

**REPORT ON EXAMINATION**  
**OF**  
**AMERICAN FEDERATION INSURANCE**  
**COMPANY**  
**CLEARWATER, FLORIDA**

**AS OF**  
**DECEMBER 31, 2003**

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

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Tallahassee, Florida

October 13, 2004

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

Honorable John Morrison  
Secretary, Western Zone, NAIC  
Commissioner  
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Helena, Montana 59601

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Honorable Jose Montemayor  
Chair, Examination Oversight (E) Task Force  
Commissioner  
Texas Department Of Insurance  
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Austin, Texas 78701

Dear Sirs:

Pursuant to your instructions, in compliance with Section 624.316/641.27, 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 as of December 31, 2003, of the financial condition and corporate affairs of:

**AMERICAN FEDERATION INSURANCE COMPANY  
25400 U. S. 19 NORTH, SUITE 185  
CLEARWATER, FLORIDA 33763**

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, 2001 through December 31, 2003. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2000. This examination commenced, with planning at the Office, on August 16, 2004, to August 17, 2004. The fieldwork commenced on August 19, 2004, and was concluded as of October 13, 2004. 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 represents an association zone statutory financial examination conducted in accordance with the Financial 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, the NAIC IRIS ratio report, 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) 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, 2003. Transactions subsequent to year-end 2003 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 accounts:

- Premium and Claim Systems Internal Controls
- Cash On Deposit
- Contingent Liabilities

### **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, 2000, along with resulting action taken by the Company in connection therewith.

### **Audit Committee**

The Company did not maintain an audit committee in accordance with Section 624.424 (8) (c), FS.

**Resolution:** The Company requested and received an exception from the Office allowing them to utilize the Audit Committee of their parent company.

## **Accounts and Records**

The Company erroneously reported December 2, 1983 as its date of incorporation on its Annual Statement.

**Resolution:** The Company correctly reported its date of incorporation as September 13, 1983.

## **Custodial Agreement**

The Company's custodial agreement with Chase Manhattan Bank (currently named JP MorganChase Bank) did not contain certain provisions required by Rule 69O-143.042, FAC.

**Resolution:** The Company amended its custodial agreement to comply with the provisions of Rule 69O-143.042, FAC.

## **HISTORY**

### **General**

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

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in the State of Florida on December 31, 2003:

Private Passenger Auto Liability  
PPA Physical Damage  
Mobile Home Multi Peril

The Company has reported net underwriting gains and net income in each of the last five years.

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

### **Capital Stock**

As of December 31, 2003, 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

The control of the Company was maintained by its parent, Foremost Insurance Company, a Michigan domiciled insurance company, who owned 100 percent of the stock issued by the Company, and who in turn was 100 percent 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 Company has reported profits in each year since the date of the last examination. It has reported both gains from operations and net profits after taxes during this period.

### **Dividends to Stockholders**

The Company has neither declared or paid dividends to 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, FS. Directors serving as of December 31, 2003, were:

## Directors

### Name and Location

Stephen John Boshoven  
Caledonia, Michigan

Frank Robert Woudstra  
Caledonia, Michigan

Martin Douglas Feinstein  
Los Angeles, California

John Edward Johnson  
Caledonia, Michigan

John Joseph Hannigan  
Caledonia, Michigan

Nancy Hering Treul  
Ada, Michigan

Stanley Ray Smith  
Los Angeles California

### Principal Occupation

Senior Vice President  
Foremost Insurance Company

President  
American Federation Insurance Company

Chairman, CEO, & President  
Farmers Group, Inc.

Senior Vice President  
Foremost Insurance Company

Executive Vice President  
Foremost Insurance Company

Senior Vice President  
Foremost Insurance Company

Vice President  
Foremost Insurance Company

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

## Senior Officers

### Name

Frank Robert Woudstra  
Jeffrey Len Pepper  
Martin Robert Brown  
John Edward Johnson  
Nancy Hering Treul  
John Joseph Hannigan

### Title

President  
Treasurer  
Secretary  
Senior Vice President  
Senior Vice President  
Executive Vice President

The Company did not maintain standing committees and has received an exemption from maintaining an audit committee from the Office. Instead, it utilized the services of its parent company's audit committee.

### **Conflict of Interest Procedure**

The Company had adopted a policy statement that required annual disclosure on conflicts of interest, in accordance with Section 607.0832, FS.

### **Corporate Records**

The recorded minutes of the shareholder and Board of Directors meetings 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.

There was no documentation in the minutes reviewed that the Company's directors reviewed the previous examination report.

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

There were no acquisitions, mergers or disposals or purchases through reinsurance transactions during the period of this examination.

## **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 filing with the State of Florida, as required by Section 628.801, FS, and Rule 69O-143.046, FAC, was made on April 22, 2004.

On December 31, 2003, the following agreements were in effect between the Company and its affiliates:

#### **Tax Allocation Agreement**

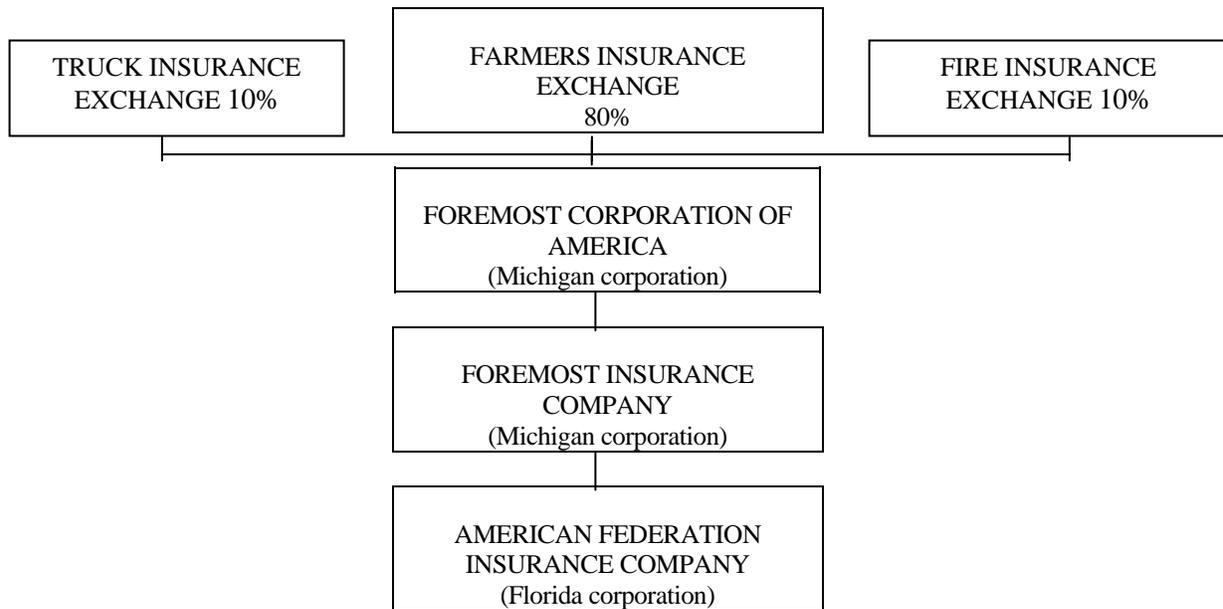
The Company, along with its parent and other affiliates, filed a consolidated federal income tax return. The method of allocation of the tax liability between the companies was based upon calculation of the tax liability on a separate return basis, including current credit for net losses. The agreement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

#### **Service Contract**

On January 1, 1986, the Company entered into a service contract with its parent, whereby the parent provided to the Company certain services necessary to conduct the daily operations of the Company. The consideration paid by the Company 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.

A simplified organizational chart as of December 31, 2003, reflecting the holding company system, is shown below. Schedule Y of the Company's 2002 annual statement provided a list of all related companies of the holding company group.

**AMERICAN FEDERATION INSURANCE COMPANY, INC.  
ORGANIZATIONAL CHART  
DECEMBER 31, 2003**



## **FIDELITY BOND AND OTHER INSURANCE**

The Company maintained fidelity bond coverage through Farmers Insurance Exchange, with single limits of \$15,000,000 with a deductible of \$1,000,000, and an aggregate limit of \$30,000,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

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

The Company had no employees at December 31, 2003. 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, FS, and with various state officials as required or permitted by law:

State	Description	Par Value	Market Value
FL	USTNTS 5.0% 02/15/11	\$250,000	\$268,515
FL	ALBANY CTY 5.0% 10/01/05	250,000	243,497
FL	GDBY TX 7.0% 08/01/04	65,000	67,208
FL	GDBY TX 7.0% 08/01/05	185,000	185,625
FL	WNBGO 5.9% 02/01/05	<u>250,000</u>	<u>248,200</u>
	TOTAL FLORIDA DEPOSITS	\$1,000,000	\$1,013,045
AR	USTNTS 5.0% 02/15/11	\$110,000	\$118,146
IN	USTNTS 5.0% 02/15/11	200,000	214,812
NM	USTNTS 3.25% 08/15/08	250,000	251,562
NM	WASH ST 6.0% 07/01/06	100,000	103,906
CO	USTNTS 3.25% 08/15/08	500,000	503,125
CO	USTNTS 5.0% 02/15/11	300,000	322,218
CO	USTNTS 5.875% 11/15/05	350,000	376,579
CO	Grnd Val mi 4.55% 02/01/08	<u>200,000</u>	<u>200,000</u>
	Total Other Deposits	\$2,010,000	\$2,090,348
	Total Special Deposits	<u>\$3,010,000</u>	<u>\$3,103,393</u>

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operation**

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

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 had 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 Company ceded all premium and losses to its parent through a 100% quota share treaty, which has been in effect since the inception of the Company.

The reinsurance agreement reviewed as of December 31, 2003, met NAIC regulations with respect to the standard insolvency clause, arbitration clause, reporting and settlement information deadlines and transfer of risk.

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

## **ACCOUNTS AND RECORDS**

The Company was audited annually by a CPA for the years 2001, 2002 and 2003, in accordance with Section 624.424(8), FS. Audited statutory financial statements and supporting work papers were prepared by the CPA as required by Rule 69O-137.002, FAC.

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

The Company had established, with approval of the Office and in compliance with Section 628.281, FS, its principal operational offices at the parent in Caledonia, Michigan, where this

examination was conducted. The Company's statutory home office and claim office was located in Clearwater, Florida.

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

#### **Custodial Agreement**

The Company was party to a custodial agreement with JP MorganChase Bank for the safekeeping of its securities. This agreement was found to be in compliance with Rule 69O-143.042, FAC.

#### **Independent Auditor Agreement**

The Company engaged PriceWaterhouseCoopers for the purpose of auditing and reporting on the balance sheet and statutory financial statement of 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, 2003, and the results of its operations for the year then ended as determined by this examination.

**AMERICAN FEDERATION INSURANCE COMPANY**  
**Assets**

**DECEMBER 31, 2003**

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$11,551,866		\$11,551,866
Cash:			
On deposit	27,976		27,976
Short-term investments	1,299,955		1,299,955
Investment Income Due & Accrued	169,190		169,190
Agents' Balances:			
Uncollected premium	1,328,479		1,328,479
Deferred premium	4,005,301		4,005,301
Reinsurance recoverable	1,183,629		1,183,629
Guaranty Funds Receivable/On Deposit	19,139		19,139
Receivable from PSA	598,536		598,536
Totals	\$20,184,071		\$20,184,071

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

**DECEMBER 31, 2003**

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$0		\$0
Loss adjustment expenses	0		0
Commissions payable	461,332		461,332
Taxes, licenses and fees	221,262		221,262
Current federal income taxes	11,056		11,056
Net deferred tax liability	98,546		98,546
Unearned premium	0		0
Ceded reinsurance premiums payable	6,535,300		6,535,300
Remittances and items not allocated	68,064		68,064
	<hr/>		<hr/>
Total Liabilities	\$7,395,560		\$7,395,560
Common capital stock	2,350,000		2,350,000
Gross paid in and contributed surplus	2,000,000		2,000,000
Unassigned funds (surplus)	<u>8,438,511</u>		<u>8,438,511</u>
Surplus as regards policyholders	<u>\$12,788,511</u>		<u>\$12,788,511</u>
Total liabilities, capital and surplus	<u>\$20,184,071</u>	<u>\$0</u>	<u>\$20,184,071</u>

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

**DECEMBER 31, 2003**

**Underwriting Income**

Premiums earned	\$0
DEDUCTIONS:	
Other underwriting expenses incurred	(59,999)
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>(\$59,999)</u>
Net underwriting gain or (loss)	\$59,999

**Investment Income**

Net investment income earned	\$513,832
Net realized capital gains or (losses)	20,928
Net investment gain or (loss)	<u>\$534,760</u>

**Other Income**

Net gain or (loss) from agents' or premium balances charged off	\$291
Finance and service charges not included in premiums	0
Aggregate write-ins for miscellaneous income	0
Total other income	<u>\$291</u>

Net income before dividends to policyholders and before federal & foreign income taxes	\$595,050
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$595,050
Federal & foreign income taxes	<u>104,281</u>
Net Income	\$490,769

**Capital and Surplus Account**

Surplus as regards policyholders, December 31 prior year	\$12,316,308
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**Gains and (Losses) in Surplus**

Net Income	\$490,769
Net unrealized capital gains or losses	0
Change in Net Deferred Income Tax	(36,830)
Change in in nonadmitted assets	18,264
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$472,203</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$12,788,511</u></u>

## 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, 2003, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements. The examination actuary concurred with this opinion.

**AMERICAN FEDERATION INSURANCE COMPANY**  
**Comparative Analysis of Changes in Surplus**

**DECEMBER 31, 2003**

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, 2003, Annual Statement	\$12,788,511
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
No adjustments necessary.			
LIABILITIES:			
No adjustments necessary.			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2003, Per Examination			\$12,788,511

## **SUMMARY OF FINDINGS**

### **Compliance with previous directives**

The Company has taken the necessary actions to comply with the comments made in the 2000 examination report issued by the Office.

### **Current examination comments and corrective action**

None.

## CONCLUSION

The customary 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, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$12,788,511, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Frank W. Brooks, CFE, of INS Regulatory Insurance Services, Inc., was the examiner-in-charge participating on this examination.

Respectfully submitted,

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John C. Berry  
Financial Examiner/Analyst Supervisor  
Florida Office of Insurance Regulation

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Stephen J. Szypula, CFE, CPM, CGFM  
Financial Administrator  
Florida Office of Insurance Regulation