 | 130,467 | 1,285,502 | 1,635,232 |
| Ceded reinsurance payable | 3,939,844 | 475,777 | 544,677 | 449,567 |
| Funds held under reinsurance treaties, net | 190,107 | - | - | - |
| Part 1 and 1B - Premiums Written/Earned | | | | |
| Direct business | 70,349,350 | 37,975,118 | 45,638,590 | 19,385,801 |
| Reinsurance assumed from non-affiliates | 2,259,468 | 2,474,079 | 263,025 | (49,373) |
| Reinsurance ceded to non-affiliates | (40,283,775) | 16,215,146 | 17,295,417 | 2,074,082 |
| Net premiums writtren per Part 1 | 32,325,042 | 24,234,051 | 28,606,198 | 17,262,347 |
| Premiums earned, part 1 Cloumn 4 | 45,518,887 | 25,766,384 | 26,910,551 | 14,872,431 |
| Part 2, Column 3, Reinsurance Recovered | 29,037,628 | 21,963,799 | 19,557,605 | 18,315,298 |
| Schedule F, Part 3 | | | | |
| Reinsurance premium ceded | 40,284,000 | 16,215,000 | 17,295,000 | 2,074,000 |
| Paid losses and LAE | 1,337,000 | 129,000 | 1,285,000 | 1,635,000 |
| Known case loss and LAE reserves | 13,076,000 | 18,059,000 | 20,682,000 | 19,319,000 |
| IBNR loss and LAE reserves | 51,318,000 | 33,681,000 | 24,908,000 | 17,340,000 |
| Unearned premiums | 9,863,000 | 5,126,000 | 4,666,000 | 1,124,000 |
| | <u>75,594,000</u> | <u>56,995,000</u> | <u>51,541,000</u> | <u>39,418,000</u> |
| Ceded balances payable | 4,851,000 | 5,309,000 | 4,079,000 | 4,805,000 |
| Net recoverable | <u>70,743,000</u> | <u>51,686,000</u> | <u>47,462,000</u> | <u>34,613,000</u> |

²⁰ AIC Annual Statement Filing for the Year Ended December 31, 2009 - Schedule F, Part 1

²¹ AIC Annual Statement Filing for the Year Ended December 31, 2009 - Schedule F, Part 3

²² AIC Annual Statement Filing for the Year Ended December 31, 2010 (Unfiled) - Schedule F, Part 1

²³ AIC Annual Statement Filing for the Year Ended December 31, 2010 (Unfiled) - Schedule F, Part 3

Financial:

According to AICs 2010 Annual Statement (Unfiled):

Total Surplus at December 31, 2010 was a negative (\$9,693,571). 2010 net underwriting loss was (\$21,389,450) consisting primarily of \$14,872,431 premiums earned less \$36,261,881 loss, LAE and underwriting expenses. Additionally, AIC incurred (\$2,125,038) of investment related losses during 2010.

Conclusions:

For the years that AIC operated as an insurance company, substantially all of its business was from writing workers' compensation and commercial automobile coverage. AIC incurred continuing and growing losses from 2007 to 2010 largely due to deteriorating loss ratios.

AIC changed actuaries in 2008, and the opening actuary was an employee (Vice President and Chief Actuary) of AIC during 2008 and 2009. During 2008, the actuary introduced a new method that resulted in an expected lower ultimate loss. However, by 2010 the estimated losses increased dramatically, when the opening actuary resigned as Chief Actuary and was brought in by management as a consulting actuary²⁴.

The Company paid commissions, claims servicing, and management fees to various related parties. The engagement team was unable to determine whether these payments were in compliance with agreements that should have been filed and approved by the FOIR, as the accounting records failed to provide sufficient support.

Since the liquidation of AIC, losses continued their trend of adverse development. The cost of the remaining claims are significantly higher than the remaining assets, which sum, will be borne by the Florida Insurance Guaranty Association and ultimately by other Florida auto insurance policyholders²⁵.

²⁴ DHG report to Florida Department of Financial Services dated October 10, 2014

²⁵ DHG report to Florida Department of Financial Services dated October 10, 2014