

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

AS OF
DECEMBER 31, 2002

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida
January 23, 2004

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

Dear Sir:

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 as of December 31, 2002, of the financial condition and corporate affairs of:

**AUTO CLUB SOUTH INSURANCE COMPANY
1515 N. WESTSHORE BLVD.
TAMPA, FLORIDA 33631**

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, 2000 through December 31, 2002. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 1999. This examination commenced with planning at the Office on December 8, 2003 to December 12, 2003. The fieldwork commenced on December 15, 2003, and was concluded as of January 23, 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 was a 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, 2002. Transactions subsequent to year-end 2002 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:

Federal Income Taxes Recoverable
Federal Income Taxes Payable

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, 1999, along with resulting action taken by the Company in connection therewith.

Organizational Chart

The Company did not complete Schedule Y – Part 2 correctly. **Resolution:** Part 2 of Schedule Y was correctly completed on the 2002 annual statement.

Cash

Several errors were found within the Company's cash account. **Resolution:** No material exceptions were noted of this examination of the cash account.

Aggregate write-ins for other than invested assets

The Company incorrectly included a receivable from the Florida Automotive Joint Underwriting Association (FAJUA) under aggregate write-ins for other than invested assets rather than under equities and deposits in pools and associations. **Resolution:** The receivable from the FAJUA was properly recorded in equities and deposits in pools and associations in the 2002 annual statement.

Other Expenses

The Company reported payroll taxes under other expenses rather than under taxes, licenses and fees. **Resolution:** No material exceptions were noted regarding payroll taxes in the 2002 annual statement.

Federal Income Taxes

The Company reported state income taxes under federal income taxes rather than under taxes, licenses and fees. **Resolution:** State income taxes were properly included in taxes, licenses and fees on the 2002 annual statement.

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.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2002:

Homeowners Multi Peril	Allied Lines
Inland Marine	Other Liability
Private Passenger Auto Liability	PPA Physical Damage
Accident and Health	

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

Capital Stock

As of December 31, 2002, 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

The control of the Company was maintained by its parent, Auto Club South Financial Services Inc., a wholly owned subsidiary of AAA Auto Club South, Inc. (AAA).

Profitability of Company

The Company reported earned premiums of \$18,558,182 and \$15,894,201 for 2002 and 2001 respectively. In 2002, the Company reported a net underwriting gain of \$574,793 and after tax income of \$1,640,737. In 2001, the Company reported a net underwriting gain of \$487,872 and after tax income of \$2,290,973.

Dividends to Stockholders

In accordance with Section 628.371, FS, the Company declared and paid \$1,000,000 in dividends to its stockholder in 2002.

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, 2002, were:

Directors

Name and Location

Principal Occupation

John Tomlin
Tampa, Florida

President
Auto Club South Insurance Company

Cindy M. Potts
Tampa, Florida

Secretary
Auto Club South Insurance Company

Robert R. Sharp
Tampa, Florida

Vice President
Auto Club South Insurance Company

Thomas E. O'Brien
Tampa, Florida

Vice President
Auto Club South Insurance Company

Larry D. Patrick
Tampa, Florida

Chief Operating Officer
Auto Club South Insurance Company

Robert A. McKee
Tampa, Florida

Chief Financial Officer
Auto Club South Insurance Company

In accordance with the Company's bylaws, the board of directors appointed the following senior officers:

Senior Officers

Name	Title
John Tomlin	President
Robert A. McKee	CFO and Treasurer
Cindy M. Potts	Secretary

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. The following are the principal internal board committees and their members as of December 31, 2002:

Executive Committee	Audit Committee	Investment Committee
Robert R. Sharp	Robert R. Sharp	Robert R. Sharp
Thomas E. O'Brien	Thomas E. O'Brien	Thomas E. O'Brien
John Tomlin	Cindy M. Potts	John Tomlin

Conflict of Interest Procedure

The Company had 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 Investment Committee 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 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, disposals, dissolutions or purchase or sales through reinsurance during the period covered by this examination.

Surplus Debentures

As of December 31, 2002, there were no outstanding surplus debentures of the Company.

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 May 24, 2002, 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:

Tax Allocation Agreement

The Company, along with its parent, filed a consolidated federal income tax return. As of December 31, 2002, the method of allocation between the Company and its parent was pursuant to Section 1552 (a)(1) of the Internal Revenue Code.

Management Cost Sharing Agreement

The Company maintained an agreement with its ultimate parent, AAA, effective October 1, 1996 wherein AAA incurred certain costs which accrued in part to the benefit of the Company. The agreement provided for the manner in which such costs allocated to the Company.

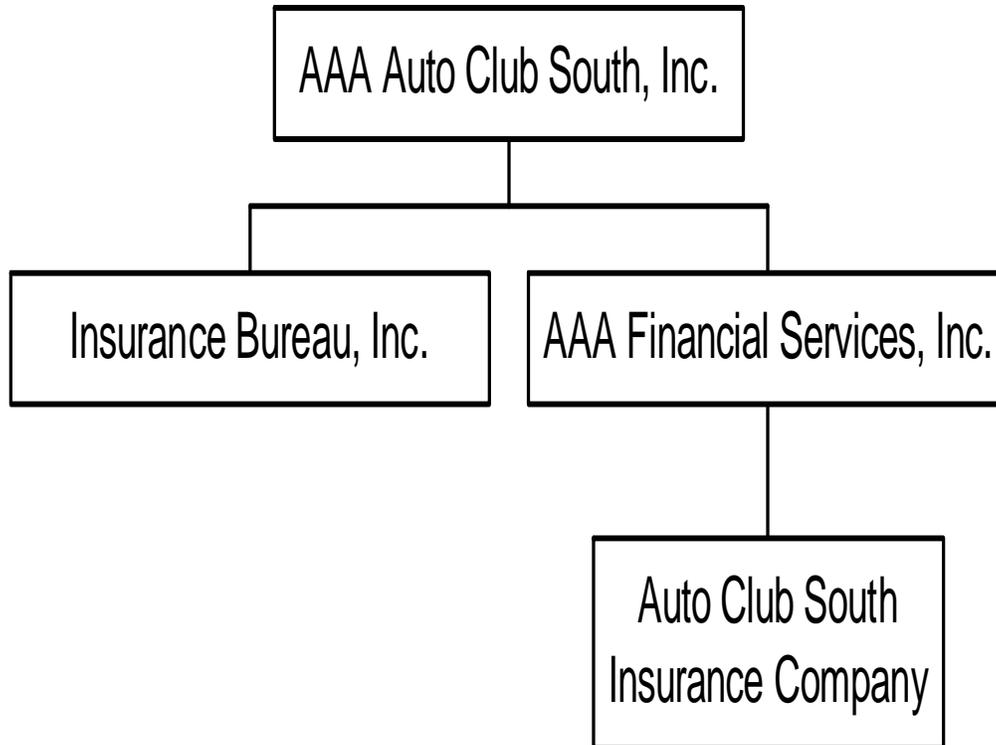
Agency Agreement

The Company maintained an agency agreement with Insurance Bureau Inc. effective October 1, 2001, to act as their agent for personal property-casualty lines of insurance subject to the underwriting standards and rules of the Company. Under the agreement, the agent was authorized to solicit, bind, execute and service the Company's policies and endorsements.

A simplified organizational chart as of December 31, 2002, 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.

AUTO CLUB SOUTH INSURANCE COMPANY

**ORGANIZATIONAL CHART
DECEMBER 31, 2002**



FIDELITY BOND AND OTHER INSURANCE

The Company, along with its parent and affiliates, maintained a \$5 million blanket employee dishonesty policy plus an additional \$5 million policy covering select directors and/or officer positions for a total of \$10 million. This policy adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company's parent sponsored a defined benefit pension plan and a postretirement healthcare benefit plan covering substantially all employees of the company. The benefits were based on years of service and compensation. The expenses were allocated in accordance with the Management Cost Sharing Agreement.

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	US Treasury Note, 5.00%, 02/15/11	<u>\$ 350,000</u>	<u>\$ 384,563</u>
	TOTAL FLORIDA DEPOSITS	\$ 350,000	\$ 384,563
GA	Evergreen MM Fund	<u>\$ 35,000</u>	<u>\$ 35,122</u>
	TOTAL OTHER DEPOSITS	\$ 35,000	\$ 35,122
	Total Special Deposits	<u><u>\$ 385,000</u></u>	<u><u>\$ 419,685</u></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:

Florida

Georgia

Tennessee

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 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 assumed risk on a quota share basis from Progressive Express and Infinity Insurance Company.

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 \$11 Million to the Federal Emergency Management Association (FEMA) for flood insurance.

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

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years 2000, 2001 and 2002 in accordance with Section 624.424(8), FS. 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. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

The Company maintained its principal operational offices in Tampa, Florida, where this examination was conducted.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company utilized the services of Sun Trust Bank. The safekeeping agreement between the Company and Sun Trust Bank contained the appropriate safeguards and controls indemnifying the Company as provided by Rule 69O-143.042, FAC.

Investment Advisor Agreement

The Company entered into an agreement with Montag & Caldwell, Inc., as investment advisor for the Company. The agreement granted the investment advisor authority to supervise and direct the investment of the Company's account and implement investment decisions without prior consultation with the Company in accordance with the Company's investment policy and guidelines.

Independent Auditor Agreement

The Company engaged Hacker, Johnson & Smith, P.A. for the purpose of annually auditing and reporting on the statutory basis financial statements at year-end.

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, 2002, 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, 2002

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$34,922,952		\$34,922,952
On deposit	959,331		959,331
Short-term investments	1,936,354		1,936,354
Uncollected premium	572,935		572,935
Deferred premium	3,351,277		3,351,277
Reinsurance Recoverable	101,435		101,435
FIT Recoverable	708,096		708,096
Interest and dividend income due & accrued	598,231		598,231
Equities and deposits in pools and associations	5,809		5,809
Aggregate write-in for other than invested assets	226,149		226,149
Totals	\$43,382,569	\$0	\$43,382,569

AUTO CLUB SOUTH INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2002

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$10,624,527		\$10,624,527
Loss adjustment expenses	1,729,574		1,729,574
Other expenses	857,355		857,355
Taxes, licenses and fees	347,489		347,489
Federal & Foreign income taxes	412,614		412,614
Unearned premium	8,465,771		8,465,771
Ceded Reinsurance premiums payable	411,256		411,256
Remittances and items not allocated	278,960		278,960
Payable to parent, subsidiaries and affiliates	218,127		218,127
Total Liabilities	\$23,345,673		\$23,345,673
Common capital stock	1,000,000		1,000,000
Gross paid in and contributed surplus	2,750,000		2,750,000
Unassigned funds (surplus)	16,286,896		16,286,896
Surplus as regards policyholders	20,036,896		20,036,896
Total liabilities, capital and surplus	\$43,382,569	\$0	\$43,382,569

AUTO CLUB SOUTH INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2002

Underwriting Income

Premiums earned	\$18,558,182
DEDUCTIONS:	
Losses incurred	12,041,936
Loss expenses incurred	2,096,654
Other underwriting expenses incurred	3,844,799
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$17,983,389</u>
Net underwriting gain or (loss)	\$574,793

Investment Income

Net investment income earned	\$1,847,839
Net realized capital gains or (losses)	180,536
Net investment gain or (loss)	<u>\$2,028,375</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$0
Finance and service charges not included in premiums	199,183
Aggregate write-ins for miscellaneous income	0
Total other income	<u>\$199,183</u>

Net income before dividends to policyholders and before federal & foreign income taxes	\$2,802,351
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	<u>\$2,802,351</u>
Federal & foreign income taxes	<u>1,161,614</u>
Net Income	\$1,640,737

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$19,317,996
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Gains and (Losses) in Surplus

Net Income	\$1,640,737
Net unrealized capital gains or losses	0
Change in deferred income tax	83,318
Change in non-admitted assets	(5,155)
Change in excess statutory over statement reserves	0
Surplus adjustments: Paid in	0
Dividends to stockholders	(1,000,000)
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>718,900</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$20,036,896</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$12,354,101

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, 2002, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

**AUTO CLUB SOUTH INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2002

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, 2002, Annual Statement	\$20,036,896
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment.			\$0
LIABILITIES:			
No adjustment.			\$0
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2002, Per Examination			\$20,036,896

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 1999 examination report issued by the Office.

Current examination comments and corrective action

There were no material findings noted in the financial examination as of December 31, 2002.

CONCLUSION

The customary 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, 2002, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$20,036,896, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Mary M. James, CFE, Financial Examiner/Analyst Supervisor and Doug Haseltine, Actuary, participated in the examination.

Respectfully submitted,

Kethessa Carpenter
Financial Specialist
Florida Office of Insurance Regulation