

REPORT ON EXAMINATION
OF
AUTO CLUB SOUTH INSURANCE
COMPANY
TAMPA, FLORIDA

AS OF
DECEMBER 31, 2010

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

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March 30, 2012

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

Joseph Torti III
Chairman, NAIC Financial Condition
(E) Committee
Superintendent
State of Rhode Island
Department of Business Regulation,
Division of Insurance
1511 Pontiac Avenue, Building 69-2
Cranston, Rhode Island 02920

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, Rule 690-138.005 Florida Administrative Code 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, 2010, of the financial condition and corporate affairs of:

**AUTO CLUB SOUTH INSURANCE COMPANY
14055 RIVEREDGE DRIVE, SUITE 500
TAMPA, FLORIDA 33637**

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, 2006, through December 31, 2010. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2005. This examination commenced with planning at the Office on January 9, 2012, to January 12, 2012. The fieldwork commenced on January 17, 2012, and concluded as of March 30, 2012.

This financial examination was a multi-state 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.

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

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

SUMMARY OF SIGNIFICANT FINDINGS

Current Exam Findings

There were no material findings or exceptions noted during the examination as of December 31, 2010.

Prior Exam Findings

There were no findings, exceptions or corrective action to be taken by the Company for the examination as of December 31, 2005.

HISTORY

General

The Company was incorporated in Florida on December 14, 1990, and commenced business on January 2, 1991, as Auto Club South Insurance Company.

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2010:

- Allied Lines
- Private passenger auto physical damage
- Private passenger auto liability

The Articles of Incorporation were not amended during the period covered by this examination. The bylaws were amended during the period covered by this examination. On September 12, 2006, the bylaws were amended to update the language with standard Article language found in current drafted bylaws. This included expanding the existing Articles to include more expansive language and the addition of an Article for Indemnification and Insurance.

Dividends to Stockholders

The Company did not declare or pay any dividends during the period of this examination.

Capital Stock and Capital Contributions

As of December 31, 2010, the Company's capitalization was as follows:

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

Control of the Company was maintained by its parent, Auto Club South Financial Services, who owned 100% of the stock issued by the Company, who in turn was owned 100% by AAA Auto Club South, Inc. (Auto Club), a Florida corporation.

The parent contributed \$2,750,000 in cash to the Company as of December 31, 2010.

Surplus Debentures

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

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

The Company had no acquisitions, mergers, disposals, and purchase or sales through reinsurance during the period of this examination.

CORPORATE RECORDS

The recorded minutes of the Shareholder(s), Board of Directors (Board) and certain internal committees 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 compliance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code, including the authorization of investments as required by Section 625.304, Florida Statutes.

Conflict of Interest

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

MANAGEMENT AND CONTROL

Management

The annual shareholder meeting for the election of directors was held in accordance with Section 628.231, Florida Statutes. Directors serving as of December 31, 2010, were:

Directors

Name and Location	Principal Occupation
Kevin W. Bakewell Largo, Florida	Senior Vice President Auto Club South Insurance Company
Edward J. Fandel Tampa, Florida	Senior Vice President Auto Club South Insurance Company
Robert A. McKee Palm Harbor, Florida	SVP, CFO, & Treasurer Auto Club South Insurance Company
Larry D. Patrick Seffner, Florida	President & CEO Auto Club Insurance Company of Florida
Robert R. Sharp Tampa, Florida	Chairman of the Board Auto Club South Insurance Company
John A. Tomlin St. Petersburg, Florida	President & CEO Auto Club South Insurance Company

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

Senior Officers

Name	Title
Larry D. Patrick	President
John A. Tomlin	Chief Executive Officer
Robert McKee	Treasurer
James C. Santo	Chief Underwriting Officer
Steven W. Brown	Chief Operating Officer
Edward J. Fandel	Vice President
Kevin Bakewell	Secretary

The Company's Board appointed several internal committees. Following were the principal internal board committees and their members as of December 31, 2010:

Executive Committee	Audit Committee	Investment Committee
Robert R. Sharp ¹	Edward J. Fandel ¹	John A. Tomlin ¹
Larry D. Patrick	Robert R. Sharp	Larry D. Patrick
John A. Tomlin	Kevin W. Bakewell	Edward J. Fandel

¹ Chairman

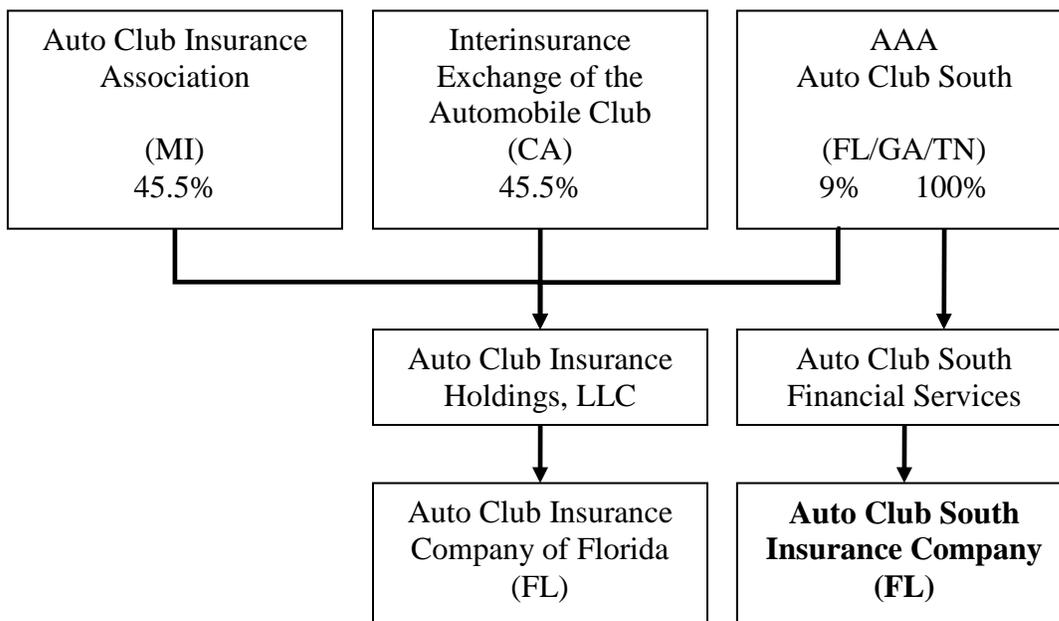
Affiliated Companies

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code.

An organizational chart as of December 31, 2010, reflecting the holding company system, is shown below. Schedule Y of the Company's 2010 annual statement provided a list of all related companies of the holding company group.

AUTO CLUB SOUTH INSURANCE COMPANY ORGANIZATIONAL CHART

DECEMBER 31, 2010



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

Tax Allocation Agreement

The Company, along with its parent and affiliates, filed a consolidated federal income tax return. On December 31, 2010, the method of allocation between the Company and its parent was based upon the ratio of taxable income of the Company to the total of taxable income of all companies in the group. Each member of the group recorded a quarterly, inter-company income tax receivable or payable with Auto Club for estimated taxes. Within ten (10) days of the remittance by Auto Club of any estimated income tax payment to the taxing authorities, all inter-company tax receivables/payables were settled. Additionally, within thirty (30) days of the filing of the consolidated tax return, all intercompany tax balances were settled.

Administration Agreement

The Company had an administration agreement with Auto Club Insurance Company of Florida (ACICF), an affiliated company, effective September 25, 2006 and later amended, restated and effective June 1, 2007. Under the agreement, the Company provided executive and managerial services, underwriting services, policyholder services, collection and handling of premium and other funds, accounting and financial services, marketing support and product development, producer management services, producer commission computation or payment, information technology support, personnel services, facilities support, legal and regulatory compliance services, procurement support, insurance support services, transitional services and other administrative services to ACICF. The agreement had an initial term until September 24, 2011, with automatic renewal for five-year periods. The agreement may be terminated with 90 days written notice. The Company received actual cost for these services.

Consulting Agreement

The Company had a consulting agreement with ACICF, an affiliated company, effective June 1, 2007. Under the agreement, ACICF provided executive and managerial services, claims management oversight, product management, and other management services as agreed upon to the Company. The agreement had an initial term of one year with automatic renewal for one-year terms. The agreement may be terminated with 180 days written notice. The Company paid actual cost for these services.

Management Cost Sharing Agreement

The Company had an agreement with Auto Club the ultimate parent, whereby the Company would pay the parent an amount equal to the Company's allocated portion of miscellaneous charges, salaries, wages, and average costs per person of the group insurance plan in effect, of those employees performing insurance duties for the prior calendar month. The agreement called for the Company to pay the costs according to the charge schedule filed with the holding company registration statement for the prior calendar month on or before the twenty-fifth day of each calendar month, with charges for the information systems no later than the fifteenth business day after notification.

Agency Agreement

The Company maintained an agency agreement with Insurance Bureau, Inc. (Agency), an affiliate, dated January 1, 2007 and as amended January 1, 2008 and January 1, 2010. The Agency acted on behalf of the Company for personal property casualty lines of insurance subject to the underwriting standards and rules of the Company. Under the agreement, the Agency was authorized to solicit, bind, execute, and service the Company's policies and endorsements. The

Company paid commissions of \$9,190,733 and \$8,753,261 and incentive commissions of \$38,902 and \$44,868 to the Agency in 2010 and 2009, respectively.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$10,000,000 with a deductible of \$50,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained Directors and Officers (D&O) liability insurance and other property and liability coverage.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company sponsored a qualified pension plan and post-retirement medical and life benefits plan for employees. All of these plans were contributory, with participants' medical plan contributions adjusted annually. Effective July 1, 2007, the Company amended its pension plan to prohibit new entrants and excluding existing participants with less than five years of service. At the same time, the Company amended its 401(k) plan, creating an additional matching level for new employees and those existing employees with less than five years of service in the pension plan. The Company's match for this new layer was 50% of the first 6% of contributions and was not subject to any performance criteria. Also effective July 1, 2007, retiree medical and life benefits were no longer available to new employees. The parent company charged the Company \$0 and \$52,013 for pension cost during the years ending December 31, 2010, and December 31, 2009, respectively. All employees were covered by a section 401(k) defined contribution plan of the parent. Employer contributions were met at the discretion of the parent.

The Company provides employees with health and life insurance coverage.

TERRITORY AND PLAN OF OPERATIONS

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

Florida

Georgia

Tennessee

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.

COMPANY GROWTH

The Company grew through the affiliated insurance agency, Insurance Bureau, Inc., which is a wholly owned subsidiary of AAA Auto Club South, a member of the holding company. The Company uses independent agents. The Company had 89,320 and 87,783 policies in force at December 31, 2010, and 2009, respectively.

Profitability of Company

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

	2010	2009	2008	2007	2006
Premiums Earned	41,752,486	37,293,510	32,339,719	29,474,006	25,335,622
Net Underwriting Gain/(Loss)	(610,007)	(712,811)	1,739,641	1,249,581	443,976
Net Income	1,546,343	1,368,417	2,601,400	3,210,413	2,958,078
Total Assets	85,017,457	78,738,079	71,099,938	65,931,657	61,731,258
Total Liabilities	46,653,390	43,513,755	38,062,807	32,552,962	31,208,719
Surplus As Regards Policyholders	38,364,067	35,224,324	33,037,131	33,378,696	30,522,539

LOSS EXPERIENCE

During the current examination period, the Company showed a favorable development overall. This was a result of fewer claims being reported for prior accident years than management had anticipated. The one and two-year net loss developments at the end of the current examination period were both favorable at \$1.1 million and \$2.2 million, respectively. The Company's net loss ratio increased over the period under review, ending at 77.8%.

REINSURANCE

The reinsurance agreements 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 did not assume reinsurance during the period of this examination.

Ceded

The Company ceded risk on an excess of loss basis to General Reinsurance, a Delaware domiciled authorized reinsurer. The Company also ceded in excess of \$19 million to the National Flood Insurance Program, managed by the Federal Emergency Management Agency (FEMA) for flood insurance, and the Florida Hurricane Catastrophe Fund (FHCF), both mandatory pools.

The Company ceded risk on a quota share basis to Auto Club Insurance Association and Interinsurance Exchange of the Automobile Club. Both are authorized reinsurers.

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

ACCOUNTS AND RECORDS

The Company maintained its principal operational offices in Tampa, Florida.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2006, 2007, 2008, 2009 and 2010, 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:

Custodial Agreement

The Company maintained a custodial agreement with SunTrust Bank entered into on December 13, 1990. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

Independent Auditor Agreement

The Company contracted with an external independent CPA firm to perform the annual audit of its financial statements as required by Rule 69O-137.002 (7) (c), Florida Administrative Code.

INFORMATION TECHNOLOGY REPORT

Tracy Gates, CISA, IT Specialist of Highland Clark, LLC 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.

STATUTORY DEPOSITS

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

STATE	Description	Par Value	Market Value
FL	US Treasury Note, 5.0%, 2/15/11	<u>\$ 350,000</u>	<u>\$ 352,037</u>
TOTAL FLORIDA DEPOSITS		\$ 350,000	\$ 352,037
GA	Wells Fargo Adv Tr PI MM-Ins	<u>\$ 35,000</u>	<u>\$ 35,000</u>
TOTAL OTHER DEPOSITS		\$ 35,000	\$ 35,000
TOTAL SPECIAL DEPOSITS		<u>\$ 385,000</u>	<u>\$ 387,037</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2010, 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."

AUTO CLUB SOUTH INSURANCE COMPANY
Assets

DECEMBER 31, 2010

	Per Company	Examination Adjustments	Per Examination
Bonds	\$65,370,294		\$65,370,294
Stocks:			
Common	5,642,596		5,642,596
Cash and Short-Term Investments	136,746		136,746
Other investments	1,570,923		1,570,923
Agents' Balances:			
Uncollected premium	1,174,774		1,174,774
Deferred premium	8,126,103		8,126,103
Reinsurance recoverable	1,256,864		1,256,864
Net deferred tax asset	1,022,052		1,022,052
Interest and dividend income due & accrued	610,263		610,263
Aggregate write-in for other than invested assets	106,843		106,843
Totals	\$85,017,457	\$0	\$85,017,457

AUTO CLUB SOUTH INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2010

	Per Company	Examination Adjustments	Per Examination
Losses	\$17,272,692		\$17,272,692
Loss adjustment expenses	2,383,170		2,383,170
Commissions payable	54,760		54,760
Other expenses	1,080,243		1,080,243
Taxes, licenses and fees	582,231		582,231
Current federal and foreign income taxes	477,867		477,867
Unearned premium	21,057,791		21,057,791
Advance premium	1,046,942		1,046,942
Ceded reinsurance premiums payable	1,662,884		1,662,884
Payable to parent, subsidiaries and affiliates	1,034,810		1,034,810
Total Liabilities	\$46,653,390	\$0	\$46,653,390
Common capital stock	\$1,000,000		\$1,000,000
Gross paid in and contributed surplus	2,750,000		2,750,000
Unassigned funds (surplus)	34,614,067		34,614,067
Surplus as regards policyholders	\$38,364,067	\$0	\$38,364,067
Total liabilities, surplus and other funds	\$85,017,457	\$0	\$85,017,457

AUTO CLUB SOUTH INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2010

Underwriting Income

Premiums earned		\$41,752,486
	Deductions:	
Losses incurred		\$28,942,478
Loss expenses incurred		3,524,900
Other underwriting expenses incurred		9,895,115
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$42,362,493
Net underwriting gain or (loss)		(\$610,007)

Investment Income

Net investment income earned		\$2,352,239
Net realized capital gains or (losses)		345,190
Net investment gain or (loss)		\$2,697,428

Other Income

Net gain or (loss) from agents' or premium balances charged off		(\$173,645)
Finance and service charges not included in premiums		140,763
Aggregate write-ins for miscellaneous income		2,491
Total other income		(\$30,392)
Net income before dividends to policyholders and before federal & foreign income taxes		\$2,057,030
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$2,057,030
Federal & foreign income taxes		510,686
Net Income		\$1,546,343

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$35,224,324
Net Income		\$1,546,343
Net unrealized capital gains or losses		693,313
Change in deferred income tax		(3,724)
Change in non-admitted assets		903,812
Change in provision for reinsurance		0
Change in excess statutory over statement reserves		0
Surplus adjustments: Paid in		0
Aggregate write-ins for gains and losses in surplus		0
Examination Adjustment		0
Change in surplus as regards policyholders for the year		\$3,139,744
Surplus as regards policyholders, December 31 current year		\$38,364,067

A comparative analysis of changes in surplus is shown below.

AUTO CLUB SOUTH INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2010

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, 2010, per Annual Statement	\$38,364,067
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS: No Adjustment			
LIABILITIES: No Adjustment			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2010, Per Examination			<u><u>\$38,364,067</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$19,655,862

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, 2010, 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 consulting actuary, Dennis Henry, FCAS, MAAA of The Actuarial Advantage, reviewed the loss and loss adjustment expense work papers provided by the Company and was in concurrence with this opinion.

Capital and Surplus

The amount of Capital and surplus reported by the Company of \$38,364,067, exceeded the minimum of \$4,342,348 required by Section 624.408, Florida Statutes.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Auto Club South Insurance Company** as of December 31, 2010, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$38,364,067, which exceeded the minimum of \$4,342,348 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Steven Sigler, CFE, AES, Examiner-In-Charge; Tracy Gates, CPA CISA, IT Specialist and Participating Examiner; and Brad Hazelwood, CPA, Participating Examiner of Highland Clark, LLC participated in the examination. In addition, Dennis Henry, FCAS MAAA, consulting actuary of The Actuarial Advantage, Kyra Brown, Financial Specialist, APIR of the Office and Syntia King, Financial Examiner/Analyst II, APIR of the Office and Kethessa Carpenter, Financial Examiner/Analyst Supervisor of the Office also participated in the examination.

Respectfully submitted,

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