

REPORT ON EXAMINATION

OF

AMERICAN COLONIAL INSURANCE

COMPANY, INC.

MONTGOMERY, ALABAMA

AS OF

DECEMBER 31, 2004

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

October 21, 2005

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Honorable Walter Bell
Secretary, Southeastern Zone, NAIC
Commissioner of Insurance
Alabama Department of Insurance
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104

Honorable Alfred W. Gross
NAIC Financial Condition (E) Committee, Chair
Commissioner of Insurance
1300 East Main Street
Richmond, Virginia 23219

Dear Sirs:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (FS), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination of December 31, 2004, of the financial condition and corporate affairs of:

**AMERICAN COLONIAL INSURANCE COMPANY, INC.
2000 INTERSTATE PARK DRIVE
MONTGOMERY, ALABAMA 31604**

Hereinafter referred to as the "Company". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2002 through December 31, 2004. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2001. This examination commenced, with planning at the Office, on August 15, 2005 to August 19, 2005. The fieldwork commenced on September 6, 2005, and was concluded as of October 21, 2005. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This financial examination was a association zone statutory financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code (FAC), with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2004. Transactions subsequent to year-end 2004 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

Based on the review of the Company's control environment and the materiality level set for this examination, reliance was placed on work performed by the Company's CPAs, after verifying the statutory requirements, for the following account:

Federal income taxes

Status of Adverse Findings from Prior Examination

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2001, along with resulting action taken by the Company in connection therewith.

Accounts and Records

During the examination period ending December 31, 2001, the Company used as many as six managing general agents (MGA) for the reporting, underwriting, marketing, administration, and management of its insurance policies and two claims servicing agents for the administration of its claims. The data requested by this Office and subsequently provided by the selected MGA, claim administrators, and the Company, was either incomplete or not in a compatible file format. Therefore, the Company and/or its agents have failed to maintain accurate accounting records and

were in violation of Sections 607.1601(2), 626.561(2), and 626.748, FS and Rule 69O-138.024, FAC.

Resolution: The Company cancelled all agreements with MGAs and claim servicing agents as of March 2001 and entered into a status of runoff.

The Company maintained its records in the State of Alabama in violation of the consent order and Sections 624.443 and 628.271, FS.

Resolution: The Company has continued to maintain its records in the State of Alabama. This is a repeat violation.

HISTORY

General

The Company received its Certificate of Authority and its Certificate of Domestication on March 23, 1998 and May 5, 1998, respectively, under the laws of the State of Florida, as a stock property and casualty insurer and commenced business in June of 1998, with the name American Colonial Insurance Company, Inc.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2004:

Homeowners Multi Peril
PPA Physical Damage
Private Passenger Auto Liability
Fire
Surety

The Company has not written insurance coverage in the last two years in any authorized lines of business due to the Company being in runoff status.

The articles of incorporation and the bylaws were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2004, the Company's capitalization was as follows:

Number of authorized common capital shares	5,000,000
Number of shares issued and outstanding	1,500,723
Total common capital stock	\$1,500,723
Par value per share	\$1.00

Control of the Company was maintained by its parent, The Colonial Company, who owned 100 percent of the stock issued by the Company, who in turn was 100 percent owned by James K. Lowder and Thomas H. Lowder, equally.

Profitability of Company

The following table shows the profitability trend (in dollars) of the Company for the period of examination.

	2002	2003	2004
Premiums Earned	99,392	23,013	163,314
Net Underwriting Gain/(Loss)	(306,745)	(55,698)	(371,056)
Net Income	(161,849)	(598)	(290,994)
Total Assets	4,559,559	4,569,946	4,418,596
Total Liabilities	531,440	532,097	319,969
Surplus As Regards Policyholders	4,028,119	4,037,849	4,098,627

Dividends to Stockholders

No dividends were declared or paid during the examination period.

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. Directors serving as of December 31, 2004, were:

Directors

Name and Location	Principal Occupation
P.L. McLeod Jr. Montgomery, Alabama	President and CEO, The Colonial Co.
James H Farrior, Jr. Montgomery, Alabama	President, The Colonial Insurance Agency
John W. Dorough Montgomery, Alabama	Executive VP, The Colonial Co.
Michael W. Toohey Montgomery, Alabama	Executive VP, The Colonial Co.
Bryan K. Tucker Montgomery, Alabama	CFO, The Colonial Co.

The Board of Directors in accordance with the Company's bylaws appointed the following senior officers:

Senior Officers

Name	Title
P.L. McLeod, Jr.	Chairman of the Board
James H. Farrior, Jr.	President
Michael W. Toohey	Treasurer and Secretary

Other than the Audit Committee required by Section 624.424(8), FS, the Company had no established internal committees. However, the Company's Board of Directors performed duties that would normally be performed by the committees.

Audit Committee

P.L. McLeod, Jr., Chairman
Michael W. Toohey
Bryan K. Tucker

Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, FS. No exceptions were noted during this examination period.

Corporate Records

The recorded minutes of the shareholder, Board of Directors, and certain internal committee were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales Through Reinsurance

The Company was not a part of any acquisitions, mergers, disposals, dissolutions, or purchases or sales through reinsurance during the examination period.

Surplus Debentures

The Company did not have any surplus debentures during the examination period.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on February 9, 2005, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

The following agreements were in effect between the Company and its affiliates:

Management Agreement

The Company's parent, The Colonial Company, provided the Company with various management services in return for a monthly fee.

Lease Agreement

The Company leased office space from its parent, The Colonial Company, and paid rent on a monthly basis.

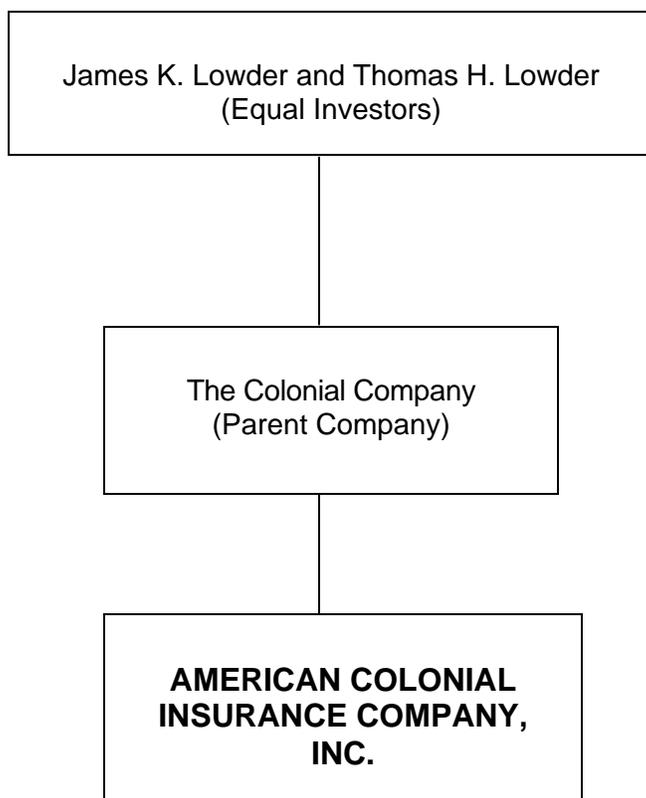
Administrative Service Agreement

On January 1, 2001, the Company entered into an administrative services agreement with its parent, The Colonial Company, whereby the parent provided administrative services on behalf of the Company in return for a fee specified in the agreement.

A simplified organizational chart as of December 31, 2004, reflecting the holding company system, is shown below. Schedule Y of the Company's 2004 annual statement provided a list of all related companies of the holding company group.

**AMERICAN COLONIAL INSURANCE COMPANY, INC.
ORGANIZATIONAL CHART**

DECEMBER 31, 2004



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$3,000,000 with a deductible of \$50,000, which adequately covered the suggested minimum amount of coverage for the Company and its affiliates as recommended by the NAIC.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company did not have a pension, stock ownership, or insurance plan. The information reported in its annual statement referred to the parent company's overall benefits for all its subsidiaries. Employees were eligible to participate in a 401K defined contribution plan and a non-contributory defined benefit pension plan.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS, and with various state officials as required or permitted by law:

State	Description	Par Value	Market Value
FL	Cash Deposit	<u>\$ 300,000</u>	<u>\$ 300,000</u>
	TOTAL FLORIDA DEPOSITS	<u>\$ 300,000</u>	<u>\$ 300,000</u>
GA	Money Market, 0.71%	\$ 25,000	\$ 25,000
LA	CD, 1.34%	<u>\$ 70,000</u>	<u>\$ 70,000</u>
	TOTAL OTHER DEPOSITS	<u>\$ 95,000</u>	<u>\$ 95,000</u>
	TOTAL SPECIAL DEPOSITS	<u>\$ 395,000</u>	<u>\$ 395,000</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company did not have any other insurance policies.

Territory

The Company was authorized to transact insurance in the following states, in accordance with Section 624.401(2), FS:

Florida	Louisiana
Georgia	Alabama

Treatment of Policyholders

The Company established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS.

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

The reinsurance agreements reviewed were found to comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines. However, the Company's reinsurance agreement with General Reinsurance Corporation was terminated by the reinsurer on December 28, 2000. The reinsurer has agreed to continue its liability obligations until all claims have been settled.

Assumed

The Company assumed no risk.

Ceded

The Company ceded risk on a quota share and excess of loss basis of 80% to General Reinsurance Corporation.

Automobile risks were ceded on an 80 percent quota share basis without a cap or limit, while homeowners risk was structured in two parts: (1) \$242,500 per risk excess of \$27,500 retention, and (2) multi-layered catastrophe coverage (included Florida Hurricane Catastrophe Fund) excess of \$400,000 retention.

The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

Pursuant to Section 624.424(8)(b), FS, the Company was not required to file an annual audit report by a CPA.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Company reported in its annual statement the settlement date of the securities purchased rather than the trade date required by SSAP No. 26, paragraph 4. The Company reported incorrect NAIC designations for two securities in violation of Section 4 of the Purposes and Procedures Manual of the NAIC Securities Valuation Office (SVO).

The Company maintained its principal operational offices in Montgomery, Alabama, where this examination was conducted.

The Company continued to maintain its records in the State of Alabama in violation of the Consent Order and Sections 624.443 and 628.271, FS.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company had a custodial agreement with AmSouth Bank for the safekeeping of its securities. Management stated it was prepared under the laws of the State of Alabama. The agreement should have been prepared in compliance with Rule 690-143.042, FAC. The agreement was not provided for review during the period of the examination.

MGA Agreement

The Company did not have any MGA agreements during the examination period. The Company's agreements with its six managing general agents were terminated with an effective date of March 9, 2001.

Independent Auditor Agreement

The Company employed the services of PriceWaterhouseCooper as their CPA even though they were exempt from filing an audit report from an independent CPA firm.

Claims Service Agreement

On August 1, 2001, the Company entered into a claims service agreement with Crawford and Company (Crawford), whereby Crawford provided claims services in behalf of the Company for a fee specified in the agreement. This agreement was cancelled on August 31, 2003. On September 1, 2003, the Company began using the services of Ron Hayes, president of Hayes Risk Services, to service the remaining open claims of the Company. The Company was billed on an hourly basis and Hayes Risk Services was paid based on the work performed. A formal agreement did not exist between Hayes Risk Services and the Company.

Risk-Based Capital

The Company reported its risk-based capital at an adequate level.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2004, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

AMERICAN COLONIAL INSURANCE COMPANY, INC.
Assets

DECEMBER 31, 2004

Assets	Per Company	Examination Adjustment	Per Examination
Bonds	\$1,456,335		\$1,456,335
Common stock	83,947		83,947
Cash:			
On deposit	516,062		516,062
Short-term investments	2,134,735		2,134,735
Investment income due & accrued	18,955		18,955
Reinsurance:			
Amounts recoverable from reinsurers	130,262	(42,972)	87,290
Current federal and foreign income taxes recoverable	121,272		121,272
Total Assets	\$4,461,568	(\$42,972)	\$4,418,596

AMERICAN COLONIAL INSURANCE COMPANY, INC.
Liabilities, Surplus and Other Funds

DECEMBER 31, 2004

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$160,932		\$160,932
Loss adjustment expenses	54,911		54,911
Other expenses	100,956		100,956
Remittances and items not allocated	170		170
Payable to parent, subsidiaries and affiliates	3,000		3,000
Total Liabilities	<u>319,969</u>		<u>319,969</u>
Common capital stock	\$1,500,723		\$1,500,723
Gross paid in and contributed surplus	918,550		918,550
Unassigned funds (surplus)	<u>1,722,326</u>		<u>1,722,326</u>
Surplus as regards policyholders	<u>\$4,141,599</u>	<u>\$42,972</u>	<u>\$4,098,627</u>
Total liabilities, capital and surplus	<u><u>\$4,461,568</u></u>	<u><u>\$42,972</u></u>	<u><u>\$4,418,596</u></u>

AMERICAN COLONIAL INSURANCE COMPANY, INC.
Statement of Income

DECEMBER 31, 2004

Underwriting Income

Premiums earned	\$163,314
DEDUCTIONS:	
Losses incurred	29,141
Loss expenses incurred	316
Other underwriting expenses incurred	504,913
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$534,370</u>
Net underwriting gain or (loss)	(\$371,056)

Investment Income

Net investment income earned	\$61,097
Net realized capital gains or (losses)	0
Net investment gain or (loss)	<u>\$61,097</u>

Other Income

Aggregate write-ins for miscellaneous income	<u>\$18,965</u>
Total other income	<u>\$18,965</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$290,994)
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$290,994)
Federal & foreign income taxes	<u>0</u>
Net Income	(\$290,994)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$4,037,849
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Gains and (Losses) in Surplus

Net Income	(\$290,994)
Net unrealized capital gains or losses	16,045
Change in non-admitted assets	(103,690)
Change in provision for reinsurance	178,800
Change in net deferred income tax	103,589
Surplus adjustments: Paid in	200,000
Aggregate write-ins for gains and losses in surplus	0
Examination Adjustment	<u>(42,972)</u>
Change in surplus as regards policyholders for the year	<u>\$60,778</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$4,098,627</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Reinsurance Recoverable \$87,290

Reinsurance recoverables were reported in the annual statement at \$130,262. This examination adjusted the Reinsurance recoverables by \$42,972, which represented recoverable amounts over ninety days past due. The Company was in violation of SSAP No. 62, paragraph 56.

**AMERICAN COLONIAL INSURANCE COMPANY, INC.
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2004

The following is a reconciliation of surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders per December 31, 2004, Annual Statement	\$4,141,599
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
Reinsurance Recoverable	\$130,262	\$87,290	(\$42,972)
LIABILITIES:			
No adjustment needed			
Net Change in Surplus:			(42,972)
Surplus as Regards Policyholders December 31, 2004, Per Examination			\$4,098,627

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has not taken the necessary actions to comply with all of the comments made in the 2001 examination report issued by the Office. The Company continued to maintain its records in the State of Alabama.

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2004.

Reinsurance

The Company reported amounts of reinsurance recoverable in the annual statement that were over 90 days old. Surplus was adjusted in the amount of \$42,972. **We recommend the Company comply with SSAP No. 62, paragraph 56 and write off the amount of the uncollectible reinsurance recoverable for reporting in all future annual and quarterly statements.**

Subsequent event:

The company acknowledged the amount of reinsurance recoverables over 90 days old and the amount was written off in the third quarter of 2005.

NAIC Designation for Bonds

The Company reported NAIC designations incorrectly for two bonds. **We recommend the Company comply with Section 4 of the Purposes and Procedures Manual of the NAIC SVO and correctly report the NAIC designations of securities in all future annual statements.**

Subsequent event:

The correct NAIC designation was reflected in the third quarter filings.

Custodial Agreement

The Company did not provide an executed copy of the custodial agreement. **We recommend the Company maintain an executed custodial agreement in accordance with Rule 690-143.042, FAC.**

Subsequent event:

A new custodial agreement was submitted. The Office approved the agreement on February 3, 2006.

Accounts and Records

The Company kept its accounting records in the State of Alabama. **We recommend the Company comply with the Consent Order and Sections 624.443 and 628.271, FS and maintain records in the State of Florida. This is a repeat violation from the 2001 examination.**

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **American Colonial Insurance Company, Inc.** as of December 31, 2004, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$4,098,627, which was in compliance with Section 624.408, FS.

In addition to the undersigned, John Berry, Financial Examiner/Analyst Supervisor and Joe Boor, FCAS, Office Actuary, participated in the examination.

Respectfully submitted,

Maurice Fuller
Financial Examiner/Analyst II
Florida Office of Insurance Regulation

Mary M. James, CFE, CPM
Deputy Director
Florida Office of Insurance Regulation