

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

**BEFORE THE
INSURANCE COMMISSIONER OF
THE DISTRICT OF COLUMBIA**

Re: Report on Examination - NationsBuilders Insurance Company as of December 31, 2007

ORDER


Pursuant to Examination Warrant 2008-1, an Examination of NationsBuilders Insurance Company as of December 31, 2007 has been conducted by the District of Columbia Department of Insurance, Securities and Banking ("the Department").

It is hereby ordered on this 31st day of October, 2008, that the attached financial condition examination report be adopted and filed as an official record of this Department.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related order.

Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.


Thomas E. Hampton
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

NATIONSBUILDERS INSURANCE COMPANY

AS OF

DECEMBER 31, 2007

NAIC COMPANY CODE 12303

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Washington, D.C.
September 3, 2008

Honorable Alfred W. Gross, Commissioner
Chairman, Financial Condition (E) Committee, NAIC
State Corporation Commission
Bureau of Insurance
Tyler Building
1300 East Main Street
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Honorable Thomas R. Sullivan
Secretary, Northeastern Zone, NAIC
Commissioner
Connecticut Insurance Department
153 Market Street
Hartford, CT 06013

Honorable Thomas E. Hampton
Commissioner
Department of Insurance, Securities and Banking
Government of the District of Columbia
810 First Street, NE, Suite 701
Washington, D.C. 20002

Dear Sirs:

In accordance with Section 31-1402 of the District of Columbia Official Code, we have examined the financial condition and activities of

NationsBuilders Insurance Company

(hereinafter called the Company) at its main administrative offices located at 2859 Paces Ferry Road, Suite 1900, Atlanta, GA 30339, and the following Report on Examination is submitted.

SCOPE OF EXAMINATION

The examination, covering the period from January 1, 2003 to December 31, 2007, and including any material transactions and/or events noted occurring subsequent to December 31, 2007, was conducted under the Association Plan of the National Association of Insurance Commissioners (NAIC) by examiners of the District of Columbia Department of Insurance, Securities and Banking (DISB) representing the Northeastern Zone of the NAIC.

Our examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook, incorporating the risk-focused examination techniques and in accordance with examination policies and standards established by the District of Columbia Department of Insurance, Securities and Banking. Accordingly, included in the examination were such tests of the accounting records and such other procedures as we considered necessary in the circumstances.

Our examination included a review of the Company's business policies and practices, management and corporate matters, a verification and evaluation of assets and a determination of the existence of liabilities and the identification of significant risks, an assessment and analysis of those risks, documentation of the results of the analysis, and development of recommendations for how the analysis can be applied to the ongoing monitoring of the insurer. In addition, our examination included tests to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly.

The Company was audited annually by an independent public accounting firm. The firm expressed an unqualified opinion on the Company's financial statements for calendar years 2003 to 2007. We placed substantial reliance on the audited financial statements for the calendar years 2003 to 2006 and, consequently, performed only minimal testing for those periods. We concentrated our examination efforts on the year ended December 31, 2007. We reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2007, and directed our efforts to the extent practical to those areas not covered by the firm's audit.

STATUS OF PRIOR EXAMINATION FINDINGS

Our examination included a review to determine the current status of the two exceptions commented upon in our preceding Report on Organizational Examination as of March 31, 2006 and fifteen exceptions commented upon in Nevada Report of Examination as of December 31, 2002. We determined that the Company had satisfactorily addressed those items.

SUMMARY OF SIGNIFICANT FINDINGS

DISB defines material adverse finding as follows:

“A material adverse finding is defined as a finding, typically made by a financial examiner or financial analyst, with respect to an event, trend, transaction or series of transactions, fluctuation, agreement, arrangement, operating results or violation of law, which either has, or reasonably could have, a significant negative impact on a company's financial position.”

No material adverse findings were noted during the examination. In addition, no material changes were made to the financial statements. Significant non-compliance findings are noted under “Comments and Recommendation” section of this report.

SUBSEQUENT EVENTS

As indicated in the “Comparative Financial Position of the Company” section of this Report, from 2003 to 2006 the Company experienced a steady increase in earned premiums, surplus, and net underwriting gains. However, the Company reported “Earned Premiums” totaling \$46,947,140 for 2007, as compared to \$58,177,855 for 2006, an almost 20% decline. Through the second quarter of 2008, premiums have dropped more than 35% below the 2007 mid-year level. Management notes that while residential premiums are lower than in 2007, the shift from a primarily residential to a commercial portfolio has been substantial moving from a 1% commercial portfolio to 26% as of June 30, 2008 (see chart below). Management believes this diversification will dilute the impact of the residential market on the Company going forward.

		06/30/2008 (YTD)		06/30/2007 (YTD)	
		\$	% to Total	\$	% to Total
Assumed Premiums:					
PBSIC	Residential	8,201,249	74%	18,348,491	99%
NIIC	Commercial	2,846,066	26%	169,281	1%
Total Assumed Premiums		11,047,315	100%	18,517,772	100%

Management attributes the decline in earned premiums to the following:

- The soft construction market and a mature U.S. insurance market have attracted some “A” rated insurers to the marketplace, taking business share from ProBuilders Specialty Insurance Company, RRG (ProBuilders).
- ProBuilders premiums, which represent a significant portion of the Company’s assumed premiums, are from the residential marketplace and are therefore impacted by the depressed housing market, a downturn in the economy, and a very competitive insurance market.
- The residential book of business has seen a substantial movement away from mid-size development general contractors, which has historically been the Company’s focus.

As a result of the above conditions, management has taken the following steps to address the downward trend in surplus and operating results:

- Effective July, 2007 NationsBuilders Insurance Services, Inc. (NBIS) began placing most non-residential policies through National Interstate Insurance Company (NIIC) with the Company assuming approximately 49.5% of NIIC’s written premium after external excess reinsurance. Commercial premiums have

grown in 2008, and the company forecasts \$8,400,000 assumed premium (net of expenses) for 2008 and in excess of \$10,000,000 for 2009.

- NBIS has been in negotiations to be an MGA program administrator for a major insurance company, and offer A-rated residential general liability coverage to homebuilders, eventually on a national scale. The Company could assume 50% or less of the risk. ProBuilders would be impacted by builders who would possibly renew coverage in this new program since the expectation is that ProBuilders quota share treaty may be less than twenty percent. Both parties have targeted a run rate of \$20,000,000 annual written premium within one year.
- While ProBuilders' has seen a sharp decline in insured builders, the number of insured trades has been maintained. ProBuilders will focus its product and service on the construction trades, and adjust its marketing to grow this base. NBIS has reorganized the ProBuilders' underwriting to better service its key producers by providing quick-quote capabilities and faster turn-around on quotes.

Change in Business Model:

An organizational examination of the Company was conducted by DISB as of March 31, 2006. At that point, the Company had plans to seek eligibility to become a direct writer of business on a surplus line basis in targeted U.S. states, intending to write a contractor's liability product similar to those currently written by ProBuilders. In addition, it had plans to offer builders risk coverage, inland marine coverage and commercial auto coverage for contractors. Since receiving its certificate of authority, residential premiums have been impacted by the depressed housing market, a downturn in the economy, and a more competitive insurance market. The Company encountered aggressive competition from insurers who had once avoided the West Coast construction markets. As a result, the plan to seek eligibility to do business on a direct and surplus lines basis in targeted U.S. states has been put on hold indefinitely.

HISTORY

General:

The Company was incorporated as Southwestern Casualty Insurance Company, an agency captive insurance company, under the laws of Nevada on October 30, 2001. In February 2002, the Company received its certificate of authority from the Nevada Division of Insurance (NDOI) to operate as a captive insurer. The Company was formed by and was wholly owned by National Builders Insurance Services (NBIS), which is now named NationsBuilders Insurance Services, Inc. (NBIS).

In April 2003, the NDOI issued a cease and desist order to the Company, its parent, NBIS, and its affiliate, Builders and Contractors Insurance Company, RRG (now named ProBuilders Specialty Insurance Company, RRG, a Risk Retention Group). The order,

which required the companies to cease and desist soliciting or transacting any new business, alleged that certain information regarding the operation of the Company and its affiliates had been omitted from the October 2001 applications for certificates of authority submitted to the NDOI for the Company and for Builders and Contractors Insurance Company, RRG to operate as captive insurance companies.

The Company and its affiliates denied all allegations of wrongdoing and in April 2003 entered into a consent order addressing the concerns of the NDOI. In September 2003, the NDOI indicated the Company and its affiliates had addressed all issues in the consent order except for one that could not yet be completed.

In May 2004, the Company redomesticated to the District of Columbia to operate as a captive insurer.

In June 2005, SunTx Capital Partners, a Texas private equity investment firm, through a newly formed entity named SunTx NBIS Holdings, L.P. (SunTx), acquired a majority of the common and preferred shares of the Company's parent, NBIS. Thus, the Company became an indirect subsidiary of SunTx.

In January 2006, the Company applied to convert from a District of Columbia captive insurer to a District of Columbia traditional property and casualty insurance company.

In November 2006, the Company's name was changed to NationsBuilders Insurance Company.

In March 2007, the Company was issued a certificate of authority as a traditional property and casualty insurance company.

Capital Stock:

The Company's Articles of Incorporation authorize the Company to issue 1,000,000 shares of common capital stock with a par value of \$1 per share, and 1,000,000 shares of preferred capital stock with a par value of \$1 per share. As of March 31, 2006, the Company had issued 300,000 shares of common capital stock to its parent, NBIS. On June 28, 2008, the Articles of Incorporation were amended whereby the Company is authorized to issue 25,000,000 shares of common capital stock with a par value of \$1 per share, and 5,000,000 shares of preferred capital stock with a par value of \$1 per share. Subsequently, the Company initiated a stock dividend for \$4,700,000, which increased the common capital stock to \$5,000,000.

Dividends to Stockholders:

A dividend payment in the amount to \$3,100,000 was made during 2007. No dividend payments were made during 2006.

Management:

The following persons were serving on the Company's board of directors as of December 31, 2007:

<u>Name and Address</u>	<u>Principal Occupation</u>
Ned N. Fleming III Dallas, Texas	Managing Partner, SunTx Capital Partners
John F. Gross Glen Allen, Virginia	President, Trans Globe Partners
Jason L. Jelen Dallas, Texas	Principal, SunTx Capital Partners
Mark Matteson Dallas, Texas	Partner, SunTx Capital Partners
Richard D. Stephens Lake Havasu City, Arizona	President and CEO, AJS Insurance Services

The following persons were serving as the Company's officers as of December 31, 2007:

Ned N. Fleming III	President
Ronald E. Smith	Treasurer
Robert C. Moore	Secretary
Timothy C. Conlon	Senior Vice President
Michael Lemanczyk	Senior Vice President
Beth K. Levy	Vice President

Committees

As of December 31, 2007, the Company's Audit Committee was not in compliance with District of Columbia Official Code Section 31-706(c)(4). The Company complied with the Code's requirement that the board establish one or more committees comprised of individuals who are not officers or employees of the Company, or of any entity controlling, controlled by or under common control with the Company. This committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the Company's financial condition, nominating candidates for director, evaluating the performance of officers of the Company, and recommending to the board the selection and compensation of principal officers. The Audit and Compensation Committee while formed on May 9, 2007 did not meet during 2007 and therefore did not approve the selection of the certified public accountants.

See the "Comments and Recommendations" section of this report, under the caption "Management" for further comment regarding this issue.

Conflicts of Interest:

Directors, officers and responsible employees of the Company regularly responded to conflict of interest questionnaires. If possible conflicts were disclosed, Company officials scrutinized them further. Our review of the responses to the questionnaires completed for 2007 disclosed no conflicts that would adversely affect the Company. Furthermore, our examination did not disclose any additional conflicts of interest.

Corporate Records:

We reviewed the minutes of the meetings of the shareholders, board of directors and committees for the period under examination. Based on our review, it appeared that the minutes documented the Company's significant transactions and events, and that the directors approved those transactions and events.

AFFILIATED COMPANIES

The Company is a wholly owned subsidiary of NBIS, a Delaware corporation that is a licensed producer. NBIS manages the operations of the Company and those of a District of Columbia captive insurer.

NBIS has three classes of stock and is majority-owned by SunTx NBIS Holdings, L.P., a Delaware limited partnership. (See the organizational chart below for the ownership of the three classes of NBIS stock and for the general and limited partnership interests in SunTx NBIS Holdings, L.P.)

Individuals or entities ultimately owning and/or controlling 10 percent or more of the Company are as follows:

SunTx Capital Partners
Ned N. Fleming, III
Rudd Family Trust
X-10 Capital (public entity hedge fund)

The Company's holding company structure as of December 31, 2007, is depicted in the chart below.

In April 2006, the Company purchased a 16.95 percent interest in Special Risk Services Group, LLC (SRS), a managing general agency. The Company's affiliate, Turnkey Specialty Insurance Services, Inc., acquired the remaining 83.05 percent interest in SRS. Turnkey Specialty Insurance Services, Inc. changed its name to NBIS Construction and Transport Underwriters, Inc. (CTU). On March 30, 2007, NBIC sold its 16.95% minority interest in CTU to its parent company for \$2,500,000 cash. This

investment occurred when on April 2, 2006, two of NBIS's wholly owned subsidiaries, TurnKey Specialty Insurance Services, Inc. and the Company, entered into a Membership Purchase Agreement with the equity owners of SRS, a Delaware limited liability company, pursuant to which TurnKey and the Company, acquired all of the outstanding membership interest in SRS. Subsequently, SRS and TurnKey were merged into CTU.

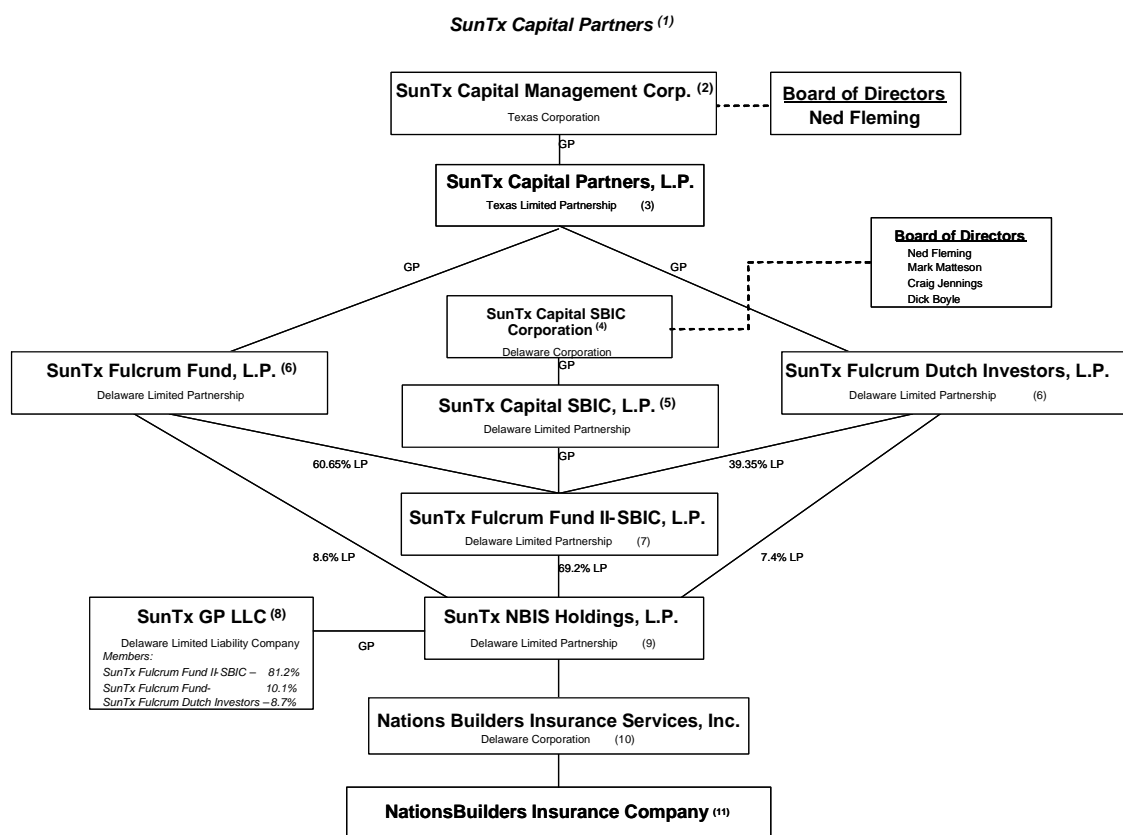
On September 1, 2007 the following companies, directly owned by NBIS, were dissolved:

NBIS Captive Management, an Arizona corporation, which provided captive management services to its clients.

NBIS Marketing Services, Inc., a Georgia corporation, which provided comprehensive marketing and sales support services to insurers and producers serving the construction industry.

NBIS Risk Services, LLC, a Georgia corporation, which provided loss control and claims investigation services to the residential construction, crane, rigging and heavy hauling industries.

ORGANIZATIONAL CHART



⁽¹⁾ **SunTx Capital Partners**, Texas private equity investment firm. The partners of **SunTx Capital Partners** are Ned N. Fleming, III (managing partner), Richard J. Boyle, Craig J. Jennings and Mark R. Matteson.

⁽²⁾ **SunTx Capital Management Corp.**, which is wholly owned by Ned N. Fleming, III, is the management company of SunTx Capital Partners. **SunTx Capital Management Corp.**, is the general partner of SunTx Capital Partners, L.P.

⁽³⁾ **SunTx Capital Partners, L.P.** is the general partner of SunTx Fulcrum Fund, L.P. and SunTx Fulcrum Dutch Investors, L.P. The sole general partner of **SunTx Capital Partners, L.P.** is SunTx Capital Management Corp. There are no limited partners owning or controlling 10 percent or more of the outstanding limited partnership interests in **SunTx Capital Partners, L.P.**

⁽⁴⁾ **SunTx Capital SBIC Corporation** is wholly owned by Ned N. Fleming, III, and is the general partner of SunTx Capital SBIC, L.P. **SunTx Capital SBIC Corporation** is governed by a board of directors consisting of Ned N. Fleming, III, Richard J. Boyle, Craig J. Jennings and Mark R. Matteson.

⁽⁵⁾ **SunTx Capital SBIC, L.P.** is the general partner of SunTx Fulcrum Fund II-SBIC, L.P. The sole general partner of **SunTx Capital SBIC, L.P.** is SunTx Capital SBIC Corporation. There are no limited partners owning or controlling 10 percent or more of the outstanding limited partnership interests in **SunTx Capital SBIC, L.P.**

⁽⁶⁾ **SunTx Fulcrum Fund, L.P.** and **SunTx Fulcrum Dutch Investors, L.P.** are private investment limited partnerships that invest in middle market companies.

⁽⁷⁾ **SunTx Fulcrum Fund II-SBIC, L.P.** is funded by SunTx Fulcrum Fund, L.P. (60.65 percent limited partnership interest) and SunTx Fulcrum Dutch Investors, L.P. (39.35 percent limited partnership interest).

⁽⁸⁾ **SunTx GP LLC** is the general partner of SunTx NBIS Holdings, L.P. The members of **SunTx GP LLC** are SunTx Fulcrum Fund II-SBIC, L.P. (81.2 percent), SunTx Fulcrum Fund, L.P. (10.1 percent) and SunTx Fulcrum Dutch Investors, L.P. (8.7 percent). **SunTx GP LLC** does not hold any funds, but only acts in a management capacity as a general partner for SunTx NBIS Holdings, L.P.

⁽⁹⁾ **SunTx NBIS Holdings, L.P.** is owned by SunTx Fulcrum Fund, L.P. (8.6 percent), SunTx Fulcrum Dutch Investors, L.P. (7.4 percent), and SunTx Fulcrum Fund II-SBIC, L.P. (69.2 percent). These affiliates own combined 85.2 percent limited partnership interests in **SunTx NBIS Holdings, L.P.** The remaining 14.8 percent limited partnership interest in **SunTx NBIS Holdings, L.P.** is owned by X-10 Capital, a non-affiliated public equity hedge fund. The general partner of **SunTx NBIS Holdings, L.P.** is SunTx GP LLC.

⁽¹⁰⁾ **NationsBuilders Insurance Services, Inc. (NBIS)** owns 100 percent of the outstanding stock of the Company. **NBIS** also wholly owns Construction Transport Underwriting (CTU) and Claims and Risk Management (CRM). In addition, **NBIS** is affiliated with ProBuilders Specialty Insurance Company, RRG, a Risk Retention Group (ProBuilders). CRM processes claims under policies issued by ProBuilders. **NBIS Construction & Transport Underwriters, Inc (CTU)** is an underwriting management company for members of the construction and specialized transportation industries. ProBuilders is a District of Columbia captive risk retention group. ProBuilders is owned by its policyholders, but is controlled by NationsBuilders Insurance Services, Inc., as the exclusive underwriting manager for ProBuilders. The **NBIS** organizational structure is as follows:

	<u>Domiciliary Jurisdiction</u>
NationsBuilders Insurance Services, Inc.	Delaware
NationsBuilders Insurance Company (NAIC #12303) ⁽¹¹⁾	District of Columbia
NBIS Claims and Risk Management Services, Inc.	Georgia

NBIS Construction and Transport Underwriting, Inc.

Delaware

ProBuilders Specialty Insurance Company, RRG (NAIC #11671)^(Controlled)

District of Columbia

Ownership of **NationsBuilders Insurance Services, Inc.** is as follows (only individuals or entities owning and/or controlling 10 percent or more of each class of stock are shown):

NationsBuilders Insurance Services, Inc. – Common Stock:

SunTx NBIS Holdings, L.P.	58.3 percent
Rudd Family Trust	<u>15.5 percent</u>
	<u>73.8 percent</u>
Remainder ^a	<u>26.2 percent</u>

NationsBuilders Insurance Services, Inc. – Series A Preferred Stock: ^b

SunTx NBIS Holdings, L.P.	87.4 percent
Rudd Family Trust	<u>12.6 percent</u>
	<u>100 percent</u>

NationsBuilders Insurance Services, Inc. – Series B Preferred Stock: ^c

SunTx NBIS Holdings, L.P.	32.3 percent
Rudd Family Trust	<u>18.2 percent</u>
	<u>50.5 percent</u>
Remainder ^d	<u>49.5 percent</u>

^a Remainder of common stock is owned by directors and officers of the Company and of companies in the NBIS group, and by various other stockholders, none of which own or control 10 percent or more of the remaining outstanding shares. There are approximately 45 common stockholders, including the above-mentioned individuals or entities owning and/or controlling 10 percent or more of the common stock.

^b Series A preferred stockholders hold the same voting rights as common shareholders and are entitled to elect a majority of the NBIS directors. These stockholders receive preferential dividends (6.734 percent – cumulative, annual) over all other classes of stock. Approximately 97 percent of the dividend is paid in additional shares of Series A preferred stock, and the remaining 3 percent is paid in shares of NBIS common stock. Series A preferred stock has preference in liquidation over all other classes of stock and has a stated liquidation value of \$11.10 per share plus any accumulated dividends.

^c Series B preferred stockholders have no voting rights and have preference in liquidation over common stockholders. Series B preferred stock has a stated liquidation value of \$8.10 per share. There are no stated dividends and dividends may only be paid with the consent of the holders of a majority of the Series A preferred stock.

^d Remainder of Series B preferred stock is owned by directors and officers of the Company and of companies in the NBIS group, and by various other stockholders, none of which own or control 10 percent or more of the remaining outstanding shares. There are approximately 45 Series B preferred stockholders, including the above-mentioned individuals or entities owning and/or controlling 10 percent or more of the Series B preferred stock.

⁽¹¹⁾ **NationsBuilders Insurance Company**, a licensed District of Columbia licensed as a traditional insurer.

INTERCOMPANY AGREEMENTS

There are no employees of the Company. All personnel, management and administrative services are provided to the Company by its parent and affiliates under various intercompany agreements. In addition, the Company has entered into reinsurance agreements with affiliates (see the “Reinsurance” section of this Report for further comments regarding the company’s affiliated reinsurance agreements).

The Company has entered into the following intercompany agreements:

Management and Underwriting Agreement:

Effective April 1, 2007, the Company entered into an “Amended and Restated Management and Underwriting Agreement” with its affiliate, CTU. Under terms of the agreement, CTU is appointed as the Company’s operating, administrative, financial, investment and underwriting manager, and is granted authority (subject to the authority of the Company’s officers, directors, Articles of incorporation and by-laws, and subject to the District of Columbia Insurance Code) to act for the Company and in the Company’s name. In return for services provided by CTU, the Company pays CTU a fee not to exceed the fairly allocated portion of overhead and other costs incurred by NBIS in providing services to the Company. Under terms of the agreement, the fee is to be determined by the affiliate on a quarterly basis and shall be paid by the Company within fifteen days following the end of each calendar month. Effective April 1, 2007 compensation provisions under the Management and Underwriting Agreement were changed to a monthly flat fee (\$149,000 per month), plus the Company’s quota share percentage of net deferred acquisition costs.

Tax Sharing Agreement:

Effective January 1, 2003, the Company entered into a “Tax Sharing Agreement” with its parent, NBIS, and with affiliated entities for the respective year(s) filed. Under terms of the agreement, the consolidated federal income tax liability of the affiliated group shall be allocated among the members based on the proportion of each member’s taxable income to the consolidated taxable income of the group.

It was noted during the examination that while these agreements have been submitted to DISB, they were never formally approved by DISB. Subsequent to the completion of the examination, DISB approved the 4/1/07 Management Agreement and the 01/01/03 Tax Sharing Agreement. In addition, the “Management and Underwriting Agreement” was never signed.

See the “Comments and Recommendations” section of this report, under the caption “Intercompany Agreements” for further comment regarding this issue.

FIDELITY BOND AND OTHER INSURANCE

As of December 31, 2007, the Company's parent, NBIS had a commercial crime policy covering employee theft and forgery or alteration. The employee theft coverage included a limit of \$1,000,000 and a deductible of \$5,000 per occurrence and the forgery or alteration coverage included a limit of \$1,000,000 and a deductible of \$5,000 per occurrence.

As of December 31, 2007, the Company was a named insured on a liability policy issued to its parent, NBIS. The policy provides management liability, employment practices liability and pension and welfare benefit plan fiduciary liability coverage. The Company did not have any other insurance coverage.

PENSION, STOCK OWNERSHIP AND INSURANCE PLAN

The Company did not have any employees. Therefore, the Company did not have any pension, stock ownership or insurance plans.

STATUTORY DEPOSITS

The Company is not required to maintain a statutory deposit in the District of Columbia. However, the Company has established such a deposit, and had deposited in trust with the DISB, United States Treasury Notes and Cash Equivalents of \$2,914,934 and market value of \$2,998,092 as of December 31, 2007. These funds were held for the protection of all policyholders.

TERRITORY AND PLAN OF OPERATION

The Company's current business is serving as a quota share reinsurer of risks underwritten by its affiliate, ProBuilders and other third party commercial risks (e.g., NIIC). During 2007, the Company assumed premiums totaling approximately \$35.4 million from ProBuilders.

As a licensed producer and approved captive manager, NBIS manages the operations of the Company and of ProBuilders. As of December 31, 2007, NBIS has approximately 85 employees in five offices, located in Atlanta, Georgia, Palm Desert, California, Chicago, Illinois, Baltimore, Maryland and Denver, Colorado. ProBuilders writes contractors' liability insurance for contractors, developers and other members of the construction industry. ProBuilders' policies are specially drafted and restrictive. The policies, which are generally 12-month policies, and which provide third party coverage for property damage or personal injury loss caused by the contractor, generally cover claims arising from projects completed during the project period, and for which the accident date occurs during the policy period. In addition, the policies with sunset clauses limit the reporting of claims to the two, three and five years following the policy period.

depending on what type of sunset clause the policyholder elected to purchase. Policyholders of ProBuilders can choose a policy without the sunset clause for an additional premium, which would not have a claims limit-reporting period. All policies carry asbestos, environmental, and mold exclusions.

GROWTH OF COMPANY

The comparative financial position of the Company for the five-year period ended December 31, 2007, is as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Assets	\$ 150,141,448	\$ 130,044,934	\$ 89,196,849	\$ 45,039,247	\$ 15,310,187
Liabilities	109,951,540	98,216,933	73,208,652	38,275,985	11,174,566
Capital and Surplus	40,189,908	31,828,001	15,988,197	6,762,915	4,135,621
Premiums earned	46,947,140	58,177,855	36,317,634	19,105,718	7,530,709
Net underwriting gain (loss)	7,968,905	10,529,269	(403,486)	2,758,419	1,225,331
Investment gain	6,059,272	3,642,889	1,053,413	262,185	35,667
Net income (loss)	9,531,749	8,017,005	(1,777,643)	1,760,260	977,062

Amounts in the preceding financial statements are the amounts per examination.

Earned premiums were \$46,947,140, dropping almost 20%, as compared to \$58,177,855 for 2006.

The Company assumes most of its business from an affiliate ProBuilders. ProBuilders premiums are impacted by the depressed housing market, a downturn in the economy, and a very competitive insurance market. The current market for the ProBuilders product is viable, but mostly at lower average premium levels. The residential book of business has seen a substantial movement away from general contractors, which has historically been the Company's focus.

LOSS EXPERIENCE

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Premiums earned	46,947,140	58,177,855	36,317,634	19,105,718	7,530,709
Losses & Loss					
Adjustment Expenses	23,717,054	27,635,215	18,158,679	8,910,974	3,388,819
Loss Ratio	50.51%	47.50%	49.99%	46.63%	44.99%

The Company records its losses using a target loss ratio approach. The target loss ratios are as follows: 2003, 45%; 2004, 47% and 2005 through 2007, 50%. This is because the Ultimate loss experience is determined as 50% of earned premiums, which the Company reduces by actual claims experience to arrive at its computed Incurred But

Not Reported (IBNR). The examination actuaries determined the loss ratios and IBNR to be adequate.

REINSURANCE

Assumed Business

Effective July 1, 2006, the Company assumed business under a Casualty Quota Share Reinsurance Contract (Contract). In accordance with the terms of the Contract, the Company, as the reinsurer, agrees to accept a quota share participation of its affiliate's, ProBuilders, net liability and net written premium on policies (the policies) issued or renewed on or after the effective date of the Contract.

The Company's quota share participation is 85% of the net liability and net written premium of ProBuilders with respect to the first \$1 million of loss, per occurrence, under the policies and 75% of net liability and net written premium with respect to the second \$1 million of loss, per occurrence, under the policies after taking into effect premium and losses ceded for reinsurance that inures to the benefit of the Contract.

Effective January 1, 2007, the Contract was amended whereby the Company's quota share participation with respect to the first \$1 million of loss was reduced to 80%.

Effective July 1, 2007, the Company entered into a new Casualty Quota Share Reinsurance Contract with ProBuilders, which covers ProBuilders policies issued or renewed on or after July 1, 2007. Under this new contract, the Company's quota share participation is 80% of the net liability and net written premium of ProBuilders with respect to the first \$1 million of loss, per occurrence, under the policies and 75% of net liability and net written premium with respect to the second \$1 million of loss, per occurrence.

Ceded Business

For the period July 1, 2004 to December 31, 2004, the Company retro-ceded ProBuilders business to Starwest Insurance Company Ltd. through a quota share reinsurance agreement. During the period this agreement was in effect, the reinsurer's pro rata participation varied between 68.1% and 80.98% of the Company's 85% share.

There were no other ceded reinsurance agreements in effect during the period covered by this examination.

ACCOUNTS AND RECORDS

The Company's statutory home office is located at 1401 H. Street N.W. Washington, D.C. 20005. The Company's main administrative office, as well as the primary location of its books and records, is in Atlanta, Georgia, at the location of the principal offices of the Company's parent, NBIS. This arrangement does not meet the requirements of Section 31-5204 of the District of Columbia Official Code, which requires that a domestic insurer maintain its principal office within the District. Specifically, Section 31-5204 of the District of Columbia Official Code requires that a domestic insurer maintain its principal office within the District and shall keep its books, records, and files therein, and shall not remove from the District either its principal office or its books, records, or files without the permission of the Commissioner.

Therefore, in a May 25, 2006 letter to the Commissioner, the Company requested permission to continue to maintain its books and records in Atlanta, Georgia, upon licensing as a District of Columbia domestic insurer.

In a letter dated July 12, 2006, permission was granted by the Commissioner for the Company to maintain its books and records in Atlanta, Georgia.

The Company's general accounting records are maintained by its parent, NBIS, on its parent's systems. The general ledger and premium accounting systems are maintained on a packaged software system. However, spreadsheets are used to calculate certain loss reserve and reinsurance data. During the prior examination, examiners discussed with the Company the importance of ensuring the Company's accounting systems remain adequate, particularly if the Company continues to grow, and we discussed with the Company the importance of ensuring appropriate procedures and controls are maintained over the accounting systems and records, particularly controls over accounting and other records maintained on spreadsheets. The Company has since undertaken efforts to implement a reinsurance accounting system, which was the majority of the risk and amount of spreadsheets used by the accounting department.

See the "Comments and Recommendations" section of this report, under the caption "Record Keeping Functions" for further comment regarding this issue.

FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Company as of December 31, 2007, as determined by this examination:

<u>STATEMENT</u>	<u>PAGE</u>
Balance Sheet:	
Assets	17
Liabilities, Surplus and Other Funds	18
Statement of Income	19
Capital and Surplus Account	20
Examination Changes to Surplus	21

The accompanying “Notes to Financial Statements” are an integral part of these financial statements.

Balance Sheet

Assets

	Assets	Nonadmitted Assets	Net Admitted Assets	Examination Adjustment Increase (Decrease)	Net Admitted Assets Per Examination
Bonds	\$ 137,915,974	\$ 0	\$ 137,915,974	\$ 0	\$ 137,915,974
Cash (\$751,592, cash equivalents \$0 and short term investments \$2,138,052)	2,889,644		2,889,644		2,889,644
Subtotals, cash and invested assets	\$ 140,805,618	\$ 0	\$ 140,805,618	\$ 0	\$ 140,805,618
Investment income due and accrued	1,356,633		1,356,633		1,356,633
Amounts recoverable from reinsurers	112,324		112,324		112,324
Funds held by or deposited with reinsured companies	1,893,442		1,893,442		1,893,442
Other amounts recoverable under reinsurance contracts	4,284,629		4,284,629		4,284,629
Net deferred tax asset	5,248,422	3,559,621	1,688,801		1,688,801
Aggregate write-ins for other than invested assets	18,750	18,750	0		0
Totals	\$ 153,719,819	\$3,578,371	\$ 150,141,448	\$ 0	\$ 150,141,448

Liabilities, Surplus and Other Funds

	Liabilities per Company	Examination Adjustments	Liabilities per Examination
Losses (NOTE 1)	\$ 53,318,523		\$ 53,318,523
Reinsurance payable on paid losses	671,492		671,492
Loss adjustment expenses	24,173,184		24,173,184
Other expenses (excluding taxes, licenses and fees)	86,912		86,912
Current federal and foreign income tax	1,027,401		1,027,401
Unearned premiums	19,190,675		19,190,675
Funds held by company under reinsurance treaties	10,783,116		10,783,116
Payable to parent, subsidiary & affiliates	423,472		423,472
Aggregate write-ins	267,765		267,765
Total liabilities	<u>\$ 109,951,540</u>	<u> </u>	<u>\$ 109,951,540</u>
Common capital stock	\$ 5,000,000		\$ 5,000,000
Gross paid in and contributed surplus	21,245,003		21,245,002
Unassigned funds (surplus)	<u>13,994,906</u>	<u> </u>	<u>13,994,906</u>
Surplus as regards policyholders	<u>\$ 40,189,908</u>	<u> </u>	<u>\$ 40,189,908</u>
Total liabilities and surplus	<u><u>\$ 150,141,148</u></u>	<u><u> </u></u>	<u><u>\$ 150,141,148</u></u>

Statement of Income

Premiums earned		<u>\$ 46,947,140</u>
Underwriting deductions:		
Losses incurred	\$ 15,939,704	
Loss expenses incurred	7,777,350	
Other underwriting expenses incurred	<u>15,261,180</u>	
Total underwriting deductions		<u>\$ 38,978,234</u>
Net underwriting gain (loss)		<u>7,968,905</u>
Investment Income		
Net investment income earned	\$ 6,054,833	
Net realized capital gains (losses) less capital gains tax of \$(0)	4,439	
Net investment gain		<u>\$ 6,059,272</u>
Other Income		
Net gain (loss) from agents' or premium balances charged Off (amount recovered \$371,384; amount charge off \$824,887)	<u>\$ (453,503)</u>	
Total other income		<u>\$ (453,503)</u>
Net income after dividends to policyholders and before federal and foreign income taxes		<u>13,574,674</u>
Federal and foreign income taxes incurred		<u>4,042,926</u>
Net Income		<u><u>\$ 9,531,749</u></u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2006	<u>\$ 31,828,001</u>
Net Income, 2007	\$ 9,531,749
Change in net deferred income tax	544,293
Change in non admitted asset	(1,435,718)
Stock dividends	4,700,000
Capital Changes - Paid in surplus	2,925,000
Surplus adjustment	(4,700,000)
Dividend to Stockholders	(3,100,000)
Aggregate write-ins	<u>(103,417)</u>
Net change in surplus as regards policyholders	8,361,907
Surplus as regards policyholders, December 31, 2007	<u><u>\$ 40,189,908</u></u>

Analysis of Examination Changes to Surplus

There were no changes to the Company's surplus as a result of our examination.

NOTES TO FINANCIAL STATEMENTS

1. Loss Reserves

The Company reported “Losses” and “Loss adjustment expenses” reserves totaling \$53,318,523 and \$24,173,184 respectively. These reserves, which represent management’s best estimate of the amounts necessary to pay all claims and related expenses that had been incurred but still unpaid as of December 31, 2007, are shown net of estimated amounts recoverable from various reinsurance companies under the Company’s reinsurance treaties. Reserve credits taken as of December 31, 2007 for cessions to reinsurers totaled approximately \$6,863,965. If the reinsurers were not able to meet their obligations under the reinsurance treaties, the Company would be liable for any defaulted amounts.

The methodologies utilized by the Company to compute reserves, and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2007, were reviewed as part of our examination. As part of our review, we relied on the Company’s independent actuary, who concluded that the methodologies and reserves appeared to be sufficient. In addition, the methodologies utilized by the Company to compute these reserves, and the adequacy of the loss reserves and loss adjustment expense reserves were reviewed by an independent actuary engaged as part of our examination. This independent actuary engaged as part of our examination, concluded that overall the methodologies and reserves appeared to be reasonable. However, the actuary reported some deficiencies which are noted under “Comments and recommendations” section of this report, under the caption “Loss Reserves”.

2. Earned Premiums:

As of December 31, 2007, the Company reported “Earned Premiums” totaling \$46,947,140, as compare to December 31, 2006 for \$58,177,855. This represents approximately 20% drop in reported “Earned Premiums” between the years. This mainly resulted from the following factors:

1. ProBuilders is not rated by AM Best, which is affecting marketability of its products, which in turn, affects the level of premiums available for the Company to assume from ProBuilders.
2. The Company assumes most of its business from an affiliate ProBuilders. The soft construction market and a mature U.S. insurance market have led some “A” rated insurers to take business share from ProBuilders. An organizational examination of the Company was conducted by DISB as March 31, 2006. At that point, the Company had plans to seek eligibility

to write surplus line and direct business. Since receiving the certificate of authority, residential premiums are impacted by the depressed housing market, a downturn in the economy, and a very competitive insurance market. As a result the plans to seek eligibility to do business on a direct and on a surplus lines basis in targeted U.S. states has been put on hold indefinitely.

3. Prior to 2006, business was primarily concentrated in one line of business. As noted above, ProBuilders' premiums are impacted by the depressed housing market, a downturn in the economy, and a very competitive insurance market. The residential book of business has seen a substantial movement away from general contractors, which has historically been the Company's focus. During late 2006, the Company embarked on a new partnership with National Interstate Insurance Company to expand assumption of premiums in commercial lines. The program developed significantly during 2007 and even more during the first part of 2008. Diversification into new lines is part of Company management's strategy to hedge against downturns in one particular segment of its book of business.

COMMENTS AND RECOMMENDATIONS

Committees

As of December 31, 2007, the Company was not in compliance with District of Columbia Official Code Section 31-706(c)(4). The Company complied with the Code's requirement that the board establish one or more committees comprised of individuals who are not officers or employees of the Company, or of any entity controlling, controlled by or under common control with the Company. This committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the Company's financial condition, nominating candidates for director, evaluating the performance of officers of the Company, and recommending to the board the selection and compensation of principal officers. This was established as an Audit and Compensation Committee of the Board of Directors, which was formed and approved by the Board of Directors at the May 9, 2007 meeting. The Audit and Compensation Committee did not meet during 2007 and therefore did not approve the selection of the certified public accountants. **We recommend that the Company comply with the above mentioned requirement of the District of Columbia.**

Annual Statement Preparation

Section 31-1901 of the District of Columbia Official Code requires each insurer authorized to transact business in the District to annually file with the Commissioner a true statement of its financial condition, transactions and affairs as of the end of the preceding calendar year. The section further provides that the annual financial statements must be in such form and content as is approved or adopted for current use by the National Association of Insurance Commissioners (NAIC). The NAIC's *Annual Statement Instructions* and *Accounting Practices and Procedures Manual* specify the procedures to be followed in completing the Annual Statement. However, our examination disclosed certain instances where the Company did not complete its Annual Statement in accordance with the Instructions. The following are certain examples:

- The Company did not complete "Schedule Y Part 2 - Summary of Insurer's Transactions With Any Affiliates".
- Improperly listed affiliate reinsured under " Inter-company pooling" when it was not part of a pool

We recommend that the Company complete its Annual Statements in accordance with the provisions of Section 31-1901 of the District of Columbia Official Code and the NAIC *Annual Statement Instructions* and *Accounting Practices and Procedures Manual*.

Loss Reserves

As indicated in **NOTE 1** the “Notes to Financial Statement” section of this Report, the Company reported “Losses” and “Loss adjustment expenses” reserves totaling \$53,318,523 and \$24,173,184, respectively. The methodologies utilized by the Company to compute these reserves, and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2007 were reviewed as part of our examination by an independent actuary engaged as part of our examination. Although this independent actuary engaged as part of our examination concluded that these reserves appeared to be sufficient, the actuary noted the following:

- Appointed Actuary failed to document the industry information relied upon in selecting payment and reporting patterns for Construction Defect claims. These patterns are materially relied on by the Appointed Actuary and significantly affect the results of the utilized actuarial methods. The failure to include this documentation is not consistent with applicable Annual Statement instructions and Actuarial Standards of Practice.
- Company management has not documented their adherence to Statements of Statutory Accounting Principles (SSAP) 55 as it relates to using past experience in the setting of their carried reserves. Instead, the Company management explained that their philosophy is to carry reserves at a level above the Appointed Actuary’s selected reserves, but below the high end of his range.
- During the review of the Actuarial Report as of December 31, 2007, our actuaries found that the Appointed Actuary uses payment and reporting patterns, derived from paid and incurred loss and allocated loss adjustment expense triangles, to calculate loss and loss adjustment expense (Defense Cost and Containment Expense and Adjusting & Other Expense, allocated and unallocated) IBNR. Our actuaries felt it was inappropriate for the Appointed Actuary to use development calculated from Loss and Allocated Loss Adjustment Expense numbers to project Loss and Total Loss Adjustment Expense IBNR.
- During their review of the Actuarial Report as of 12/31/07, our actuaries found that the Appointed Actuary analyzes traditional general liability exposures in the same procedure with the Construction Defect exposures. Since, the majority of variation and uncertainty in the resulting estimate is a product of the Construction Defect exposures, it would be more reasonable to identify, analyze, and set reserves for the traditional general liability exposures in isolation and then separately analyze and produce estimates for the highly volatile Construction Defect exposures.

We recommend Company comply with the above recommendations.

Strategic Plan

The DISB has made several requests to the Company to submit a strategic business plan for approval. The business plan originally submitted was never successfully carried out, partly due to the housing market downturn and the Company's direct affiliate's inability to get a positive AM Best rating. The Company had invested resources towards becoming a recognized surplus lines direct writer in several states, but the plan is on hold indefinitely. On June 10, 2008, a revised business plan was submitted to examiners. A review of this plan revealed that the assumptions made in this plan did not coincide with the Company's recent changes in its business model.

We recommended that the Company file an updated and thoroughly documented business plan with the DISB.

Information Technology (IT) General Controls

The Company utilized an electronic data processing system to process the majority of its significant functions (e.g., reserving, claims processing, general ledger, etc.) During our review of the procedures and controls over the Company's electronic data processing system, we noted the following areas where controls could be improved.

- a. Management and Organizational Controls - In reviewing the Management and Organizational Controls, it was noted the Company did not have an IT Steering Committee in place, did not have an IS strategy in place that is consistent with the overall business strategy and the IT Director's position was vacant (as of December 31, 2007) which was subsequently filled in April 2008. It was also noted, the Company did not define the roles and responsibilities of the IT staff and the descriptions of the functions performed by the IT department were not in place.

We recommend that the Company establish an IT Steering Committee and an IT Strategy consistent with the overall business strategy. We also recommended the Company further define the roles and responsibilities of the IT staff and complete and document descriptions of the functions performed by the IT department.

- b. Logical and Physical Security - In reviewing the Logical and Physical Security controls, we noted the Company did not demonstrate an awareness of security risk or promote security awareness across the organization, did not have an Information Security Policy in place, did not have a written statement defining restrictions on access to the computer room, did not review facility access logs, did not have documented procedures for granting computer room access, did not have financially significant system level password controls in place, did not utilize system/resource/internet security authorization forms, did not have user access capabilities reviewed by the user departments, did not have documented termination procedures and management did not review and resolve reports of security violations. It was also noted, the Company did not have procedures in

place for granting authorized users permission to use specific resources, did not have VPN authorization forms in place, did not have application level password controls in place, did not have application security forms in place, did not document application access procedures, did not have a computer equipment sign-out procedure, nor an asset management system in place, did not have security incident response procedures in place, did not have a functioning Intrusion Detection System (IDS) in place, did not have a wireless security policy in place and did not scan for rogue access points.

We recommend that the Company develop and implement a comprehensive Information Security Policy which addresses, security awareness, computer room access, system level password controls, system/resource/internet security access, user department access capabilities, termination procedures, security violation review/resolution, computing resource access authorization, VPN authorization, application level password controls, application security authorization, application access procedures, computer equipment sign-out procedures, asset management systems, emergency response procedures after a security incident, an intrusion detection policy and a wireless security policy. We also recommend the Company periodically review facility access logs and monitor for rogue access points.

- c. Changes to the Application - In our review of Changes to Applications, we noted there was no control in place that ensures user needs result in appropriate program change requests and the requests are properly evaluated, prioritized, authorized, monitored and tested, no control was in place that would prevent or detect unauthorized changes made to applications after the completion of testing but before transfer to the live environment, no control was in place that ensures only properly tested, reviewed and approved changes to applications are transferred into the production environment, application documentation was not updated and distributed to affected users and IT staff and technical documentation was not updated to document program or database structural changes.

We recommend that the Company develop a process for evaluating, prioritizing, authorizing, monitoring and testing program change requests, implement a control to prevent or detect unauthorized changes made to applications after completion of testing but before transfer to the live environment, implement a control to ensure only properly tested, reviewed and approved changes to applications are transferred into the production environment, distribute and update application documentation and submit to affected users and IT staff after application change and create and update technical documentation for all program and database structural changes.

- d. Contingency Plan - The Company had not developed a formal disaster recovery plan to be utilized in the event of a major disaster that could disrupt its computer operations. A formal disaster recovery plan identifies those application systems and business processes, which are critical to daily processing, and prioritizes them

in the order in which they should be restored. Additionally, such a plan should include formal arrangements for alternative processing capabilities at another location with compatible hardware in the event of an emergency causing prolonged disruption. Any disaster recovery plan needs to be documented and tested.

We recommend that the Company design and implement a Disaster Recovery Plan that addresses all significant business activities, including financial functions, telecommunication services, data processing and network services. The Plan should be current and tested periodically, describe senior managements' roles and responsibilities during an emergency, identify individuals authorized to declare an emergency, contain a list of critical computer application programs, operating systems and data files, contain a list of supplies needed in a disaster and the suppliers contact information, address the restoration priority of all significant business activities, address manual processing procedures, if applicable, have copies maintained off-site, contain information on backup tapes, detail the information for an alternate site, if applicable and be based on a business impact analysis.

- e. Service Provider Controls - In our review of Service Provider Controls, the Company stated that AMS Services, Inc. is used as an outside service provider, but did not answer the questionnaire completely and did not provide the IS Specialist with requested information so a determination could be made on the extent of the processing, development or system management.

For future examinations, we recommend that the Company provide adequate information regarding service provider controls so that the IS Specialist can examine the extent of the processing, development or system management provided by that service provider.

- f. Operations - In our review of Operations. we noted the Company did not maintain detailed listings of hardware and software, did not maintain a standard operations procedure manual, that authorization procedures were not in place to control changes to preapproved job schedules, on-site media (backup tapes) were not stored in a locked waterproof/fireproof storage area/unit, the Company did not have a retention policy for backup tapes and the Company did not have documented procedures in place for operational failures. We also noted the system hardware and software selection procedures were not in place, the Company did not test new systems or upgrades to existing systems prior to deployment into production and the process for changing the system architecture was not documented.

We recommend that the Company create and maintain detailed lists of all hardware and software, create and maintain a standard operations procedure manual, establish a control procedure to ensure all changes to preapproved job schedules are appropriate and authorized, obtain a locked

waterproof/fireproof storage unit to store all on-site media (backup tapes) prior to shipment to an off-site storage facility, develop and implement a retention policy (off-site storage rotation) for backup tapes and document the procedures used in the event of operational failures.

We also recommended that the Company develop procedures for selecting system hardware and software, develop procedures and test all new systems or upgrades to exiting systems prior to deployment into production and document the process for changing the system architecture.

- g. Processing Controls - In our review of Processing Controls, we noted the Company did not have a control procedure in place to ensure electronic data transmissions are transmitted and received completely and accurately and the Company did not have a control procedure in place to detect data that is input incorrectly or inaccurately.

We recommend that the Company create control procedures regarding accurate and complete data transmissions and inaccurate and incomplete data input.

- h. Net Work and Internet Controls - During our review of Network and Internet Controls, we noted the Company had not documented the process for changing the network configuration, the Company did not have an Internet Usage Policy in place, the Company had adequate utilities in place to scan all incoming e-mail, files and other network traffic for malicious content, but did not disinfect e-mail, files and other network traffic for identified malicious content and the Company did not scan/filter outbound e-mail for either offensive or potentially damaging content.

We recommend that the Company document the process for changing the network configuration, develop and implement an Internet Usage Policy, utilize the disinfecting feature in the Symantec, McAfee and Barracuda utilities to disinfect identified malicious content and scan/filter all outbound e-mail for offensive and potentially damaging content.

Inter Company Agreements

It was noted during the examination that the Company's intercompany agreements were submitted but never approved by DISB. In addition, the "Management and Underwriting Agreement" was never signed. This is contrary to the provisions of DC Code 31-706 (2) (B) & DCMR 26-1602.2.

Subsequent to the completion of the examination, DISB approved the 04/01/07 Management Agreement and the 01/01/03 Tax Sharing Agreement.

We recommend that the Company continue to seek approval from DISB with respect to its 07/01/07 Reinsurance Agreement and hereinafter comply with the provisions of DC Code 31-706 (2) (B) & DCMR 26-1602.2.

Ethics Policy

NAIC *Financial Condition Examiners' Handbook* recommends that insurance companies have an overall ethics policy in place. This policy requires the Company to explain the commitment to ethics by the board/committee and explain how the board/committee conveys that commitment to employees. The Handbook further recommends that this code be approved and enforced by the Company officers, directors and responsible employees. We noted during our examination that while the Company had adopted an Ethics policy, it had not effectively enforced and communicated that to its employees.

We recommend that the Company comply with the aforementioned Handbook Provisions and ensure that an ethics policy is implemented and enforced by the Company officers, directors and responsible employees. Subsequent to the date of this examination, a revised ethics policy was approved by the Board of Directors and an implementation and enforcement policy has been established.

Record Keeping Practices

The Company's general accounting records are maintained by its parent, NBIS, on its parent's systems. The general ledger and premium accounting systems are maintained on a packaged software system. However, spreadsheets are used to calculate certain loss reserve and reinsurance data. During the prior examination, examiners discussed with the Company the importance of ensuring the Company's accounting systems remain adequate, particularly if the Company continues to grow, and we discussed with the Company the importance of ensuring appropriate procedures and controls are maintained over the accounting systems and records, particularly controls over accounting and other records maintained on spreadsheets. The Company has undertaken efforts to implement a reinsurance accounting system, which was the majority of the spreadsheets used by the accounting department.

In addition to the above, the examiners noted the following:

- The Company does not maintain a procedure manual for various job functions.
- Inter-company payments are not always paid in accordance with the agreements.

We recommend the Company take the necessary corrective measures to address these issues.

Additional Comments and Recommendations

During our examination, in addition to the above Comments and Recommendations, we made other suggestions and recommendations to the Company with regard to record

keeping and other procedures related to its operations. These additional suggestions and recommendations were not deemed significant for purpose of our Report on Examination, and were not included in our Report on Examination.

CONCLUSION

Our examination disclosed that as of December 31, 2007, the Company had:

Admitted assets	<u>\$ 150,141,448</u>
Liabilities	<u>\$ 109,951,540</u>
Common capital stock	\$ 5,000,000
Gross paid in and contributed surplus	21,245,002
Unassigned funds (surplus)	13,944,906
Surplus as regards policyholders	<u>\$ 40,189,908</u>
Total liabilities, capital and surplus	<u>\$ 150,141,448</u>

Based on our examination, the accompanying balance sheet properly presents the statutory financial position of the Company as of December 31, 2007, and the accompanying statement of income properly presents the statutory results of operations for the period then ended. The supporting financial statements properly present the information prescribed by the District of Columbia Official Code and the National Association of Insurance Commissioners.

Chapters 20 (RISK-BASED CAPITAL) and 25 (FIRE, CASUALTY AND MARINE INSURANCE) of Title 31 (Insurance and Securities) of the District of Columbia Official Code specify the level of capital and surplus required for the Company. We concluded that the Company's capital and surplus funds exceeded the minimum requirements during the period under examination.

ACKNOWLEDGMENT

In addition to the undersigned, the following examiners representing the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

Alvin J. Burrell, CFE, AIE, Huff Thomas & Company
Chidinma Ukairo, D.C. Department of Insurance, Securities and Banking

The electronic data processing review and computer assisted data analysis were performed by Brandon Thomas, HISP from Huff Thomas & Company.

The actuarial portion of this examination was completed by David M. Shepherd, FCAS, MAAA, from Merlinos & Associates, Inc.

Respectfully submitted,



Neeraj Gupta, CFE
Examiner-In-Charge
Representing the District of Columbia
Department of Insurance, Securities and
Banking

Under the Supervision of,



Nathaniel Kevin Brown, CFE, CPA
Acting Chief Financial Examiner
District of Columbia Department of
Insurance, Securities and Banking

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

September 19, 2008

Ned N. Fleming
President
NationsBuilders Insurance Company
2859 Paces Ferry Road, Suite 1900
Atlanta, Georgia 30339

Dear Mr. Fleming:

Pursuant to the provisions of Section 31-1404 of the D.C. Official Code, enclosed is a draft copy of the Report on the Examination of the affairs and financial condition of NationsBuilders Insurance Company as of December 31, 2007.

Please call our attention to any errors or omissions. In addition, if this Report on Examination contains a section entitled "Comments and Recommendations" that discloses certain areas requiring action, the Company shall submit a statement covering the corrective measures which will be taken. If the Company's position on any of these points is contrary to the Examiner's findings, an explanation should be submitted covering each contested comment and/or recommendation.

If there are no errors or omissions to be brought to our attention, and there are no "Comments and Recommendations" requiring a response, please submit a statement that the Company accepts the Report.

All of your comments concerning these matters must be in writing and shall be furnished to this Department within thirty (30) days from the date of this letter (October 19, 2008).

Sincerely,

A handwritten signature in black ink, appearing to read "Nathaniel Kevin Brown".

Nathaniel Kevin Brown, CFE, CPA
Acting Chief Financial Examiner

Enclosure



October 17, 2008

Nathaniel Kevin Brown, CFE, CPA
Acting Chief Financial Examiner
Government of the District of Columbia
Department of Insurance, Securities and Banking
810 First Street, NE, Suite 701
Washington, DC, 20002

Dear Mr. Brown:

We are in receipt of the Report on the Organization Examination of the affairs and financial condition of NationsBuilders Insurance Company.

We accept the report and listed below is the action the Company is going to take to address the Comments and Recommendations.

Committees

As of December 31, 2007, the Company was not in compliance with District of Columbia Official Code Section 31-706(c)(4). The Company complied with the Code's requirement that the board establish one or more committees comprised of individuals who are not officers or employees of the Company, or of any entity controlling, controlled by or under common control with the Company. This committee or committees shall have responsibility for recommending the selection of independent certified public accountants, reviewing the Company's financial condition, nominating candidates for director, evaluating the performance of officers of the Company, and recommending to the board the selection and compensation of principal officers. This was established as an Audit and Compensation Committee of the Board of Directors, which was formed and approved by the Board of Directors at the May 9, 2007 meeting. The Audit and Compensation Committee did not meet during 2007 and therefore did not approve the selection of the certified public accountants.

The Company's audit committee met with the auditors on May 23, 2008. No material adjustments were recommended by the auditors. The committee is scheduling a meeting to discuss and review the audit for 2008. This meeting should take place late October, or early November.

Annual Statement Preparation

Section 31-1901 of the District of Columbia Official Code requires each insurer authorized to transact business in the District to annually file with the Commissioner a true statement of its financial condition, transactions and affairs as of the end of the preceding calendar year. The section further provides that the annual financial statements must be in such form and content as is approved or adopted for current use by the National Association of Insurance Commissioners (NAIC). The NAIC's *Annual Statement Instructions* and *Accounting Practices and Procedures Manual* specify the procedures to be followed in completing the Annual Statement. However, our examination disclosed certain instances where the Company did not complete its Annual Statement in accordance with the Instructions. The following are certain examples:

- The Company did not complete "Schedule Y Part 2 - Summary of Insurer's Transactions With Any Affiliates".
- Improperly listed affiliate reinsured under "Inter-company pooling" when it was not part of a pool

The Company has hired personnel who have experience in the insurance industry and annual statement presentation. As a result we feel all future filings to the NAIC and the Department will be in compliance with all NAIC and DC regulations.

Loss Reserves

As indicated in **NOTE 1** the "Notes to Financial Statement" section of this Report, the Company reported "Losses" and "Loss adjustment expenses" reserves totaling \$53,318,523 and \$24,173,184, respectively. The methodologies utilized by the Company to compute these reserves, and the adequacy of the loss and loss adjustment expense reserves as of December 31, 2007 were reviewed as part of our examination by an independent actuary engaged as part of our examination. Although this independent actuary engaged as part of our examination concluded that these reserves appeared to be sufficient, the actuary noted the following:

- Appointed Actuary failed to document the industry information relied upon in selecting payment and reporting patterns for Construction Defect claims. These patterns are materially relied on by the Appointed Actuary and significantly affect the results of the utilized actuarial methods. The failure to include this documentation is not consistent with applicable Annual Statement instructions and Actuarial Standards of Practice.

The industry information relied on was not in the form of pure data, as there are no publicly available historical data available on



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payment and reporting patterns of construction defect claims. Rather, the information considered was in the form of industry publication articles, actuarial conference presentations and other knowledge obtained through the professional experiences of the Insurance Industry Consultants, LLC (IIC) actuaries. Hence, this form of information does not lend itself to the traditional form of documentation in the same manner as data based sources are traditionally documented. The patterns selected were developed based on the judgment of the IIC actuaries with consideration to the information available. IIC will clarify its footnote in future actuarial studies to emphasize that the patterns are selected using judgment after consideration of the available qualitative information.

- Company management has not documented their adherence to Statements of Statutory Accounting Principles (SSAP) 55 as it relates to using past experience in the setting of their carried reserves. Instead, the Company management explained that their philosophy is to carry reserves at a level above the Appointed Actuary's selected reserves, but below the high end of his range.

Company management is currently reviewing its reserve determination process as well as industry practices and will develop a revised process that will sufficiently comply with SSAP #55 Paragraph 8. Company management anticipates the reserves underlying its December 31, 2008 financial statements will be determined under this revised process.

- During the review of the Actuarial Report as of December 31, 2007, our actuaries found that the Appointed Actuary uses payment and reporting patterns, derived from paid and incurred loss and allocated loss adjustment expense triangles, to calculate loss and loss adjustment expense (Defense Cost and Containment Expense and Adjusting & Other Expense, allocated and unallocated) IBNR. Our actuaries felt it was inappropriate for the Appointed Actuary to use development calculated from Loss and Allocated Loss Adjustment Expense numbers to project Loss and Total Loss Adjustment Expense IBNR.

The appointed actuary will review Adjusting and Other Expense liabilities separately from Loss and Defense Cost and Containment Expense liabilities as part of future actuarial reviews.



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- During their review of the Actuarial Report as of 12/31/07, our actuaries found that the Appointed Actuary analyzes traditional general liability exposures in the same procedure with the Construction Defect exposures. Since, the majority of variation and uncertainty in the resulting estimate is a product of the Construction Defect exposures, it would be more reasonable to identify, analyze, and set reserves for the traditional general liability exposures in isolation and then separately analyze and produce estimates for the highly volatile Construction Defect exposures.

The appointed actuary will review "Non-Construction Defect" liabilities separately from "Construction Defect" liabilities as part of future actuarial reviews.

Strategic Plan

The DISB has made several requests to the Company to submit a strategic business plan for approval. The business plan originally submitted was never successfully carried out, partly due to the housing market downturn and the Company's direct affiliate's inability to get a positive AM Best rating. The Company had invested resources towards becoming a recognized surplus lines direct writer in several states, but the plan is on hold indefinitely. On June 10, 2008, a revised business plan was submitted to examiners. A review of this plan revealed that the assumptions made in this plan did not coincide with the Company's recent changes in its business model.

NationsBuilders Insurance Services (NBIS) formed a Strategic Planning Committee that has been leading a planning process with an objective of producing a plan document that includes forecast financials. Much of the plan has been drafted to this point. The Company's extended leadership team met offsite October 8 and 9 2008 to review the progress to date, and finalize goals and strategies. A final draft plan including financials will be completed in the very near future, at which time we will forward the Department a copy of this draft plan for their review.

Information Technology (IT) General Controls

Please see the enclosed attachments to this document addressing the IT recommendations and the anticipated time frame for implementing them.

Inter Company Agreements

It was noted during the examination that the Company's intercompany agreements were submitted but never approved by DISB. In addition, the "Management and Underwriting Agreement" was never signed. This is contrary to the provisions of DC



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Code 31-706 (2) (B) & DCMR 26-1602.2. Subsequent to the completion of the examination, DISB approved the 04/01/07 Management Agreement and the 01/01/03 Tax Sharing Agreement.

The Company will continue to keep the department updated on all inter company agreements.

Record Keeping Practices

The Company's general accounting records are maintained by its parent, NBIS, on its parent's systems. The general ledger and premium accounting systems are maintained on a packaged software system. However, spreadsheets are used to calculate certain loss reserve and reinsurance data. During the prior examination, examiners discussed with the Company the importance of ensuring the Company's accounting systems remain adequate, particularly if the Company continues to grow, and we discussed with the Company the importance of ensuring appropriate procedures and controls are maintained over the accounting systems and records, particularly controls over accounting and other records maintained on spreadsheets. The Company has undertaken efforts to implement a reinsurance accounting system, which was the majority of the spreadsheets used by the accounting department.

In addition to the above, the examiners noted the following:

- The Company does not maintain a procedure manual for various job functions.
- Inter-company payments are not always paid in accordance with the agreements.

The Company's HR department will be documenting various job functions, which we expect to be completed by the second quarter of 2009. In addition, the Company has established controls to ensure intercompany payments are paid in accordance with the agreements.

Should you have any further questions or comments, please do not hesitate to contact me.

Sincerely,



A handwritten signature in black ink, appearing to read "Ron Smith", is written over a horizontal line.

Ron Smith, CFO, SVP

Encl.

DOI Audit Action Plan
10/15/2008

[illegible]

Scope		Changes to Applications				Est. Complete Date	
		Request	Response	Notes	Plan	Responsible	
Can the company make changes to the program source code, either in-house developed software or vendor developed packages, which comprise the financially significant information systems identified through INSTRUCTION NOTE 4 in the front of the questionnaire?			Yes				
Have any changes, other than vendor-installed updates, been made to financially significant computer programs (e.g., in-house enhancements, vendor changes for company specifications, bug fixes, etc.) during the period identified in INSTRUCTION NOTE 3 in the front of the questionnaire?			Yes				
Does management monitor the level of open requests for changes to applications and the satisfaction of users with changes made? Please provide a copy of reports on application performance, which have been reviewed and approved by management and include information regarding the volume of changes made to applications, application problems, emergency fixes, application related help desk calls, backlog of requests from users for application changes and users' views on the functional and operational quality of applications. Test procedure: The examiner's evaluation of the reports and evidence provided will generally be sufficient for this test.			Yes	Part Governance, Part review of TrackIT. Performance checking - No			
Is there a control that ensures that user needs result in appropriate program change requests and the requests are properly evaluated, prioritized, authorized, monitored and tested? Please provide a list of all program change requests made during the period under review. Test procedure: The examiner's evaluation of the list of program changes and the related evidence provided, along with an attribute sample of between 11 and 76 program changes made within the past 12 to 24 months on each computer processing platform that contains a financially significant information system, will generally be sufficient for this test.			No				
Is there a control that ensures that the correct program libraries are updated with the most recent version of the program? Please provide a description of the control and the name and phone number of the person who can demonstrate or validate the control.			Yes	Jim Copp DBA 770-257- 	Will finalize SDLC and approval of Red's by end users	Tim	Nov-08
Is there a control that ensures that the source code used corresponds to the most recent version of the program and modifications to a program by more than one programmer are coordinated? Please provide a description of the control and the name and phone number of the person who can demonstrate or validate the control.			Yes	Jim Copp DBA 770-257- 	Build, SCS	Tim, Jim	Dec-08
Is there a control that would prevent or detect unauthorized changes made after the completion of testing but before transfer to the live environment?			No		Need to note in SDLC around SCS branching	Tim, Jim	Dec-08
Is there a control that ensures that only properly tested, reviewed and approved changes are transferred into the production environment?			No		Yes. All builds must be requested/approved. SDLC. SCS note to SDLC, add testing signoff	Tim, Jim	Dec-08
Where applications run at multiple sites, is there a control that ensures that all copies of production programs are updated?			N/A		DR impacted. Ensure testing cycles are in place w/ DR/BCP plan	Tim, Jim	Dec-08
Is application documentation appropriately updated and distributed to affected users and IS staff?			No	Under Development	Will need to require from Vendor/so we make NBIS specific/Branded?	Jim	Jan-09
Is technical documentation updated to reflect program or database structural changes?			No	Under Development	Underdevelopment O4/inclusive of SRS's moving forward (where applicable)	Jim	Dec-08
Have any financially significant information systems, including new vendor packages, been developed and/or implemented during the period identified in INSTRUCTION NOTE 3 in the front of the questionnaire?			No				
Have any financially significant information systems, including new vendor packages, been in the process of development and/or implementation during the period identified in INSTRUCTION NOTE 3 in the front of the questionnaire?			No				

Logical and Physical Security Controls						Request	Response	Notes	Plan	Responsible	Est Complete Date
Does management demonstrate an awareness of security risks, recognize that security is both a technical and operational, as well as a cultural issue, and promote security awareness across all levels of the organization? Please provide a copy of the company security policy and evidence of security awareness training. Test procedure: The examiner's evaluation of the material provided. Does the company's information security policy clearly define the responsibilities of users, management and security personnel? Test procedure: The examiner's evaluation of the policy provided will generally be sufficient for this test.	No	Under Development	Need Security Policy (inclusive of laptop, workstation, locking offices, private data emails/transmission, data on portable devices (usb, iphones) Antivirus/malware/spam/ etc	Tim, Matt, Dave, HR	Oct-08						
Are the assigned tasks of the individual responsible for information security consistent with the company's security policy statement? Please provide a list of all personnel with security administration responsibilities. Test procedure: The examiner's evaluation of the information provided will generally be sufficient for this test. Are there physical access controls over the computer/communication facilities, such as, wiring closets, server rooms, etc. including: Are the computer/communication facilities located out of the main flow of traffic away from public view? Are the computer/communication facilities behind substantial walls? Do the computer/communication facilities have a fire detection system and/or a fire suppression system, such as sprinklers charged with water at points outside the computer room? Are computer/communication facilities protected from damage resulting from electronic power interruption, surges and spikes? Please provide the name and phone number of the person who can arrange a tour of the computer/communication facilities. Test procedure: The examiner's observation of the data center will generally be sufficient for this test. Has a written statement been issued that defines the restrictions on access to the computer/communication facilities? Please provide a copy of the statement. Test procedure: The examiner's evaluation of the written statement provided will generally be sufficient for this test.	No	Under Development	Does Security Policy match job description of admins. Controls around Admin group, periodic checks	Tim, HR	Nov-08						
Are procedures in effect in the computer/communication facilities to verify that only authorized individuals are being permitted to enter the facility? Please provide a copy of the procedures and the name and phone number of the person who can demonstrate or validate the procedures. Test procedure: The examiner's evaluation of the procedures provided, corroborating inquiry with the person identified, and observation of the procedures, if possible, will generally be sufficient for this test. Does the system that controls access to restricted facilities keep a log of individuals who enter the facilities? Please provide a copy of the log(s) and a copy of the procedures that govern its review. Please provide contact information for the person responsible for the log review. Test procedure: the examiners review of the log review procedure, the existing log report and spot checks of the accuracy of the report will be sufficient for this examination	Yes	See Exhibit I	Make inclusive of NBIS Security Policy: Schedule formal reviews, output results	Matt	Nov-08						
Is this log reviewed daily, weekly, monthly? How long are logs retained for and where? The logs are retained for a minimum of 1 year within the ADP security software.	No	Need to create documents; however, procedures are in place.	Make inclusive of NBIS Security Policy: Schedule formal reviews, output results	Matt	Nov-08						
Does the IS department have procedures for adding individuals to the list of those authorized to have access to computer/communication facilities, changing their access capabilities, and deleting them from this list? Please provide a copy of the procedures and the list of authorized personnel, including their access capabilities. Test procedure: The examiner's evaluation of the procedures and the list provided, along with corroborating inquiry with a judgmental sample of people included on the list, will generally be sufficient for this test. Is there a system level control that ensures the effectiveness of financially significant system password controls (e.g., unique user IDs, passwords)? Please provide a copy of the logical security procedures used to determine the structure and use of system passwords (e.g., password expiration, password composition and password confidentiality) and the name and number of the person who can demonstrate system security settings. Test procedure: The examiner's evaluation of the procedures provided, corroborating inquiry with the person identified, and execution of the password procedures will generally be sufficient for this test.	Yes	System level controls are under development.	Make inclusive of security policy; request form	Jim	Nov-08						

Are passwords generated by each user rather than assigned by the company?	No	Compliant for reporting systems. See Exhibit C.	Make inclusive of security policy; request form	Jim	Nov-08
Are passwords properly not displayed during the login process and properly omitted from printed output?	No	Exhibit C	Confirm with Jim; masked pw change w/ Jim. This will	Jim	Nov-08
Are passwords stored in an encrypted state and not viewable by security administrators?	No	Exhibit C	Follow up with Jim. This will	Jim	Nov-08
Are passwords transmitted in an encrypted state across the network during the authentication and authorization process?	No	Exhibit C	Yes-AD; no for else. Check new systems	Jim	Nov-08
Does the system automatically prompt users to change their passwords at least quarterly and prevent passwords from being reused by the same individual? Please provide a printout of the security parameters, such as password aging and password history.	No	Exhibit C	Yes-AD; add pw exp on SP. Check w/ Jim for each systems	Jim	Nov-08
Are system resource/network security authorization forms completed and approved by management to ensure that system and Internet access granted to users and IS staff is commensurate with their job responsibilities? Please provide a list of all authorized system users, including system or application account IDs, for each platform on which financially significant applications reside. If one platform (e.g., Windows or Novell) is used to authenticate all users to the company network, then one list will be sufficient, so long as all users from all significant computer systems are included on this list. Test procedure: The examiner should select an attribute sample of users from the list provided by the company. If all financially significant information systems reside on the same computer platform or essentially similar computer platforms that are subject to the same or similar logical security controls, it is sensible to select a single attribute sample. If not, an attribute sample should be selected from the population of employees who have security access accounts on each dissimilar computer platform.	No	Under Development	Need to create an approval process (artifacts) that show application request by owners, approved (handwritten?) and submitted. Make inclusive of a New Hire Policy/New Hire Request form	Jim	Nov-08
Does user department management periodically validate the access capabilities currently provided to individuals in their department? Please provide evidence of the last user access review performed during the period under review. Test procedure: The examiner's evaluation of the evidence provided will generally be sufficient for this test.	No		Jim doing; need to solidify, make enterprise wide; automate, build platform for it	Jim	Nov-08
Do procedures provide for prompt cancellation of identification codes and passwords when the employment of the individual to whom they were assigned has been terminated? Please provide a copy of the procedures and evidence that the procedures were followed for the last IS person or user terminated. If any, during the period under review. Test procedure: The examiner's evaluation of the procedures and evidence provided will generally be sufficient for this test.	No	Need to create documents; however, procedures are in place.	In conjunction w/ new hire policy; need to come up with a flow, policy, procedures; (users data, email)	Jim, HR	Nov-08
Does management review and resolve reports of security violations? Please provide evidence of IS management's review of security violation reports and subsequent resolution of violations. Test procedure: the examiner's evaluation of the evidence provided will generally be sufficient for this test.	No		Matt; Scheudle reg meetings around auditable logs (lockouts, dos, etc)	Matt	Nov-08
Do procedures exist which require authorized users of computing resources to be given specific permission to access particular resources, including data files, applications, the operating system and utilities? Please provide a copy of the procedures. Test procedure: The examiner's evaluation of the procedures provided will generally be sufficient for this test.	No	There is no formal/ authorized process.	Newhire, sp, etc. inclusive	Matt	Dec-08
Is there a control that ensures appropriate restriction of remote access (e.g., through networks or using dial-up facilities)? Please provide a summary or list of all methods of remote access. Please provide a description of the control and the name and phone number of the person who can demonstrate or validate the control. Test procedure: The examiner's evaluation of the control, corroborating inquiry with the person identified and observation of the control, if possible, will generally be sufficient for this test.	Yes	Remote access is provided via IPSEC VPN connection using Cisco VPN concentrator hardware and client software. This access is controlled via Active Directory.			
Is there a control that ensures that users are restricted to their applications (i.e., preventing users from escaping from application menus)? Please provide a description of the control and the name and phone number of the person who can demonstrate or validate the control. Test procedure: The examiner's evaluation of the control, corroborating inquiry with the person identified and observation of the control, if possible, will generally be sufficient for this test.	Yes	Users are granted control on a per application basis.			
Is there an application level control that ensures the effectiveness of financially significant application password controls (e.g., unique user IDs and passwords)? Please provide a copy of the logical security procedures used to determine the structure and use of application passwords (e.g., password expiration and password confidentiality) and the name and number of the person who can demonstrate or validate the procedures. Test procedure: The examiner's evaluation of the procedures, corroborating inquiry with the person identified and observation of the procedures, if possible, will generally be sufficient for this test.	No		Stated above. PW policy		

Are application security authorization forms completed and approved by management to ensure application access granted to users is commensurate with their job responsibilities? Please provide a copy of a completed and approved application security authorization form for one user from each financially significant application. Test procedure: The examiner's evaluation of the application security authorization forms provided, along with the application security authorization forms on file for the employees selected from the attribute sample selected for question B9 above, should be sufficient for this test.	No	Under Development	Stated above. PW policy		
Are periodic checks carried out to confirm that employees' current application access is commensurate with their job responsibilities? Please provide evidence of the last check performed during the period under review. Test procedure: The examiner's evaluation of the evidence provided will generally be sufficient for this test.	No	Under Development	Stated above. PW policy		
Are there procedures that ensure that application access is appropriately changed on a timely basis when employees transfer or terminate? Please provide a copy of the procedures and evidence that the procedures were followed for the last user terminated, if any, during the period under review. Test procedure: The examiner's evaluation of the procedures and related evidence will generally be sufficient for this test.	No	Under Development	Stated above. PW policy. And term Asset tracking platform; IT or Accounting?	Matt	Feb-09
Is there an appropriate sign-out procedure for computer equipment that is removed from the company's offices?	No		No, but need to look at for DR/BCP as well	Matt	Feb-09
Does the equipment have asset management tags affixed and recorded in an asset management system?	No				
Please provide a copy of the procedure and the name and phone number of the person who can demonstrate and validate the procedure. Test procedure: The examiner's evaluation of the procedure, corroborating inquiry with the person identified, and observation of the procedure, if possible, will generally be sufficient for this test.					
Is there a control over administrator-level access to the operating system that ensures access to sensitive software utilities is appropriately restricted and monitored (consider the use of these sensitive facilities during an emergency situation)? Please provide a list of the sensitive software utilities commonly used by the company and evidence that the last use of each utility during the period under review was approved. If applicable, are personnel with access to sensitive software utilities restricted access to physical financial significant assets? Please provide a copy of the job description for the last person who executed each of the utilities identified in question B20. Test procedure: The examiner's evaluation of the job description provided will generally be sufficient for this test.	Yes	Operating System administrator access is controlled by local security policies on all Windows PCs and servers. Members of the Domain Admins Active Directory security group are granted full control to all systems while individual users are granted full control only to their personal equipment.	Make note in SP as well		
Does the company have formal emergency response procedures to follow if a computer security incident occurs? Please provide a copy of the incident response procedure. Test procedure: The examiner's evaluation of the procedures will generally be sufficient for this test.	Yes		Security policy (laptops); ensure ODBC configs change down to Prod		
	No	Under Development	Stolen Iphone, laptop; Add to SP. Add to policy's do not store information on local drives	Matt	Dec-08
Does the company have formal monitoring procedures and systems to detect unauthorized access attempts from either outside or inside the company? Please provide copies of the intrusion detection policy, documentation of the systems in place and the review process followed. Please provide the name and phone number of the person who can provide evidence of the use of intrusion detection systems and/or penetration studies. Test procedure: The examiner's review of the documentation and corroborating inquiry with the person identified and observation of the technology in use will be sufficient evidence for this test.	No	We have no formal monitoring procedures; however, unauthorized access attempts are logged by Event Log Analyzer. Should the number of attempts exceed 4 within 1 minute, the system will automatically notify the IT staff upon which we will investigate the issue and make necessary adjustments. Currently there is no functioning intrusion Detection System. This function will be performed by Cisco ASA devices in the near future.			TBD
Has management developed a comprehensive policy addressing the unique security risks associated with wireless technologies? Please provide a copy of policies addressing wireless technology risks.	No	Under Development	Add to SP, add to 2008/9 IPS budget	TBD	
Does the company monitor for rogue access points? Please provide evidence of the most recent scan for rogue access points.	No		Wifi is not enabled; Add note to SP about limited Wifi accessibility	Matt	Dec-09
			NA		

<p>Does the company utilize a virus detection system on all personal processing devices (desktops workstations, laptops, notebooks, personal information devices (PIDs), etc.) that are regularly updated and, if yes, does it have a disinfecting feature (i.e., the ability to restore files to a healthy state)?</p> <p>Where remote access is permitted, are remote devices scanned for current versions of the virus-scanning engine and the virus definition library prior to the network?</p> <p>Please provide the name of the virus detection and/or anti-virus software, the company's methodology for distributing and updating the software, and the name and phone number of the person who can provide evidence of the mandatory, periodic use and update of the anti-virus software across the network. Test procedure: The examiner's corroborating inquiry with the person identified and observation of the software in use will generally be sufficient for this test.</p>	Yes	<p>The Company uses Symantec Enterprise Edition Anti-Virus software on all desktops, laptops and servers. The anti-virus central management console checks with the vendor daily for updated virus definitions. Typically these are released every Wednesday by Symantec unless there is a specific threat in which case definitions will be released as needed. Once new definitions are downloaded they are distributed to all Symantec AV clients.</p>		
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Development										Program Development			Request			Response			Notes			Plan			Responsible			Est Complete Date		
Is there a control that ensures that all necessary steps are appropriately included in a project plan (e.g., use of a system development methodology)? Please provide a copy of an overview of the current system development life cycle methodology (SDLC) and a copy of the policy that requires development projects to have a clear sponsor at the senior management level.										Forthcoming			SDLC			Tim									Nov-08					
Do user departments (e.g., accounting department), auditors (e.g., external and internal), computer operation and system architect personnel participate in the early stages of planning and development of new systems? Please provide evidence of user department, auditor and computer operations involvement throughout each significant project identified in question D3													SDLC			Tim									Nov-08					
Do plans include cost justification? Please provide a list of projects during the period under review and a copy of a project cost justification for the most significant project from each system (i.e., most significant in terms of cost or business impact).													Requirements matrix - SDLC			Tim									Nov-08					
Does senior management approve the plan before work commences? Please provide evidence of senior management approval of the project plan for the most significant projects identified in question D3.													Need follow up																	
Is there a procedure that provides for management's review of progress on the project at critical stages of its development and, if so, does the procedure provide that work cannot progress to the next phase (systems design, programming, testing, conversion, etc.) until and unless approval has been given? Please provide evidence of senior management's review of progress for each significant project identified in question D3													Need to follow up, get signatures, will be a yes																	
Is there a systems design standards manual? Please provide a copy of the index from the manual.													Need			TBD									TBD					
Is there a programming standards manual? Please provide a copy of the index from the manual													Need			TBD									TBD					
Is there a control that prevents testing from being performed on production data files? Please provide a description of the control and the name and phone number of the person who can demonstrate or validate the control.													Yes, we have separate environments			Tim									Nov-08					
Is appropriate program testing performed by the IS staff, QA staff and users to prevent or detect errors in program coding and ensure that the application operates as intended in the production environment and provides appropriate data output?													IT-Unit Testing, BA - UAT, Mark in SDLC			Tim									Nov-08					
Is there a control that ensures that when modifications are made subsequent to initial testing they are also subject to appropriate program testing procedures?													Include Changes Req, docs, test			Tim									Nov-08					
Is there a control that ensures that unauthorized changes cannot be made after the completion of program testing but before transfer into the production environment?													Leave open for now			TBD									TBD					
Is an effort made to perform a parallel run by program and by system, where possible? Please provide for each project identified in question D3, evidence of parallel test results.													Make part of testing phase of SDLC			Tim									Nov-08					
Is there a control that ensures that purchased software packages are subject to adequate selection procedures, such as a thorough investigation of package capabilities compared to business needs and system architecture and a thorough comparison of several packages to one another? Please provide a list of financially significant software packages that were purchased during the period under review and evidence of management's justification for each purchase.													Yes, requirements matrix, sme involvement,etc			Tim									Nov-08					
Is there a control that ensures that packaged software options selected and parameters set are appropriate to achieve business and application control requirements? Please provide evidence of management's review of options selected and parameters set for each project identified in question D3.													Yes, requirements matrix, sme involvement,etc			Tim									Nov-08					
Does the company have legal ownership or rights (e.g., escrow account) to the application source code for software?													Yes, NBIS standard contract verbiage			Tim									Nov-08					
Is the conversion process controlled for old transaction data, standing data and establishment of data not used by the old application? Please provide evidence of management's review and approval of the data conversion plan and data conversion results for each major project identified in question D3.													Yes, Part of Vendors documents. Need business review artifact																	
Is user documentation available to users at implementation? Please provide a copy of the index to user documentation manuals prepared as part of the most significant project identified in question D3.													Yes. Need to obtain																	
Is the technical documentation available to technical staff at implementation? Please provide a copy of the index to technical documentation manuals prepared as part of the most significant project identified in question D3.													Yes.																	

<p>Is program code secured for access by only authorized individuals? Please describe procedures to secure directories, datasets or other containers of source code, code being tested, tested code awaiting movement to production areas, and production object code for financially significant systems. Has the company issued written policy statements regarding the user development of financially significant applications and/or tools and reports? If yes, do the statements include appropriate requirements for development and testing, documentation, input, processing and output controls, backup and recovery of programs and data and security over custody and use of personal computer assets, including hardware, software and data?</p>				<p>Yes. Subversion</p>				<p>SDLC (follow up with company guide)</p>	<p>Tim</p>	<p>Nov-08</p>
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Request		Contingency Planning		Responsible		Est. Complete Date	
Request		Response		Plan		Responsible	
Is the disaster recovery/business contingency plan current?		No		End of Year, working document with DR team. Testing Q1 2009		Tim	
Is the disaster recovery/business contingency plan based on a business impact analysis?		No					
Is the disaster recovery/business contingency plan tested periodically?		No					
Is the disaster recovery/business contingency plan developed to address all significant business activities, including financial functions, telecommunication services, data processing and network services? Please provide a copy of the plan and evidence of test results, including management's resolution of test discrepancies. Test procedure: The examiner's evaluation of the plan and evidence provided will generally be sufficient for this test.		No					
Does the disaster recovery/business continuity plan clearly describe senior management's roles and responsibilities associated with the declaration of an emergency and implementation of the disaster recovery/business continuity and disaster recovery plans?		No					
Does the plan clearly identify the general process by which the threat will be assessed and the specific individuals who are authorized to declare an emergency?		No					
Does the plan address communication of the disaster event and provide for alternative points of contact (if necessary) to customers, vendors and state and other regulatory officials?		No					
Please indicate where individuals with the authority to declare an emergency are listed within the plan document. Test procedure: The examiner's evaluation of the evidence provided will generally be sufficient for this test.		No					
Does the plan contain a list of critical computer application programs, operating systems and data files?		No					
Does the plan contain a list of the suppliers that would be needed in the event of a disaster, together with names and phone numbers of the suppliers?		No					
Has a restoration priority been assigned to all significant business activities? Please provide a copy of the prioritized business activities. Test procedure: The examiner's evaluation of the activities provided will generally be sufficient for this test.		No					
Have user departments developed adequate manual processing procedures for use until the electronic data processing function can be restored? Please provide the name and phone number of one person from each financially significant user area who can demonstrate the procedures.		No					
Are copies of the plan kept in relevant off-site locations? Please provide a list of the locations and the name and phone number of the person who can validate the existence of the copies at the off-site locations. Test procedure: The examiner's evaluation of the list and corroborating inquiry with the person identified will generally be sufficient for this test.		No					
Are current backup copies of programs, essential documents, records and files stored in an off-premises location? Please provide an inventory of the contents of off-premises locations and the name and phone number of the person who can be contacted to verify the contents of the off-premises locations. Test procedure: The examiner's evaluation of the inventory list and corroborating inquiry with the person identified will generally be sufficient for this test.		No					
Does a written agreement or contract exist for use by IS of a specific alternate site and computer hardware to restore data processing operations after a disaster occurs and does the site have a backup generator in place in case of local power outages, a fire detection and suppression system and moisture sensors in place under the raised floor? Please provide a copy of the agreement and the name and phone number of the person who can validate the existence of the equipment at the alternate site.		No					
Is your contingency planning based on a business impact analysis, which is periodically reviewed to determine the appropriateness of maximum recovery times?		No					

Disaster Recovery and Business Continuity

Operations						
Request	Response	Notes	Plan	Responsible	Est Complete Date	
Is an inventory of hardware and software maintained? Please provide an inventory of hardware and software on the spreadsheet provided	No		Asset Management	Matt	Dec-08	
Does management make use of automated tools to record mainframe, server and network performance and use the output of these tools to proactively upgrade or replace components when they approach their operating capacity or show signs of imminent failure?	No	Orion	Need to make part of overall IT Strategy/Policy	Matt	Dec-08	
Does IS management provide a periodic maintenance schedule for changes to computer systems and infrastructure as well as a mechanism by which the ramifications of these changes can be considered by all impacted groups? Please provide a log of all significant systems and infrastructure changes implemented during the last year of the period under review, including evidence of the review of these changes by impacted groups.	No	Under Development	SDLC, IT Strategy/Policy, Coverage of testing of applications (smoke screen)	Matt, Tim	Dec-08	
Is there a control that ensures the prior release of a program can be restored if an upgrade causes a problem in the production environment?	No	IT takes snapshots of all critical systems prior to performing any major changes or upgrades. If problems arise after the change is made, we revert to this snapshot.				
Is there a standard operations procedures manual that is current and enforced?	No	Under Development	SDLC, IT Strategy/Policy	Tim	Nov-08	
Is there a control that ensures that all changes to preapproved job schedules are appropriate and authorized? Please provide a description of the control and evidence of management's approval of the last job schedule change made during the period under review.	No	Under Development	IT Strategy/Policy RE: Operations, Change Management, IT Strategy/Policy	Tim, Matt	Dec-08	
Are on-site backup copies of data files and programs maintained in a locked waterproof and fireproof storage area? Please provide an inventory of the contents of the storage area and the name and phone number of the person who can arrange a tour of the storage area	No	however, NBIS has recently contracted with Iron Mountain for secure offsite backup media storage	IT Strategy/Policy: 24 hours onsite (tapes), but replica to Chicago (DR)	Matt	Dec-08	
Is a records-retention program in effect to define how long data and backups must be retained? Please provide a copy of record-retention policies and procedures, the considerations used in devising the policy and procedures and an assessment of whether they are in compliance with applicable regulatory requirements.	No	Under Development	Victor as document; make inclusive of IT Strategy/Policy	Matt	Dec-08	
Does the program include data generated through e-commerce? Please provide a copy of the e-commerce electronic record keeping policy and the contact information for a person responsible for ensuring compliance with this policy.	No		New: Part of ITS/P part of backup polieys (part of ITS/p	Matt	Dec-08	
Does the program address scanned image documents?	No		ITS/p	Matt	Dec-08	
Are there appropriate escalation procedures in place to report and resolve operational failures in a timely manner	No		Just need to document those	Matt	Dec-08	
Are appropriate IS staff and, where appropriate, users involved in the resolution of operational failures	No	Under Development	ITS /p	TBD	TBD	
Is there a control that ensures that the underlying causes of operational failures are identified and addressed (as opposed to applying short-term fixes)?	Yes	Exhibit G (Jim's description)	ITS/P -- Trackit	TBD	TBD	
Is there a control that ensures the effective administration of databases including integrity checks (e.g., is it the responsibility of a database administrator)?	Yes	See Exhibit I	Look at Exhibit.			
Does insurance coverage exist to protect against loss of equipment, programs and data?	Yes	Ron?	Look at Exhibit.			
If the company provides data processing services for others, is there insurance to protect it from liability for errors and omissions?	No					
Are system updates (patches, anti-virus/and-malware, etc) monitored to ensure that all systems are updated in a timely manner? Please provide a description of the technology used to keep systems current (e.g., Windows server update service)	Yes	We use Symantec Enterprise Edition malware protection and Windows Server Update Service as outlined previously.	ITS/P: Monthly calendar, subnet monitoring			

Operations

DOI Audit Action Plan
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Is the selection of system hardware and software and related options controlled? Please provide a copy of system hardware and software selection and option review procedures	No	Under Development	Make standard noted in ITS/p	Matt	Dec-08
Are new systems or upgrades to existing system hardware or software appropriately tested before being moved to the production environment? Please provide a description of the control, a list of all system hardware or software changes made during the period under review, and a copy of the most significant change, including test results and IS management approval.	No		SDLC	Tim	Nov-08
Is the process used in changing the system architecture documented?	No		SDLC (Architectural topic)	Tim	Nov-08

Processing Controls						
Processing Controls	Request	Response	Notes	Plan	Responsible	Est. Complete Date
	Are there control procedures in place to ensure electronic data transmissions are transmitted and received completely and accurately? Please provide a copy of the control procedures and the name and phone number of the person who can demonstrate or validate the procedures. Test procedure: The examiner's evaluation of the control, corroborating inquiry with the person identified and observation of the control, if possible, will generally be sufficient for this test.	No		Look at in 2009	TBD	TBD
	Are there control procedures in place to detect data that is input inaccurately or incompletely? Please provide a description of the control and the name and phone number of the people who can demonstrate or validate the control for each financially significant application. Test procedure: The examiner's evaluation of the control, corroborating inquiry with the people identified and observation of the control, if possible, will generally be sufficient for this test.	No		Per app basis	TBD	TBD
	If there are any negotiable forms, such as checks, are they kept under strict inventory control? Please provide the name and phone number of the person who can demonstrate or validate inventory control. Test procedure: The examiner's corroborating inquiry with the person identified and observation of the control, if possible, will generally be sufficient for this test.	Yes	Lisa Wardlaw, Controller			
	Does the audit trail of records and reference provide the means to adequately trace any transaction forward to the final total, trace any transaction back to the original source document or input and trace any final total back to the component transactions? Please provide audit trail documentation for one transaction from each financially significant application. Test procedure: The examiner's evaluation of the audit trail for the transaction provided from each financially significant application, as well as a judgmental test of at least one more transaction for each financially significant application, will generally be sufficient for this test.	Yes				
	Does the company have a data warehouse which includes financially significant data? If so, identify the types of data which are accumulated in the data warehouse and the document the process for ensuring that the data warehouse accurately and completely represents the data in the company's production systems.	No		Yes with FRS. Need to document high level Data Model's and process/controls	David B	Dec-08

e-Commerce					
Request	Response	Notes	Plan	Responsible	Est Complete Date
Does the company utilize e-commerce for the submission, acceptance and/or changes to policies?	No		NA in 2008, 2009 will update policies	Tim	2009
Does the company utilize e-commerce for the submission, acceptance and/or the processing of claims and/or annuity products?	No				
Does the company utilize e-commerce in the processing, or to supplement the processing of any other financially significant account balances or sets of transactions described in Instruction Note 4, such as investments, reinsurance, procurement, employee benefits, etc.?	No				
Are the company's e-commerce initiatives led by a knowledgeable team including executive management and IS security personnel?					
Is a formal e-commerce strategy included in the company's strategic plan and?					
Does the strategy include consideration of the availability of appropriate technology, as well as technically competent personnel, necessary to support the company's e-commerce initiatives?					
Has company management developed a formal document that clearly defines the tactical methods and technologies for implementing the company's e-commerce strategy?					
Have internal controls been established at the company to help ensure compliance with applicable regulations?					
Are the risks involved with the company's e-commerce activities covered by an insurance policy?					
Is there a control that service level agreements (SLAs) with e-commerce partners are actively monitored to ensure that IS responsibilities are appropriately managed?					
Have the following operational resilience elements been addressed for e-business initiatives?	N/A				
a. Scalability of architecture?					
b. Redundancy?					
c. Load balancing?					
d. Performance monitoring?					
e. Disaster recovery/business continuity?					
Has the company reviewed its business processes and controls and assessed its e-commerce security risks in terms of authentication, confidentiality, integrity, auditability and non-repudiation?					
Has the company considered, documented and implemented a process for the creation, maintainability, and archiving of all the company's web content?					
adequately protected?					
Has management taken precautions through legal and technical means to protect the company's Web content?					
Does management ensure contracts with IT vendors and partners address intellectual property rights?					
Please provide a copy of the procedures document that describes management's approach to these issues. Test procedure: The examiner's evaluation of the documentation will generally be sufficient for this test. Does company management take reasonable security precautions to ensure that personal data about the company's web site visitors is not accessible by unauthorized persons?					
Are there controls in place to ensure that the company's approved Internet privacy policy is provided to all web visitors as required?					
Has company management created channels for the company's customers to provide electronic feedback about the company's products and services?					
Does the company utilize encryption technology for securing its E-Commerce transactions? If yes, what forms of encryption and how are they used? Please provide documentation of the types of transactions and the types of encryption used, such as simple PGP, Secure Socket Layer (SSL).					
Does the company operate its own digital certificate authority (CA)?					
Has the company outsourced that function?			✓		

Network and Internet Controls					Request	Response	Notes	Plan	Responsible	Est Complete Date
Does the company have documentation to identify and describe network nodes and network configurations?						Yes		Diagrams complete. Make part of ITS/P	Matt	Dec-09
Is the process used in changing the network configuration documented?						No		Needs to be. Trackit, change management, etc (SDLC)	Matt	Dec-09
Are controls in place to help ensure employee Internet usage is commensurate with the Internet usage policy?						No		ITS/P: Barracuda	Matt	Dec-09
Is access to the Internet restricted so that inappropriate locations may not be accessed?						Yes		ITS/P: Barracuda	Matt	Dec-09
Is financially significant accounting information or sensitive management information transmitted across the network or Internet and, if yes, is a data encryption feature in place and functioning?						Yes	Cisco VPN	Open		
Does the company scan all incoming e-mail, files and other network traffic for malicious content?						Yes	See Exhibit H We utilize both Symantec, McAfee and Barracuda Network software to scan all incoming email and files.	Open		
Does the company disinfect e-mail, files and other network traffic from identified malicious content?						No		Make part of ITS/P	Matt	Dec-09
Does the company scan or filter outbound e-mail for either offensive or potentially damaging content?						No		Make part of ITS/P look at as part of ITS/P. E2007 has capabilities, just need to look into them.	Matt	Dec-09

Network and Internet Controls

Government of the District of Columbia
Department of Insurance, Securities and Banking



Thomas E. Hampton
Commissioner

October 31, 2008

Ned N. Fleming
President
NationsBuilders Insurance Company
2859 Paces Ferry Road, Suite 1900
Atlanta, Georgia 30339

Dear Mr. Fleming:

We are in receipt of a response, dated October 17, 2008, from Ron Smith, Senior Vice President and Chief Financial Officer, which addresses the corrective actions taken by NationsBuilders Insurance Company to comply with the recommendation made in the Report on Examination as of December 31, 2007, dated September 3, 2008.

The October 17, 2008 letter adequately addresses the recommendations made in the Report. During our next examination of the Company, we will review the implementation of the corrective actions taken.

The adopted Report (which includes a copy of this letter), and the Order evidencing such adoption are enclosed. Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the adopted Report will be held private and confidential for a period of 10 days from the date of the Order evidencing such adoption. After this 10 day period has passed, the Report will be publicly available, and will be forwarded electronically to each Commissioner whose name is set forth on Page 1 of the Report, as well as to each of the participating zone examiners, to the National Association of Insurance Commissioners, and to each state in which the Company is licensed, according to your Annual Statement.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the date of the above-mentioned Order, affidavits executed by each Company director stating under oath that he or she has received a copy of the adopted examination Report and related Order shall be filed with this Department. Please send these affidavits to my attention here at the Department.

Ned N. Fleming
October 31, 2008

Please contact me at 202-442-7832 if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Nathaniel K. Brown", written in a cursive style.

Nathaniel Kevin Brown
Acting Chief Financial Examiner

Enclosures