

**REPORT ON EXAMINATION**  
**OF**  
**AMERICAN FEDERATION INSURANCE**  
**COMPANY**  
**TAMPA, FLORIDA**  
**AS OF**  
**DECEMBER 31, 2008**

**BY THE**  
**OFFICE OF INSURANCE REGULATION**

## TABLE OF CONTENTS

<b>LETTER OF TRANSMITTAL</b> .....	-
<b>SCOPE OF EXAMINATION</b> .....	<b>1</b>
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION .....	3
<b>HISTORY</b> .....	<b>3</b>
GENERAL .....	3
CAPITAL STOCK .....	4
PROFITABILITY OF COMPANY .....	4
DIVIDENDS TO STOCKHOLDERS.....	5
MANAGEMENT .....	5
CONFLICT OF INTEREST PROCEDURE .....	6
CORPORATE RECORDS .....	7
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASE OR SALES THROUGH REINSURANCE .....	7
SURPLUS DEBENTURES.....	7
<b>AFFILIATED COMPANIES</b> .....	<b>7</b>
<b>ORGANIZATIONAL CHART</b> .....	<b>8</b>
TAX SHARING AGREEMENT .....	9
SERVICE CONTRACT .....	9
<b>PENSION, STOCK OWNERSHIP AND INSURANCE PLANS</b> .....	<b>9</b>
<b>STATUTORY DEPOSITS</b> .....	<b>10</b>
<b>INSURANCE PRODUCTS</b> .....	<b>10</b>
TERRITORY.....	10
TREATMENT OF POLICYHOLDERS .....	11
<b>REINSURANCE</b> .....	<b>11</b>
ASSUMED .....	11
CEDED .....	11
<b>ACCOUNTS AND RECORDS</b> .....	<b>12</b>
CUSTODIAL AGREEMENT .....	12
INDEPENDENT AUDITOR AGREEMENT .....	12
INFORMATION TECHNOLOGY REPORT.....	13
<b>FINANCIAL STATEMENTS PER EXAMINATION</b> .....	<b>13</b>
ASSETS .....	14
LIABILITIES, SURPLUS AND OTHER FUNDS .....	15
STATEMENT OF INCOME .....	16
<b>COMMENTS ON FINANCIAL STATEMENTS</b> .....	<b>17</b>
LIABILITIES .....	17

CAPITAL AND SURPLUS .....	17
<b>COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS.....</b>	<b>18</b>
<b>SUMMARY OF FINDINGS.....</b>	<b>19</b>
<b>SUBSEQUENT EVENTS.....</b>	<b>19</b>
<b>CONCLUSION.....</b>	<b>20</b>

Tallahassee, Florida

August 20, 2009

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

James J. Donelon  
Secretary, Southeastern Zone, NAIC  
Commissioner  
Louisiana Department of Insurance  
1702 N. 3<sup>rd</sup> Street  
Baton Rouge, Louisiana 70802

Morris J. Chavez  
Secretary, Western Zone, NAIC  
Superintendent  
New Mexico Public Regulation Commission  
Division of Insurance  
PERA Building  
1120 Paseo de Peralta  
Santa Fe, New Mexico 84501

Honorable Alfred W. Gross  
Chairman, NAIC Financial Condition (E) Committee  
Commissioner, Virginia Bureau of Insurance  
State Corporation Commission  
PO Box 1157  
Richmond, Virginia 23218

Dear Sirs:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, 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, 2008, of the financial condition and corporate affairs of:

**AMERICAN FEDERATION INSURANCE COMPANY  
4904 EISENHOWER BOULEVARD, SUITE 375  
TAMPA, FLORIDA 33634**

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, 2004, through December 31, 2008. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2003. This examination commenced with planning at the Office on July 6, 2009, to July 8, 2009. The fieldwork commenced July 14, 2009, and concluded as of August 20, 2009.

This financial examination was an 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, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

Risk-focused examinations consist of a seven-phase process that can be used to identify and assess risk, assess the adequacy and effectiveness of strategies/controls used to mitigate risk and

assist in determining the extent and nature of procedures and testing to be utilized in order to complete the review of that activity. The process should generally include a determination of the quality and reliability of the corporate governance structure and risk management programs. In addition, it can be used for verification of specific portions of the financial statements or other limited-scope reviews, increased focus on, and can result in increased substantive testing of, accounts identified as being at high risk of misstatement. Conversely, the risk assessment process should result in decreased focus on, and fewer substantive tests on the accounts identified as being at low risk of misstatement. The risk-focused surveillance process can be used to assist examiners in targeting areas of high-risk.

In this examination, emphasis was directed to the quality, value and integrity of the statement of assets and the determination of liabilities, as those balances affect the financial solvency of the Company as of December 31, 2008. Transactions subsequent to year-end 2008 were reviewed where relevant and deemed significant to the Company's financial condition.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio reports, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) and other reports as considered necessary were reviewed and utilized where applicable within the scope of this examination.

This report on examination was confined to financial statements and comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

### **Status of Adverse Findings from Prior Examination**

There were no exceptions or findings in the examination as of December 31, 2003.

## **HISTORY**

### **General**

The Company was incorporated September 13, 1983, under the laws and regulations of the State of Florida, as a stock property and casualty insurer and commenced business on December 2, 1983, as American Federation Insurance Company.

Effective August 1, 2006, the Company changed the location of its statutory home office from Clearwater, Florida to Tampa, Florida.

The Company was not party to any consent orders during the examination period.

The Company was authorized to transact the following insurance coverage in the State of Florida on December 31, 2008:

Mobile home multi peril  
Private passenger auto liability  
Private passenger auto physical damage

The Articles of Incorporation and the Bylaws were not amended during the period covered by this examination.

## Capital Stock

As of December 31, 2008, the Company's capitalization was as follows:

Number of authorized common capital shares	300,000
Number of shares issued and outstanding	235,000
Total common capital stock	\$2,350,000
Par value per share	\$10.00

Control of the Company was maintained by its parent, Foremost Insurance Company, a Michigan domiciled insurance company, who owned 100% of the stock issued by the Company. Foremost Insurance Company was 100% owned by Foremost Corporation of America, a Michigan corporation. Foremost Corporation of America is owned by the Farmers Insurance Exchange (80%), the Truck Insurance Exchange (10%), and the Fire Insurance Exchange (10%).

## Profitability of Company

The following table shows the profitability trend (in dollars) of the Company for the period of operations, as reported in the filed annual statements.

	<b>2008</b>	<b>2007</b>	<b>2006</b>
Premiums Earned	0	0	0
Net Underwriting Gain/(Loss)	(281,355)	(303,469)	(359,521)
Net Income	347,291	476,627	380,644
Total Assets	19,873,582	19,541,651	19,922,202
Total Liabilities	4,466,488	5,011,025	5,830,161
Surplus As Regards Policyholders	15,407,094	14,530,626	14,092,041

## Dividends to Stockholders

The Company did not declare or pay dividends to its stockholders during the period of this examination.

## Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2008, were:

### Directors

<b>Name and Location</b>	<b>Principal Occupation</b>
Stephen John Boshoven Caledonia, MI	President, Farmers Specialty
Paul Norman Hopkins* Los Angeles, CA	Chief Executive Officer, Farmers Group, Inc.
Frank Robert Woudstra Los Angeles, CA	President, Farmers Group, Inc.
Michael John Cok Caledonia, MI	Vice President, Farmers Group, Inc.
Jeffery Len Pepper Caledonia, MI	Assistant Vice President, Farmers Group, Inc.
Nancy Hering Treul Caledonia, MI	Vice President, Farmers Group, Inc.
John Joseph Hannigan Caledonia, MI	Senior Vice President, Farmers Group, Inc.

**Subsequent event:** \*Paul Norman Hopkins resigned as Vice President and Director of the Company effective January 1, 2009. Dennis Ray Squibb, Senior Vice President, replaced Mr. Hopkins as Director after being elected at the annual shareholders meeting held in May 2009.

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

### Senior Officers

<b>Name</b>	<b>Title</b>
Frank Robert Woudstra	President
Stephen John Boshoven	Chief Operating Officer
Jeffery Len Pepper	Treasurer
Martin Robert Brown	Secretary

The Company's Board appointed an audit committee in accordance with Section 607.0825, Florida Statutes. Following were the audit committee members as of December 31, 2008:

### Audit Committee

Patrick H. O'Sullivan <sup>1</sup>	Scott R. Lindquist	Keitha T. Schofield
Jerry J. Carnahan	Michael Marchesani	Frank R. Woudstra
Ron A. Coble	Joachim Masur	
Paul N. Hopkins	Ronald G. Myhan	

<sup>1</sup> Chairman

At December 31, 2008, the Company's audit committee was not in compliance with Florida Statute 624.424 (8) (c), concerning independence of the committee. The Company's audit committee included the Company's President and a Vice President.

### Conflict of Interest Procedure

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook.

### **Corporate Records**

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

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

The Company had no acquisitions, mergers, disposals, dissolutions, and purchases or sales through reinsurance.

### **Surplus Debentures**

The Company had no surplus debentures at December 31, 2008.

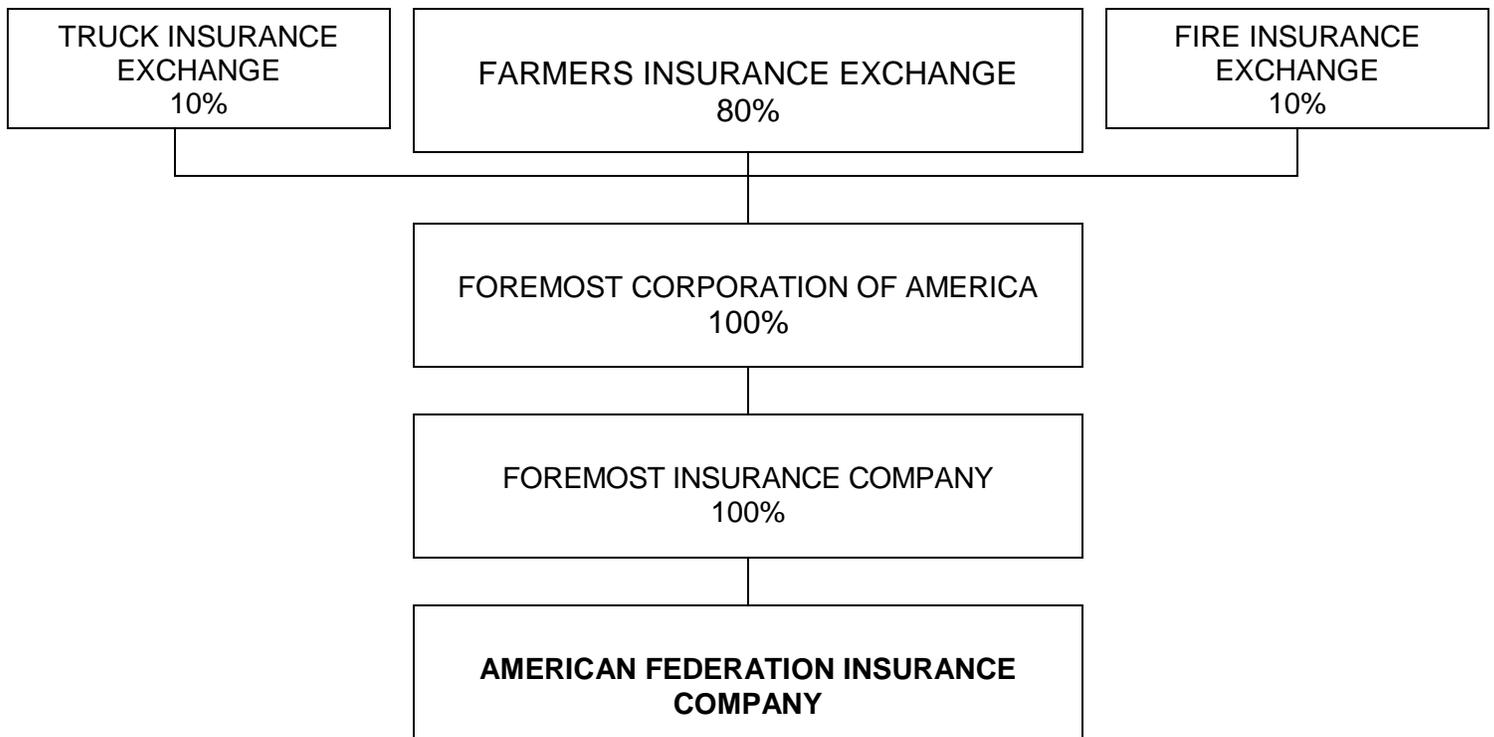
## **AFFILIATED COMPANIES**

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. A holding company registration statement was filed with the State of Florida on April 25, 2008 and April 29, 2009, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2008, reflecting the holding company system, is shown below. Schedule Y of the Company's 2008 annual statement provided a list of all related companies of the holding company group.

**AMERICAN FEDERATION INSURANCE COMPANY  
ORGANIZATIONAL CHART**

**DECEMBER 31, 2008**



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

### **Tax Sharing Agreement**

The Company, along with its parent and other affiliates, filed a consolidated federal income tax return. On December 31, 2008, the method of allocation of the tax liability between the companies was based on the calculation of the tax liability on a separate return basis, including current credit for net losses. The agreement called for inter-company tax balances to be settled within thirty days after the filing date of the consolidated return.

### **Service Contract**

The Company entered into a service contract with its parent, whereby the parent provided certain services necessary to conduct the daily operations of the Company. The consideration paid by the Company for these services approximated the cost that the parent incurred for general and administrative type expenses, but was never greater than the parent's general and administrative expense ratio to gross written premium.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained fidelity bond coverage up to \$15,000,000 with a deductible of \$1,000,000, which adequately met the suggested minimum amount recommended by the NAIC. The Company also maintained Directors and Officers (D&O) liability insurance coverage with limits of liability of \$15,000,000 and a deductible of \$1,000,000.

## **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

The Company had no employees at December 31, 2008. Pension and insurance plans were provided at the parent level for all employees.

## STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411,

Florida Statutes:

STATE	Description	Book Value	Fair Value
FL	USTNTS, 5.000%, 02/15/2011	\$ 250,000	\$ 273,350
FL	USTNTS, 3.625%, 12/31/2012	<u>785,000</u>	<u>865,070</u>
TOTAL FLORIDA DEPOSITS		\$ 1,035,000	\$ 1,138,420
AR	USTNTS, 5.000%, 02/15/2011	\$ 110,000	\$ 120,252
CO	USTNTS, 3.830%, 03/15.2010	200,000	209,032
CO	USTNTS, 4.570%, 02/15/2011	300,000	327,960
CO	USTNTS, 3.290%, 12/31/2012	850,000	936,598
IN	USTNTS, 5.000%, 02/15/2011	200,000	205,616
NM	RI HSG&MTG, 4.550%, 04/01/2009	100,000	100,630
NM	USTNTS, 3.625%, 12/31/2012	<u>250,000</u>	<u>275,548</u>
TOTAL OTHER DEPOSITS		<u>\$ 2,010,000</u>	<u>\$ 2,175,636</u>
TOTAL SPECIAL DEPOSITS		<u><u>\$ 3,045,000</u></u>	<u><u>\$ 3,314,056</u></u>

## INSURANCE PRODUCTS

### Territory

The Company was authorized to transact insurance in the following states:

Arizona	Arkansas	California
Colorado	Delaware	Florida
Illinois	Indiana	Maryland
Michigan	Minnesota	Nevada
New Mexico	Ohio	Oregon
Tennessee	Utah	Washington
Wisconsin		

### **Treatment of Policyholders**

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

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) (i) 3a, Florida Statutes.

### **REINSURANCE**

The quota share reinsurance agreement reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

#### **Assumed**

The Company had no assumed risk as of December 31, 2008.

#### **Ceded**

The Company ceded risk on a quota share basis to its parent, Foremost Insurance Company. Foremost Insurance Company assumed 100% of the Company's premiums and losses.

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

## **ACCOUNTS AND RECORDS**

The Company maintained its principal operational offices in Caledonia, Michigan, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the years under examination, in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

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 and non-affiliates had the following agreements in effect at December 31, 2008:

### **Custodial Agreement**

The Company was party to a custodial agreement with JPMorgan Chase Bank, N.A. for the safekeeping of its securities. This agreement was in accordance with Rule 69O-143.042, Florida Administrative Code.

### **Independent Auditor Agreement**

The Company engaged PricewaterhouseCoopers, LLP to perform annual audits of its statutory financial statements for the years under examination.

## **Information Technology Report**

INS Services, Inc. performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology Report provided to the Company.

## **FINANCIAL STATEMENTS PER EXAMINATION**

The following pages contain financial statements showing the Company's financial position as of December 31, 2008, 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 FEDERATION INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2008**

	Per Company	Examination Adjustments	Per Examination
Bonds	\$7,796,085		\$7,796,085
Cash	7,537,533		7,537,533
Investment income due and accrued	57,422		57,422
Premiums and considerations:			
Uncollected premiums	686,917		686,917
Deferred premiums	2,574,423		2,574,423
Amounts recoverable from reinsurers	876,646		876,646
Guaranty funds receivable or on deposit	119,462		119,462
Receivables from parents, subsidiaries and affiliates	225,094		225,094
Totals	\$19,873,582	\$0	\$19,873,582

**AMERICAN FEDERATION INSURANCE COMPANY**  
**Liabilities, Surplus and Other Funds**

**DECEMBER 31, 2008**

	Per Company	Examination Adjustments	Per Examination
Commissions payable, contingent commissions and other similar charges	\$266,989		\$266,989
Taxes, licenses and fees	82,324		82,324
Current federal and foreign income taxes	59,534		59,534
Net deferred tax liability	31,640		31,640
Ceded reinsurance premiums payable	3,989,759		3,989,759
Remittances and items not allocated	10,116		10,116
Deferred Commission Revenue	26,126		26,126
<b>Total Liabilities</b>	<b>\$4,466,488</b>	<b>\$0</b>	<b>\$4,466,488</b>
Common capital stock	\$2,350,000		\$2,350,000
Gross paid in and contributed surplus	2,500,000		2,500,000
Unassigned funds (surplus)	10,557,094		10,557,094
Surplus as regards policyholders	\$15,407,094		\$15,407,094
<b>Total liabilities, surplus and other funds</b>	<b>\$19,873,582</b>	<b>\$0</b>	<b>\$19,873,582</b>

**AMERICAN FEDERATION INSURANCE COMPANY**  
**Statement of Income**

**DECEMBER 31, 2008**

**Underwriting Income**

Premiums earned		\$0
	<b>Deductions:</b>	
Other underwriting expenses incurred		281,355
Total underwriting deductions		\$281,355
Net underwriting gain or (loss)		(\$281,355)

**Investment Income**

Net investment income earned		\$519,769
Net realized capital gains or (losses)		(1,232)
Net investment gain or (loss)		\$518,537

**Other Income**

Net gain or (loss) from agents' or premium balances charged off		\$6
Finance and service charges not included in premiums		331,167
Total other income		\$331,173

Net income before dividends to policyholders and before federal & foreign income taxes		\$568,355
Net income, after dividends to policyholders, but before federal & foreign income taxes		\$568,355
Federal & foreign income taxes		221,064
Net Income		\$347,291

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year		\$14,530,626
Net Income		\$347,291
Change in net deferred income tax		29,304
Change in non-admitted assets		(127)
Surplus adjustments: Paid in		500,000
Surplus as regards policyholders, December 31 current year		\$15,407,094

## COMMENTS ON FINANCIAL STATEMENTS

### Liabilities

#### Losses and Loss Adjustment Expenses \$0

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2008, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office contracted with an independent actuarial firm, INS Consultants, Inc., to perform an actuarial review of the Company's loss and loss adjustment expense reserves. INS Consultants, Inc. reported that the recorded December 31, 2008 reserves made reasonable provisions for the gross and net unpaid loss and loss adjustment expenses.

### Capital and Surplus

The amount reported by the Company of \$15,407,094, exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

**AMERICAN FEDERATION INSURANCE COMPANY  
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

**DECEMBER 31, 2008**

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 December 31, 2008, per Annual Statement	\$15,407,094
---	--------------

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No Adjustment			
LIABILITIES:			
No Adjustment			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2008, Per Examination			\$15,407,094

## SUMMARY OF FINDINGS

### **Compliance with previous directives**

There were no exceptions or findings in the examination as of December 31, 2003.

### **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, 2008.

### **Audit Committee**

At December 31, 2008, the Company's audit committee was not in compliance with Florida Statute 624.424 (8) (c), concerning independence of the committee. The Company's audit committee included the Company's President and a Vice President. **We recommend that the Company's audit committee be comprised solely of members who are independent of the Company, as required by Florida Statute 624.424 (8) (c).**

## SUBSEQUENT EVENTS

Consent Order No. 102875-09-CO was initiated by the Office after the Company requested approval to redomesticate to Michigan pursuant to Sections 628.525 through 628.535, Florida Statutes. The Consent Order was signed and notarized by the Company on June 12, 2009.

## CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **American Federation Insurance Company** as of December 31, 2008, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$15,407,094, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Patricia Casey Davis, CFE, CPA, INSRIS Examiner Supervisor; Matt Perkins, CFE, INSRIS Examiner-in-Charge; Robert McGee, CFE, INSRIS Examiner; and Samita Lamsal, OIR Financial Examiner/Analyst II, participated in the examination. We also recognize INS Consultants, Inc. and INS Services, Inc.'s participation in the examination.

Respectfully submitted,

---

James Pafford, Jr.  
Financial Examiner/Analyst Supervisor  
Florida Office of Insurance Regulation

---

Mary James, CFE, CPM  
Chief Examiner  
Florida Office of Insurance Regulation