

ORIGINAL

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

**REPORT OF EXAMINATION OF**

**OMEGA ONE INSURANCE COMPANY**

**ELBA, ALABAMA**

**AS OF DECEMBER 31, 2009**

**PARTICIPATION:  
SOUTHEASTERN ZONE, NAIC  
ALABAMA**

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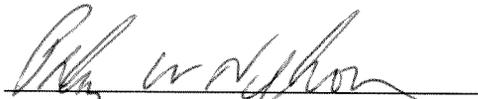
**EXAMINER'S AFFIDAVIT**

**STATE OF ALABAMA  
COUNTY OF COFFEE**

Palmer W. Nelson, CFE, being duly sworn, states as follows:

1. I have the authority to represent Alabama in the examination of Omega One Insurance Company.
2. Alabama is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination workpapers and examination report, and the examination of Omega One Insurance Company was performed in a manner consistent with the standards and procedures required by the State of Alabama.

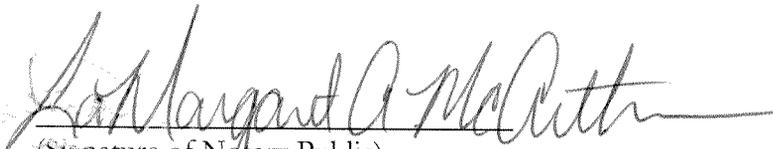
The affiant says nothing further.

  
\_\_\_\_\_  
Examiner-in-charge

Subscribed and sworn before me by PALMER W. NELSON on this  
20<sup>TH</sup>

day of MAY, 2011.

(SEAL)

  
\_\_\_\_\_  
(Signature of Notary Public)

**LaMargaret Ann McArthur  
NOTARY PUBLIC  
AL State at Large**

My commission expires My Commission Expires 01/28/2014.



ROBERT BENTLEY  
GOVERNOR

JIM L. RIDLING  
COMMISSIONER

STATE OF ALABAMA  
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CHIEF EXAMINER  
RICHARD L. FORD

STATE FIRE MARSHAL  
EDWARD S. PAULK

GENERAL COUNSEL  
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Elba, Alabama

May 6, 2011

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Chairman, Examination Oversight (E) Task Force  
Ohio Department of Insurance  
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Secretary, Southeastern Zone  
Kentucky Department of Insurance  
P. O. Box 1516  
Frankfort, KY 40602-1516

Jim L. Ridling, Commissioner  
Alabama Department of Insurance  
201 Monroe Street, Suite 1700  
Montgomery, AL 36104

Dear Director and Commissioners:

Pursuant to your authorizations and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the affairs and financial condition of

Omega One Insurance Company  
Elba, Alabama

at its home office located at 661 Davis Street, Elba, Alabama 36323 as of December 31, 2009. The report of examination is submitted herewith. Where the description "Company" appears herein without qualification, it will be understood to indicate Omega One Insurance Company.

EQUAL OPPORTUNITY EMPLOYER

## SCOPE OF EXAMINATION

The Company was last examined for the four year period ended December 31, 2004, by the examiners representing the Southeastern Zone, NAIC. The current examination covers the intervening period from the date of the last examination through December 31, 2009, and was conducted by examiners from Alabama, representing the Southeastern Zone, NAIC. Where deemed appropriate, transactions, activities and similar items subsequent to 2009 were reviewed.

The examination was conducted in accordance with applicable statutory requirements of the *Code of Alabama, 1975*, as amended, the Alabama Insurance Department regulations, bulletins and directives and in accordance with the procedures and guidelines promulgated by the NAIC, as deemed appropriate, and in accordance with generally accepted examination standards and practices.

The examination was conducted in accordance with the NAIC *Financial Condition Examiners Handbook*. The examination was planned and performed to evaluate the financial condition of the Company as of December 31, 2009, and to identify the Company's prospective risks by obtaining information about the Company including corporate governance, by identifying and assessing inherent risks within the Company and by evaluating system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with statutory accounting principles and NAIC *Annual Statement Instructions*.

The Company's annual statements for each year under examination were compared with or reconciled to the corresponding general ledger account balances.

An examination of the Company's information technology systems (IT) was conducted concurrently with the financial examination. The IT examination included a review of management and organizational controls, logical and physical security controls, changes in applications controls, system and program development controls, contingency planning controls, service provider controls, operations controls, processing controls, e-commerce controls, and network and internet controls.

A market conduct examination was performed concurrently with the financial examination. The examination included reviews of the Company's territory and plan of operation, management and operations, claims, complaint handling, marketing and sales, policyholder services, producer licensing, underwriting and rating, and privacy standards. See "MARKET CONDUCT ACTIVITIES" on page 9 for further discussion of the market conduct examination.

Warren, Averett, Kimbrough & Marino, LLC was the Company's certified public accountants (CPAs) for the final year under examination. The Company was audited by Barfield, Murphy, Shank & Smith for the previous years under examination. The examiners reviewed the CPAs' workpapers, copies of which were incorporated into the examination as deemed appropriate.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2009.

## **ORGANIZATION AND HISTORY**

The Company was incorporated on October 22, 1992, under the laws of the State of Alabama as a wholly owned subsidiary of National Security Fire & Casualty Company, an Alabama property and casualty insurance company.

The authorized capital at incorporation was set at \$2,000,000. The Company commenced business with a minimum capitalization of \$1,500,000, which consisted of \$500,000 paid in capital and \$1,000,000 paid in surplus, derived from the issuance of 500,000 shares of \$1 par value common stocks at a subscription price of \$3 per share.

In 1994, the Company issued a surplus note in the amount of \$3,500,000 to National Security Insurance Company, a life insurer affiliate. The surplus note was approved by the Alabama Department of Insurance on September 29, 1994. The Company increased its capital to \$650,000 on June 14, 1995, by declaring a stock dividend in the amount of \$150,000.

On June 7, 2000, the Company purchased all of the common stock of Liberty Southern Insurance Company (LSIC) for \$.01 per share (approximately \$7,300). Additionally, the Company paid off the outstanding surplus notes of LSIC (approximately \$625,000 including interest) to become the sole shareholder. LSIC's charter to conduct insurance business was turned in to the Alabama Department of Insurance.

At December 31, 2009, the Company's capital structure consisted of 650,000 shares of common stock, issued and outstanding, with a par value of one dollar per share for a total capital of \$650,000. Paid in and contributed surplus was \$1,000,000. The Company's reported unassigned funds was \$4,418,177. The Company also had a surplus note payable in the amount of \$3,500,000. The Company's total reported capital and surplus at December 31, 2009, was \$9,568,177.

## **MANAGEMENT AND CONTROL**

### **Stockholders**

The Company is a stock corporation with ultimate control vested in its stockholders. At December 31, 2009, 100% of the Company's issued and outstanding common stock was owned by National Security Fire & Casualty Company.

### **Board of Directors**

Members elected to the Board of Directors by the sole shareholder and serving at December 31, 2009, were as follows.

<u>Director</u>	<u>Residence</u>	<u>Principal Occupation</u>
Jack Edward Brunson	Elba, Alabama	President of National Security Fire & Casualty Company and Omega One Insurance Company
William Lister Brunson, Jr.	Elba, Alabama	President, National Security Insurance Company/CEO, The National Security Group
Mickey Lane Murdock	Elba, Alabama	Retired
Brian Richard Mcleod	Elba, Alabama	Chief Financial Officer of National Security Insurance Company, National Security Fire & Casualty Company, and Omega One Insurance Company

### Committees

No committees of the board were appointed during the examination period.

### Officers

Officers of the Company elected by the Board of Directors and serving at December 31, 2009 were as follows.

<u>Officer</u>	<u>Title</u>
Jack Edward Brunson	President
Brian Richard Mcleod	Treasurer
Tonya Mathews Jones	Secretary
Mickey Lane Murdock	Senior Vice President
Robert Glover	Vice President

### Management and Service Agreements

The following agreements between the Company and its affiliates were in effect during the examination period.

#### Agreement for the Allocation of General and Administrative Expenses

Effective January 1, 1982, the agreement provides for allocation of salaries, fringe benefits, employment taxes, and other common expenses between the National Security Insurance Company (NSIC) and National Security Fire & Casualty Company (NSF&CC) on the basis of the ratio of gross written premiums. The agreement also provides that NSF&CC will pay rent for office space based on a formula tied to NSIC's cost in the building and the number of the employees allocated to the Company.

The agreement was amended June 1, 1994, to include the Company. The Company never had employees of its own, but was operated by NSF&CC's personnel. The amended agreement included terms for the Company to pay rent for office space to NSIC.

### Agreement for Claims Adjustment Services

The Company is covered under the agreement between NSIC and NSF&CC because of its dependence on NSF&CC. Effective July, 1981, NSIC agreed to provide and train claims adjustors for NSF&CC and to adjust claims for NSF&CC and to be reimbursed by NSF&CC at industry rates on a monthly basis.

### Tax Allocation Agreement

The tax allocation agreement has been in effect since January 1, 1994. It provides that state and federal income taxes will be allocated among the parties on the basis of the actual tax liability. The parties to the agreement are:

The National Security Group, Inc.  
National Security Insurance Company  
National Security Fire & Casualty Company  
Omega One Insurance Company  
NATSCO, Inc.

The tax allocation agreement was amended on January 21, 2002, to clarify the arrangement regarding tax related settlements between the parties. Each affiliate's tax liability or benefit each year will be calculated on an individual company basis. The National Security Group (NSG) will make all federal income tax deposits. In the event that an individual company has a tax benefit that can be used to offset the taxable income of another affiliated company in the consolidated tax return, any tax savings generated by the tax benefit will be remitted by the company utilizing the tax benefit to the affiliate that generated the tax benefit at the applicable federal tax rate utilized by the entity receiving the benefit.

The agreement for the allocation of general and administrative expenses between the Company, NSIC and NSF&CC and the adjustors training agreement between NSF&CC and NSIC and the tax allocation agreement between NSG and the Company, NSIC, and NSF&CC do not provide for timely settlement of amounts owed, with a specified due date. SSAP No. 96, which is an amendment to SSAP No. 25 that became effective December 31, 2007, states:

Transactions between related parties must be in the form of a written agreement. The written agreement must provide for timely settlement of amounts owed, with a specified due date. Amounts owed to the reporting entity over ninety days from the written agreement due date shall be nonadmitted, except to the extent this is specifically addressed by other statements of statutory accounting principles (SSAPs). If the due date is not addressed by the written agreement, any uncollected receivable is nonadmitted.

The three agreements with affiliates were approved by the Department, but these approvals were prior to the implementation of SSAP No. 96.

### **Conflicts of Interest**

The conflict of interest statements filed by the officers and directors of the Company were reviewed for the period covered by this examination. There were no disclosures that indicated that any officers or directors had a conflict of interest.

### **CORPORATE RECORDS**

The Company's Articles of Incorporation, By-Laws, and amendments thereto were inspected and found to provide for the operation of the Company in accordance with Alabama statutes and regulations and with accepted corporate practices.

Minutes of the meetings of the stockholder and Board of Directors meetings from December 31, 2004, through the most recent meetings held at the conclusion of the examination were reviewed. The minutes appeared to be complete and to adequately document the actions of the respective governing bodies.

### **HOLDING COMPANY AND AFFILIATE MATTERS**

The Company was subject to the Alabama Insurance Holding Company Regulatory Act, as defined in ALA. CODE § 27-29-1 (1975). The National Security Group, Inc. was registered with the Alabama Department of Insurance as registrant of an Insurance Holding Company System.

Appropriate filings required under the Holding Company Act were made from time to time by the registrant. A review of the Company's filings during the period under examination indicated that all required filings were made.

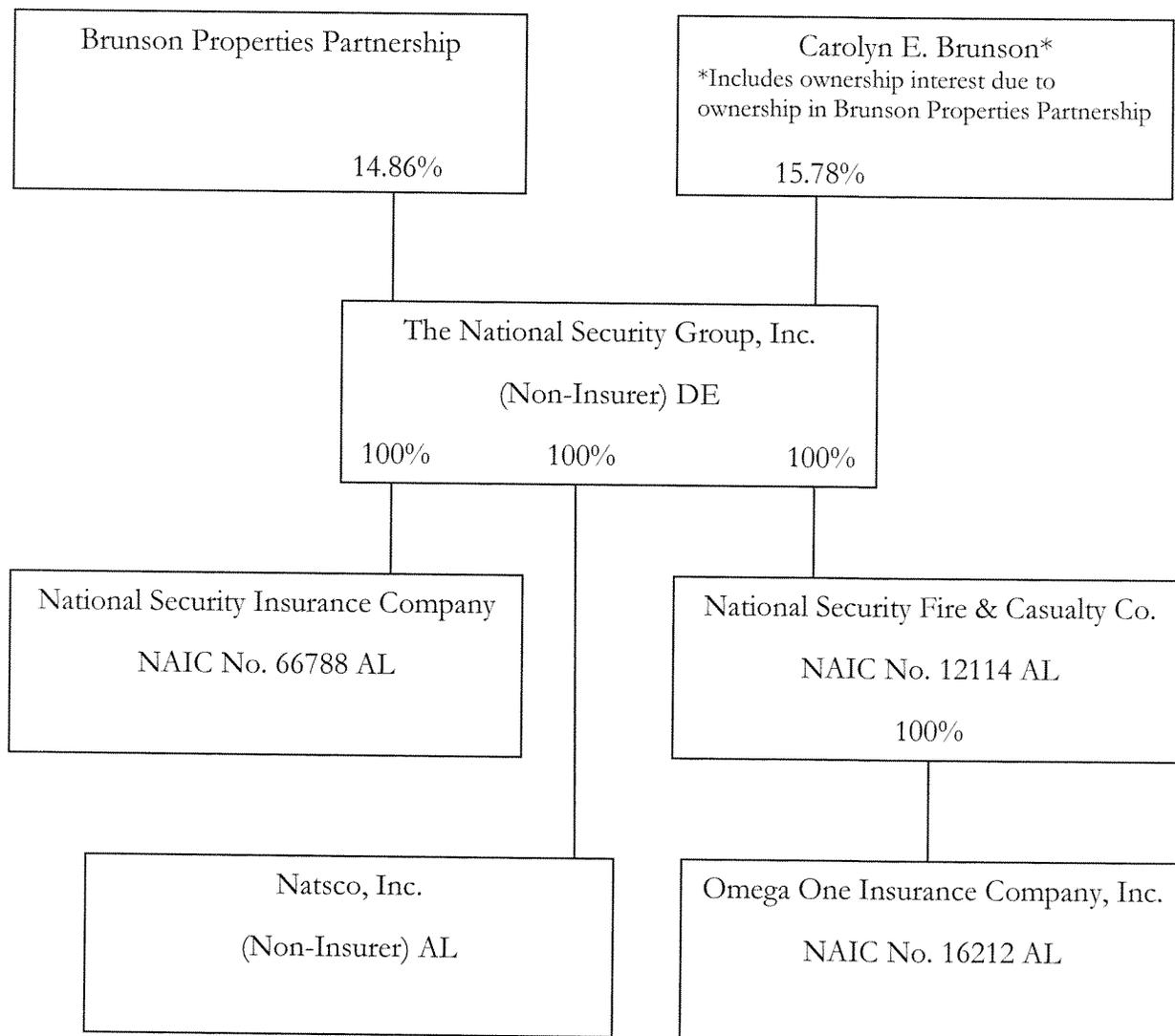
### **Dividends to Stockholder**

The Company did not pay any stockholder dividends during the examination period.

### **Organizational Chart**

The following chart presents the identities and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2009.

Organizational Chart



## **FIDELITY BONDS AND OTHER INSURANCE**

The Company was insured by a Financial Institution Bond issued by Fidelity and Deposit Company of Maryland; Baltimore, Maryland at December 31, 2009. The bond provided dishonesty and fraud coverage for salaried officers, employees and contractors. The bond did not provide coverage for forgery or alteration and securities. The amount of the fidelity bond maintained by the Company exceeded the minimum amount suggested in the NAIC *Financial Condition Examiners Handbook*.

In addition, to the above coverage, the Company was a named insured under policies affording the following protections at December 31, 2009:

- Property
- General Liability
- Commercial Automobile
- Umbrella Policy
- Vacant Land Liability
- Vacant Land Umbrella
- Workers Compensation

The coverages and limits of the Company's insurance program were reviewed and were deemed to adequately protect the Company's interests.

## **EMPLOYEE AND AGENT WELFARE**

The Company did not have any employees at December 31, 2009; therefore, it had no employee benefit plans. All functions of the Company were performed by employees of National Security Insurance Company via the provisions of administrative services agreements. See "Management and Services Agreements" on Page 4 where this is discussed. The Company uses an independent agency distribution system.

### **U. S. Code Title 18 § 1033 Compliance**

ALA. ADMIN CODE 482-1-146-.11 (2009) states:

- (1) A section 1033 insurer subject to the Commissioner's examination authority shall have and apply the following:
  - (a) An internal procedure for determining, by means of background checks or investigations or otherwise, whether applicants for employment or individuals with whom the insurer intends to contract for activities in the business of insurance, whether or not in a capacity requiring a license, have a felony conviction for a Section 1033 offense.
  - (b) An internal procedure after initial employment or contracting, applied on a periodic basis, to ascertain the existence of a felony conviction for a Section 1033 offense.

The Company did not comply with section (b) of this regulation as it did not have internal procedures in place to periodically ascertain if existing employees involved in the Company's operations had been convicted of a Section 1033 offense since the date of hire.

### **STATUTORY DEPOSITS**

At December 31, 2009, as required or permitted by law, the Company maintained deposits with the respective statutory authorities as follows.

<u>State</u>	<u>Book/Adjusted Carrying Value</u>	<u>Fair Value</u>
Alabama	\$200,000	\$215,303
Louisiana	518,545	535,580

### **FINANCIAL CONDITION/GROWTH OF COMPANY**

The following information presents significant items that reflect the growth of the Company for the years indicated.

	2004*	2005	2006	2007	2008	2009*
Admitted Assets	\$11,944,049	\$11,683,863	\$12,110,127	\$12,530,903	\$10,951,115	\$12,461,825
Liabilities	4,086,710	3,668,065	3,072,040	2,891,046	1,863,685	2,893,649
Gross Written Premium	4,265,931	3,529,764	2,807,714	2,319,876	1,574,079	3,201,277
Net Losses Incurred	2,772,832	2,144,686	1,535,792	943,119	1,345,634	1,192,266
Net Loss Adjustment Expenses Incurred	306,506	279,113	263,555	203,204	282,246	215,372
Common Capital Stock	650,000	650,000	650,000	650,000	650,000	650,000
Gross Paid in and Contributed Surplus	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Unassigned Funds	2,707,339	2,865,798	3,888,087	4,489,856	3,937,429	4,418,177

\*Per Examination

### **MARKET CONDUCT ACTIVITIES**

#### **Plan of Operation**

The Company's primary lines of business were private passenger automobile and mobile homeowners. The Company had three insurance programs: Alabama private passenger automobile, Louisiana private passenger automobile, and the Louisiana comprehensive mobile homeowners program. The Alabama private passenger automobile program was originally marketed through Gulf Life Administrators of Mobile, Alabama. It is now being marketed and underwritten through the Elba home office. The Louisiana private passenger automobile program was marketed through an exclusive agent, First Premium Insurance Group of Covington, Louisiana. The program was underwritten through the Elba home office. The Louisiana comprehensive mobile homeowners program was marketed and underwritten by First Premium Insurance Group of Covington, Louisiana.

## **Territory**

At December 31, 2009, the Company was licensed to transact business in the states of Alabama and Louisiana. The Certificates of Authority from the respective jurisdictions were inspected and found to be in order.

## **Policy Forms and Underwriting**

### **Policy Forms**

The forms and endorsements and premium rates utilized in Alabama during the examination period were reviewed and it was determined that they were properly filed and approved by the Alabama Department of Insurance.

### **Underwriting Practices**

The review of the Company's underwriting practices included a review of the Company's underwriting guidelines and the Company's procedures for handling policy declinations and cancellations. A sample of declinations, cancellations, and non-renewals was reviewed. The review indicated that the Company had valid reasons for declining applications, cancelling policies, or non-renewing policies. The Company properly mailed the cancellation notices that were required to be sent.

### **Rates and Statistical Reporting**

The Company reports all written premium, paid and unpaid losses to Independent Statistical Service (ISS). The Company also subscribes to Insurance Services Office (ISO) manuals, forms and symbols. The Company independently filed changes to ISO forms with the Departments of Insurance in states the Company wrote business.

### **Advertising and Marketing**

The National Security Group, Inc (NSG), the holding Company, did general corporate advertising with very little specific advertisement of its products. The Company does not advertise its products through traditional means, but by its longtime relationship with its independent agency force.

The Company's website ([www.nationalsecuritygroup.com](http://www.nationalsecuritygroup.com)) provided information such as: product information, access to claim forms, how to find an agent, learning how to become an agent, investor information, and other information about NSG. The Company's internet advertising was not misleading and contained appropriate language to identify the policy form(s) that was being advertised.

### **Claims Review**

The examiner reviewed samples of Alabama paid, closed without payment, and litigated claims files during the examination period. The review included an inspection of the files

for completeness of documentation and tests for timely settlement of those claims in accordance with ALA. ADMIN CODE 482-1-125 (2003), which are Alabama standards for Property and Casualty claims. There were no exceptions noted from the review.

### **Policyholder Complaints**

The Company's complaint register and the complaints filed with the Alabama Department of Insurance were reviewed for the period under examination. The Company did not have any complaints in its complaint register and did not have any complaints filed with the Department during the examination period.

### **Compliance with Producer Licensing Requirements**

The Company's listing of appointed producers at December 31, 2009 was compared to the listing maintained by the Alabama Department of Insurance. There were no discrepancies identified. The Company had 257 licensed and appointed producers at December 31, 2009. A sample of the Alabama producers' records were inspected to determine if producers writing business for the Company were properly licensed and appointed with the Alabama Department of Insurance. The examiners also inspected a random sample of Alabama terminated producers to make the determination whether the Company sent notifications of terminations to the terminated producers and the Alabama Department of Insurance. No exceptions were noted from the review of the samples.

### **Privacy Standards**

#### **Compliance with ALA. ADMIN. CODE 482-1-122 (2002)**

The Company's Privacy Notice, was reviewed for compliance with ALA. ADMIN. CODE 482-1-122 (2002). Privacy notices are sent to existing policyholders annually and are promptly provided to new policyholders at the issuance of a policy. The privacy notice indicated the types of information collected, the way the information was used and the manner in which the information was collected. The notice also informed the customer that the Company did not disclose any information to any nonaffiliated third parties.

The Company's privacy notice emphasized and explained the Company's policies. The Company does not share customer and/or consumer personal information with any nonaffiliated third parties. The Company had proper controls in place for employees and producers for the disclosure of nonpublic personal financial, health or medical information.

## **REINSURANCE**

### **Reinsurance Ceded**

#### **Unaffiliated**

The Company had four reinsurance programs: a catastrophe excess reinsurance program provided for by two catastrophe excess of loss reinsurance agreements, an ocean marine excess of loss reinsurance agreement, a private passenger automobile excess of loss reinsurance

agreement, and a primary layer catastrophe excess of loss reinsurance agreement with the parent company.

Catastrophe Excess Reinsurance Program (two agreements, four layers)

The Company's parent company, National Security Fire & Casualty Company (NSF&CC), was also covered under the contracts. The limits of the reinsurance were applicable to the combined losses of the Company and NSF&CC. The pertinent terms of the reinsurance contracts in effect at the examination date were as follows.

Business Covered – Dwelling and commercial fire, allied lines, homeowners (section I only), mobile homes, inland marine, special multi-peril (section I only) and industrial fire.

Term – January 1, 2009 to January 1, 2010, with respect to all losses occurring during the term of the contract.

First Layer – 95% of \$6.5 million each occurrence, in excess of \$3.5 million, not to exceed 95% of \$13 million or \$12.35 million, in respect to all losses during the term of the agreement.

Second Layer – 95% of \$7.5 million each occurrence, in excess of \$10 million, not to exceed 95% of \$15 million or \$14.25 million, in respect to all losses during the term of the agreement.

Third Layer – 100% of \$25 million each occurrence, in excess of \$17.5 million, not to exceed \$50 million, in respect to all losses during the term of the agreement.

Fourth Layer – 100% of \$30 million each occurrence, in excess of \$42.5 million, not to exceed \$60 million, in respect to all losses during the term of the agreement.

Reinsurers and percentage of participation:

<u>Participating Reinsurer</u>	<u>1<sup>st</sup> Layer</u>	<u>2<sup>nd</sup> Layer</u>	<u>3<sup>rd</sup> Layer</u>	<u>4<sup>th</sup> Layer</u>
Lloyds, London Syndicates*	45%	43%	50%	38%
R+V Versicherung AG	20%	19%	20%	12.5%
IPCRC Limited	20%	20%	20%	14.17%
Arch Reinsurance Company	8.5%	8.5%	8.5%	4.5%
Catlin Insurance Company Limited	5%	4%		
Employers Mutual Casualty Company	.75%	.75%	.75%	.25%
Hannover Re Limited		4%		2.5%
Coverium limited aka Scor, Switzerland				6.5%
Lloyds Syndicate No. 0382 HDU				5%
Everest Reinsurance Company				16.33%
American Agricultural Insurance Company	.75%	.75%	.75%	.25%

\*The Lloyds, London Syndicates were shared at the following levels: Syndicate 2987 – 37%, Syndicate 4444 – 22%, Syndicate 2007 – 10%, Syndicate 958 – 30%, Syndicate 4020 – 1%.

The catastrophe reinsurance was administered by reinsurance intermediary, Guy Carpenter. Interest and liability contracts with the subscribing reinsurers were a part of the agreement. Guy

Carpenter was recognized as the intermediary negotiating the agreement. All communications between the parties were transmitted through the intermediary. Payments by the Company to the intermediary were deemed to constitute payment to the reinsurers. Payments by the reinsurers to the intermediary were deemed to constitute payment to the Company, only to the extent that such payments were actually received by the Company.

#### Ocean Marine Excess of Loss Reinsurance

Business covered – Marine business produced by Pro-Mar Insurance Underwriters, Inc., and underwritten by George W. Zanthos. The agreement covers the combined losses of the Company and its parent company, National Security Fire & Casualty Company.

Term – July 1, 2009 to July 1, 2010.

Territory – Inland and coastal waters of the 48 contiguous states of the United States of America as respects policies written in the states of Florida, Georgia, Alabama, Mississippi, Louisiana, and Texas.

Retention and limits – \$250,000 excess of \$250,000, any one occurrence.

Participating reinsurers:

Lloyds Syndicate 1221 – 27.78%  
Lloyds Syndicate 1861 – 27.78%  
Lloyds Syndicate 1274 – 16.66%  
Federal Insurance Company – 27.78%

#### Private Passenger Automobile Excess of Loss Reinsurance

Business covered – Private passenger automobile. The agreement covers the combined losses of the Company and its parent company, National Security Fire & Casualty Company.

Term – October 1, 2009 to September 30, 2010.

Retention and limits – \$200,000 excess of \$100,000, any one occurrence, not to exceed \$800,000 during the term of the contract.

Reinsurer – Odyssey American Reinsurance Corporation.

All of the Company's ceded reinsurance agreements contained the usual solvency clause, which provides for reinsurance payments to a liquidator, receiver or statutory successor without diminution because of the insolvency of the ceding insurer.

The date that the reinsurer signed the ocean marine reinsurance contract between the reinsurer and the Company was not documented in the contract with a July 1, 2009 effective date. There is a specific statutory deadline in which the contract must be signed by all parties for the corresponding transactions to be accounted for using reinsurance accounting. SSAP No. 62 states, in part, "...if an agreement entered into, renewed or amended on or after January 1, 1994

has not been finalized, reduced to a written form and signed by both parties within nine months after the commencement of the policy period covered by the reinsurance arrangement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement.”

#### Affiliated

The Company had a catastrophe reinsurance agreement with its affiliate, National Security Fire & Casualty Company (NSF&CC) effective January 1, 2006. This agreement was automatically renewable for one year terms every January 1, unless cancelled by either party by giving the other 90 days notice of cancellation. The agreement covers the Company’s business known as dwelling fire, allied lines, homeowners (section I only), and mobile home. Under the terms of the agreement NSF&CC agrees to reinsure catastrophe losses in excess of \$600,000 from any one occurrence.

The Company’s reinsurance agreement with NSF&CC does not evidence the date that the agreement was signed. SSAP No. 62, paragraph 24 states, in part, “... if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by the parties, within nine months after the commencement of the policy period covered by the reinsurance agreement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement.”

The Company provided a response to the examination finding in the form of correspondence with the Alabama Department of Insurance and a Form D filing that was prepared September 18, 2006. The Form D filing indicated that the reinsurance agreement was signed by both parties on September 18, 2006, which is within nine months of the effective date of the agreement. The correspondence file provided indicated that there was some disagreement between the Company and the Analyst, but it was ultimately determined that the Company’s retention was being increased above the threshold of 5% of surplus; therefore ALA. CODE § 27-29-5 (b) (3) (1975) applied and the Company should have submitted the agreement at least thirty days prior to entering into the transaction, if the Commissioner did not disapprove the agreement during the review period. ALA. CODE § 27-29-5 (b) (1975) states:

The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period... Reinsurance agreements or modifications thereto in which the reinsurance premium or a change in the insurer's liabilities equals or exceeds five percent of the insurer's surplus as regards policyholders, as of the 31st day of December next preceding...

The Company completed its Schedule F to identify National Security Fire & Casualty Company as its sole reinsurer. The Company did not complete Schedule F accurately to identify its reinsurance activity with each of its reinsurers.

## ACCOUNTS AND RECORDS

The Company maintained its accounting, premiums and losses data electronically. The Company maintained additional electronic workpapers, reconciliations and statements in its database of imaged records.

The Company's independent audit was performed by Warren, Averett, Kimbrough & Marino, a certified public accounting firm of Birmingham, Alabama for the final year of the examination period. The independent audit for the previous years under examination was performed by Barfield, Murphy, Shank & Smith.

### Unclaimed Property

The Company provided its cash transactions for 2009 and the first two quarters of 2010. The Company's practice was to transfer stale dated outstanding checks into a specific general ledger account specifically for stale dated outstanding checks. There were two checks in this account whereby the issue dates could not be identified in the 2009 records provided by the Company. The Company's response to the examiners' request indicated that this information was not available and could not be provided. These same items remained outstanding through June 30, 2010. The 2010 records provided by the Company identified the issue dates for the outstanding checks. It was determined that the two checks were unclaimed property that had not been escheated to the respective states. The total amount of the checks was \$963.63. One of the checks for \$713.63 was issued to a payee with an Alabama address while the other check was for \$250 and was issued to a payee with a Louisiana address.

The Company did not escheat all of its unclaimed property to the State of Alabama in accordance with ALA. CODE § 35-12-76 (a) (1975). Outstanding checks issued to Alabama residents that are outstanding for three years or more are Alabama unclaimed property in accordance with ALA. CODE § 35-12-72 (a) (18) (1975) which states: "Property is presumed abandoned if its unclaimed by the apparent owner during the time set forth below for the particular property ... (18) All other property, three years after the owner's right to demand the property or after the obligation to pay or distribute the property arises, whichever first occurs." All Alabama unclaimed property is to be included in the unclaimed property reports in accordance with the reporting procedures described in ALA. CODE § 35-12-76 (1975).

The Company did not keep complete records of its transactions in accordance with ALA. CODE § 27-27-29 (a) (1975) which states: "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

### Annual Statement Exhibits

In a review of the Exhibit of Capital Gains (Losses) in the 2009 Annual Statement, it was determined that the other than temporary impairment amount of \$40,574 reported for the five CIT Group Inc. bonds held by the Company as of December 31, 2009, was reported under column 2 - Other Realized Adjustments of Line 1. U.S. government bonds, instead of being reported under column 2 - Other Realized Adjustments of Line 1.2 Other bonds (unaffiliated).

The other than temporary impairment of non-governmental unaffiliated bonds should be reported under column 2 - Other Realized Adjustments of Line 1.2 Other bonds (unaffiliated) of the Exhibit of Capital Gains (Losses), in order for the impairments to be reported correctly in the aforementioned Exhibit.

In a review of the reporting of the special deposits of the Company in Schedule E - Part 3 - Special Deposits of the Annual Statements for the period under examination, the examiner determined that the amounts of the special deposits for the states other than Alabama were reported under the column with the heading of "Deposits for the Benefit of All Policyholders" in the 2008 and 2009 Annual Statements. The amounts of the special deposits for the states other than the state of Alabama should be reported under the column with the heading "All Other Special Deposits" to be in compliance with page 430 of the 2009 NAIC *Annual Statement Instructions*, which states: "Columns 3 and 4 - Deposits for the Benefit of All Policyholders Report only the statutory deposit held for the benefit of all policyholders. Do Not Include deposits held for a special purpose. Insurers must report these special purpose deposits in Columns 5 and 6."

#### Information Technology Controls

The Company has no employees or facilities. The Company's operational functions are performed by employees of National Security Insurance Company (NSIC) utilizing the equipment and facilities of NSIC under the provisions of an administrative agreement. The examination included a review of the Company's information technology (IT) systems and controls. The following items were identified as a result of the review performed.

The Company's information systems (IS) controls governing disaster recovery were reviewed. It was determined the Company was storing its "off-site" backup tapes in its Conference Center building, a building located approximately 200 yards from the primary IS site. Discussions with management indicated they were aware of the increased risk and were looking for a suitable off-site location. Until a suitable off-site location is found and procedures implemented, the Company is at a significantly increased risk that a localized adverse event, such as a tornado, could destroy both the operational and backups of the Company's data. The impact of loss of both operational and backup data would be severe.

Interviews with senior management revealed periodic disaster recovery testing had not been accomplished during the period under examination because other higher priority projects had taken precedence. Also, the current disaster recovery document was more of a high level disaster recovery discussion as opposed to being a document that provided detailed guidance. An inadequately designed and tested disaster recovery plan significantly increases the risk that the Company will not be able to efficiently recover from an adverse event. If the Company experienced a widespread catastrophe coupled with a localized event, such as a hurricane that caused a surge in claims along with a tornado that destroyed its home office, the resulting adverse public sentiment caused by an excessive recovery time could severely impact the Company.

## FINANCIAL STATEMENTS

The financial statements included in this report were reported on the basis of the Company's records, and the valuations and determinations made during the examination for the year 2009. Amounts shown in the comparative years 2005, 2006, 2007 and 2008 were compiled from the Company's copies of the filed Annual Statements. The statements were presented in the following order.

Statement of Assets, Liabilities, Surplus and Other Funds	Page 18
Summary of Operations	Page 19
Capital and Surplus Account	Page 20

**Omega One Insurance Company**  
**Statement of Assets, Liabilities, Surplus and Other Funds**  
**for the Year Ended December 31, 2009**

**Assets**

	Assets	Non- admitted Assets	Admitted Assets
Bonds	\$8,625,747	\$ 0	\$8,625,747
Common Stocks	1,695,974	0	1,695,974
Cash and short-term investments	1,179,634	0	1,179,634
Investment income due and accrued	83,523	0	83,523
Premiums and considerations: Uncollected premiums and agents' balances in the course of collection	119,915	0	119,915
Premiums and considerations: Deferred premiums, agents' balances and installments booked but deferred and not yet due	558,985	289	558,696
Reinsurance: Amounts recoverable from reinsurers	732	0	732
Current federal and foreign income tax recoverable and interest thereon	179,503	0	179,503
Receivables from parent, subsidiaries and affiliates	18,102	0	18,102
Aggregate write-ins for other than invested assets: Premiums suspense	1,913	1,913	0
<b>Total Assets</b>	<u>\$12,464,027</u>	<u>\$2,202</u>	<u>\$12,461,825</u>

**Liabilities, Surplus and Other Funds**

Losses	\$ 956,727
Loss adjustment expenses	99,739
Commissions payable, contingent commissions and other similar charges	38,961
Other expenses	122,460
Taxes, licenses and fees	74,136
Net deferred tax liability	83,205
Unearned premiums <b>(Note 1)</b>	1,345,915
Ceded reinsurance premiums payable	168,115
Payable to parent, subsidiaries and affiliates	1,337
Aggregate write-ins for liabilities: Suspense items	3,056
<b>Total Liabilities</b>	\$ 2,893,649
Common capital stock	\$ 650,000
Surplus Note	3,500,000
Gross paid in and contributed surplus	1,000,000
Unassigned funds <b>(Note 2)</b>	4,418,177
<b>Surplus as regards policyholders</b>	<u>\$9,568,177</u>
<b>Totals</b>	<u>\$12,461,826</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

**Omega One Insurance Company**  
**Summary of Operations**  
**for the Years Ended December 31, 2005, 2006, 2007, 2008, and 2009**

	2005	2006	2007	2008	2009
<b>Underwriting Income</b>					
Premiums earned	\$3,505,026	\$2,887,754	\$2,341,255	\$1,568,614	\$2,457,895
<b>Deductions:</b>					
Losses incurred	2,144,686	1,535,792	943,119	1,345,634	1,192,266
Loss adjustment expenses incurred	279,113	263,555	203,204	282,246	215,372
Other underwriting expenses incurred	1,025,911	1,027,832	859,719	852,678	1,158,969
Aggregate write-ins for other underwriting deductions:					
ARIS Auto premiums waived	0	0	89	0	0
Total underwriting deductions	<u>3,449,710</u>	<u>2,827,179</u>	<u>2,006,131</u>	<u>\$2,480,647</u>	<u>\$2,566,607</u>
Net underwriting gain or (loss)	55,315	60,575	335,124	(912,033)	(108,712)
<b>Investment Income</b>					
Net investment income earned	417,274	424,052	496,152	\$517,519	\$450,267
Net realized capital gains or (losses) less capital gains tax	<u>180,325</u>	<u>180,016</u>	<u>(6,431)</u>	<u>(310,044)</u>	<u>(105,088)</u>
Net investment gain (loss)	597,599	604,068	489,721	\$207,474	\$345,179
<b>Other Income</b>					
Net gain from agents' or premium balances charged off	0	(2,902)	0	0	0
Finance and service charges not included in premiums	241,518	204,802	168,536	189,099	88,816
Aggregate write-ins for miscellaneous income:					
Miscellaneous income	<u>46,031</u>	<u>26,040</u>	<u>33,114</u>	<u>74,736</u>	<u>9,046</u>
Total other income	\$287,549	\$227,939	\$201,650	\$263,836	\$97,862
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	940,463	892,582	1,026,495	(440,723)	334,329
Federal and foreign income taxes incurred	<u>295,001</u>	<u>271,559</u>	<u>329,196</u>	<u>(96,304)</u>	<u>88,083</u>
Net income	<u>\$645,462</u>	<u>\$621,023</u>	<u>\$697,299</u>	<u>\$(344,418)</u>	<u>\$246,245</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

**Omega One Insurance Company**  
**Capital and Surplus**  
**for the Years Ended December 31, 2005, 2006, 2007, 2008, and 2009**

	2005	2006	2007	2008	2009
Surplus as regards policyholders, December 31 prior year	\$7,572,771	\$8,015,797	\$9,038,085	\$9,639,854	\$9,087,427
Net income	645,462	621,023	697,299	(344,418)	246,245
Change in net unrealized capital gains or (losses)	(256,166)	113,137	(64,050)	(626,577)	315,060
Change in net deferred income tax	68,000	(58,000)	9,000	335,344	(83,549)
Change in nonadmitted assets	(14,270)	(9,581)	(39,479)	82,224	2,991
Change in provision for reinsurance	0		(1,000)	1,000	
Examination correction write-in		355,709			
Change in surplus as regards policyholders	<u>443,026</u>	<u>1,022,288</u>	<u>601,769</u>	<u>(552,427)</u>	<u>480,747</u>
Surplus as regards policyholders, December 31 current year	<u>\$8,015,797</u>	<u>\$9,038,085</u>	<u>\$9,639,854</u>	<u>\$9,087,427</u>	<u>\$9,568,173</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.

## NOTES TO FINANCIAL STATEMENTS

### Note 1 – Unearned premiums

\$1,345,915

The above captioned amount is the same as reported by the Company in its 2009 Annual Statement.

In a review of the reconciliation of the unearned premiums as of December 31, 2009, it was determined that the Company used both the daily pro rata method and the monthly pro rata method to calculate the unearned premiums of the policies of the Company. The Company should use either one or the other method to calculate unearned premiums for the policies of the Company, and not both methods. This should be performed to be in compliance with paragraph 7 of SSAP No. 53 of the NAIC *Accounting Practices and Procedures Manual*, which states: “One of the following methods shall be used for computation of the unearned premium reserve: ...Daily pro rata method...Monthly pro rata method.”

Additionally, ALA. CODE §27-36-3 (1975) states, in part:

... The portions of the gross premium in force, less applicable reinsurance in solvent reinsurers, to be held as an unearned premium reserve, shall be computed according to the following table ... (c) In lieu of computation according to the table in subsection (b) of this section, the insurer at its option, may compute all of such reserves on a monthly or more frequent basis. (d) After adopting a method for computing such reserve, an insurer shall not change methods without approval of the insurance supervisory official of its state of domicile.

### Note 2 – Unassigned funds

\$4,418,177

The above captioned amount is the same as reported by the Company in its 2009 Annual Statement. The following is a reconciliation of Unassigned funds per the examination.

Unassigned funds per Company	\$4,418,177
Examination increase/(decrease) to assets:	
Examination decrease/(increase) to liabilities:	
Total Unassigned funds per examination	<u>\$4,418,177</u>

## COMMENTS AND RECOMMENDATIONS

### Organizational Chart – Page 6

**It is recommended** that the Company complete Schedule Y accurately to identify all controlling owners that have a controlling interest of ten percent or more in accordance with the NAIC *Annual Statement Instructions* which state: “If you are required to file a registration statement under the provisions of your domiciliary state’s Insurance Holding Company System Regulatory Act, the Schedule Y, Part 1, Organizational Chart must be included in the Annual Statement.” The Form B holding company filing requires disclosure of entities with a controlling interest of ten percent or more.

## Employee and Agent Welfare – Page 8

**It is recommended** that the Company establish internal procedures after initial employment or contracting, applied on a periodic basis, to ascertain the existence of a felony conviction for a Section 1033 offense in accordance with ALA. ADMIN. CODE 482-1-146-.11 (2009) which states: “(1) A Section 1033 insurer subject to the Commissioner’s examination authority shall have and apply the following... (b) An internal procedure after initial employment or contracting, applied on a periodic basis, to ascertain the existence of a felony conviction for a Section 1033 offense ...”

## Reinsurance Ceded – Page 11

**It is recommended** that the Company make certain that the signatures in the ocean marine reinsurance contract are dated to document the date that the agreement was signed. It is further recommended that the transactions associated with agreements that do not include dated signatures evidencing that the agreement was signed within nine months of the effective date be accounted for as retroactive reinsurance, in accordance with SSAP No. 62, paragraph 24 which states, in part “... if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by both parties within nine months after the commencement of the policy period covered by the reinsurance arrangement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement.”

**It is recommended** that the Company ensure that all reinsurance agreements are dated and signed to evidence that the agreements are signed within the statutory deadline to qualify for reinsurance accounting. The Company’s agreement with National Security Fire & Casualty Company did not evidence the date of signatures. SSAP No. 62, paragraph 24 states, in part, “...if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by the parties, within nine months after the commencement of the policy period covered by the reinsurance agreement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement.”

**It is recommended** that the Company submit all transactions within its holding company system that require prior approval to the commissioner at least thirty days prior to entering into such transactions in accordance with ALA. CODE § 27-29-5(b)(1975) which states:

The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period... Reinsurance agreements or modifications thereto in which the reinsurance premium or a change in the insurer’s liabilities equals or exceeds five percent of the insurer's surplus as regards policyholders, as of the 31st day of December next preceding...

**It is recommended** that the Company complete Schedule F accurately by including the pertinent information for all of its reinsurers.

#### **Accounts and Records – Page 15**

**It is recommended** that the Company properly include all unclaimed property in its unclaimed property filings to the respective states. Alabama unclaimed property is defined in ALA. CODE § 35-12-72 (a) (1975), which states, “Property is presumed abandoned if its unclaimed by the apparent owner during the time set forth below for the particular property ... (18) All other property, three years after the owner's right to demand the property or after the obligation to pay or distribute the property arises, whichever first occurs.” All Alabama unclaimed property is to be included in the unclaimed property reports in accordance with the reporting procedures described in ALA. CODE § 35-12-76(1975).

**It is recommended** that the Company keep complete records of its transactions in accordance with ALA. CODE § 27-27-29(a)(1975) which requires “Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

**It is recommended** that the Company report the other than temporary impairments of non-governmental unaffiliated bonds under column 2 - Other Realized Adjustments of Line 1.2 Other bonds (unaffiliated) of the Exhibit of Capital Gains (Losses), in order for the impairments to be reported correctly in the aforementioned Exhibit.

**It is recommended** that the Company report the amounts of the special deposits for the states other than the state of Alabama under the column with the heading “All Other Special Deposits” in Schedule E - Part 3 - Special Deposits to be in compliance with page 430 of the 2009 NAIC *Annual Statement Instructions*, which states: “Columns 3 and 4 - Deposits for the Benefit of All Policyholders Report only the statutory deposit held for the benefit of all policyholders. Do Not Include deposits held for a special purpose. Insurers must report these special purpose deposits in Columns 5 and 6.”

**It is recommended** that the Company store its data backups at a suitable off-site location.

**It is recommended** that the Company develop and test a disaster recovery plan that provides detailed guidance for personnel to efficiently recover from reasonable adverse events.

#### **Unearned premiums – Page 21**

**It is again recommended** that the Company use either the daily pro rata method or the monthly pro rata method to calculate the unearned premiums of the policies of the Company, and not both methods in order to be in compliance with paragraph 7 of SSAP No. 53 of the NAIC *Accounting Practices and Procedures Manual*, which states: “One of the following methods shall be used for computation of the unearned premium reserve: ...Daily pro rata method...Monthly pro rata method.” ALA. CODE § 27-36-3 (1975) states, in part:

... The portions of the gross premium in force, less applicable reinsurance in solvent reinsurers, to be held as an unearned premium reserve, shall be computed according to the following table ... (c) In lieu of computation according to the table in subsection (b) of this section, the insurer at its option, may compute all of such reserves on a monthly or more frequent basis. (d) After adopting a method for computing such reserve, an insurer shall not change methods without approval of the insurance supervisory official of its state of domicile.

**It is further recommended** that the Company obtain the Commissioner's approval of any changes to its methods of calculating its unearned premium reserves in accordance with ALA. CODE § 27-36-3. It will be necessary to change the Company's methods for segments of its business in order to comply with all of the recommendations included under this heading "Unearned premiums."

#### **Compliance With Previous Recommendations – Page 24**

**It is recommended** that the Company comply with the recommendations in the Report of Examination.

#### **CONTINGENT LIABILITIES AND PENDING LITIGATION**

The review of the contingent liabilities and pending litigation included an inspection of representations made by the Company's managers, a review of the Company's records and files for the period under examination and a review of the records subsequent to the examination date. The reviews performed did not identify any items that would have a material effect on the Company's financial condition in the event of an adverse outcome.

#### **COMPLIANCE WITH PREVIOUS RECOMMENDATIONS**

A review was performed to determine if the Company had complied with the recommendations made in the last examination report. The review indicated that the Company had complied with the recommendations contained in the most recent Report of Examination with the exception of the items noted below.

The previous report of examination included a recommendation for the Company to identify and properly escheat its unclaimed property in accordance with the unclaimed property laws. The examination indicated that the Company did not identify and escheat all of the unclaimed property. Further discussion of the issue is included in this report under the caption "ACCOUNTS AND RECORDS."

The previous examination included a recommendation for the Company to use one method, either the monthly pro rata method or the daily pro rata method, and not a combination of the two, to calculate its Unearned premiums in accordance with the requirements of SSAP No. 53, paragraph 7. The examination indicated that the Company did not comply with the recommendation. Further discussion of the reporting of unearned premiums is included in this report under the caption "NOTES TO FINANCIAL STATEMENTS."

## SUBSEQUENT EVENTS

The review of the events subsequent to December 31, 2009, did not reveal anything material in amount or noteworthy in nature.

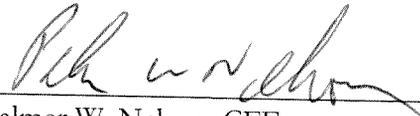
**CONCLUSION**

Acknowledgement is hereby made of the courtesy and cooperation extended by all persons representing Omega One Insurance Company during the examination.

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

In addition to the undersigned, Toni Bean, CFE, Theo Goodin, MCM, Thomas W. Salo, Robert S. Thompson, Charles Turner, CISA, Examiners; and Randall Ross, FCAS, MAAA, and Brent Sallay, FCAS, MAAA, Consulting Actuary; all representing the Alabama Department of Insurance, participated in the examination of Omega One Insurance Company.

Respectfully submitted,



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Palmer W. Nelson, CFE  
Examiner-in-charge  
Alabama Department of Insurance  
Southeastern Zone, NAIC