

REPORT ON EXAMINATION
OF
FLORIDA FAMILY INSURANCE
COMPANY

NAPLES, FLORIDA

AS OF
DECEMBER 31, 2005

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

December 1, 2006

Kevin M. McCarty
Commissioner
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, 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, 2005, of the financial condition and corporate affairs of:

**FLORIDA FAMILY INSURANCE COMPANY
720 GOODLETTE ROAD NORTH, SUITE 500
NAPLES, FLORIDA 32605**

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, 2003 through December 31, 2005. This examination commenced, with planning at the Florida Office of Insurance Regulation (Office), on August 1, 2006 to August 4, 2006. The fieldwork commenced on August 7, 2006 and was concluded as of December 1, 2006. 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 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.

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, 2005. Transactions subsequent to year-end 2005 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.

Status of Adverse Findings from Prior Examination

The Company was last examined by representatives of the Office as of December 31, 2002. The following is a summary of adverse findings contained in the Office's prior examination report along with the resulting action taken by the Company.

Capital Stock

The Company did not report Common capital stock, Gross paid in and contributed surplus and Unassigned funds properly in the Annual Statement. The Common capital stock account should equal the number of shares issued times the par value for each share. Gross paid in and contributed surplus is the amount of capital received in excess of the par value of the stock issued. Expenses relating to the issuance of capital stock are charged to Unassigned funds. **Resolution:** The Company corrected the method of reporting Common capital stock, Gross paid-in and contributed surplus and Unassigned funds in the 2004 Annual Statement and was in compliance with SSAP No. 72 on the 2005 annual statement.

Management

Most of the minutes of the meetings of the Board of Directors were not signed and none of the minutes were dated. **Resolution:** The Company provided signed and dated copies of all minutes for the Board of Directors and Audit Committee for the examination period.

Upon the conversion of Florida Family Mutual Insurance Company to Florida Family Insurance Company on March 14, 2001, there was no organization meeting of record to elect Company directors as required in Section 607.0205, Florida Statutes. **Resolution:** The Company has subsequently elected its directors and officers in accordance with its Articles of Incorporation and Bylaws.

The Company did not notify the Office regarding resignation of certain directors. **Resolution:** The Company has since notified the Office in writing of any changes in directors and have incorporated this process in their meeting minutes.

Conflict of Interest

At December 31, 2002, the Company adopted a policy statement that required annual disclosure of conflicts of interest, in accordance with the NAIC Financial Condition Examiners Handbook. However, the statement was not signed by all directors and officers on an annual basis. **Resolution:** Conflict of interest statements were signed each year since 2002.

Custodian Agreement

The custodian agreement with First Union (Wachovia) was not in compliance with parts 2a, 2b, 2g, 2h, 2j, and 2n of Rule 69O-143.042, Florida Administrative Code. Resolution: The current custodian agreement was in compliance with parts 2a, 2b, 2g, 2h, 2j, and 2n of Rule 69O-143.042, Florida Administrative Code.

HISTORY

General

The Company was incorporated on March 19, 1996, under the laws of the State of Florida, as a non-assessable mutual property and casualty insurer and commenced business on May 1, 1996, with the name of Florida Family Mutual Insurance Company.

During 2001, in conjunction with approval of the Office, the policyholders of Florida Family Mutual Insurance Company approved a conversion of the Company from a non-assessable mutual insurer to a stock insurer. Under the terms of the demutualization offering and a separate related agreement between the Company and Florida Family Insurance Services, LLC, (FFIS), a \$5 million debenture was exchanged for approximately 98.9% of the shares of the Company.

During 2001 the articles of incorporation and the bylaws were amended to reflect the demutualization documented above.

In accordance with Section 624.401(1), Florida Statutes, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2005:

- Fire, Allied Lines, Homeowners Multiple Peril and Inland Marine

Capital Stock

As of December 31, 2005, the Company's capitalization was as follows:

Number of authorized common capital shares	6,000,000
Number of authorized preferred capital shares	10,000,000
Number of shares issued and outstanding-common	449,737
Number of shares issued and outstanding-preferred	0
Total common & preferred capital stock shares issued	\$ 4,497,370
Par value per share for common	\$ 10.00
Par value per share for preferred	\$ 1.00

The control of the Company was maintained by FFIS, which owned 99.4% of the stock. Individual shareholders owned the remaining 0.6% of the stock.

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 Statement.

	2005	2004	2003
Premiums Earned	12,646,199	11,773,837	12,100,430
Net Underwriting Gain/(Loss)	(3,655,670)	(6,306,941)	2,072,205
Net Income	(2,584,197)	(3,549,982)	1,808,843
Total Assets	42,503,927	37,367,143	31,149,174
Total Liabilities	31,196,810	28,162,238	20,929,369
Surplus As Regards Policyholders	11,307,118	9,204,905	10,219,804

Dividends to Stockholders

The Company declared and paid no dividends to its stockholders in 2003, 2004 or 2005.

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, 2005, were:

Directors

Name and Location	Principal Occupation
Walter Dale Hardy Naples, FL	President & CEO, Florida Family Insurance Company
Timothy James McKay Chicago, IL	Lawyer, McKay & Nora, LLP
William Henry Wiggs Arlington Heights, IL	CFO, Florida Family Insurance Company
William Tuttle Montei Middleton, WI	President & CEO, PIC Wisconsin
Amy Houghton Bash Barrington, IL	Homemaker
David Paul Behnke	CFO, BCS Financial Corp.

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

Senior Officers

Name	Title
Walter Dale Hardy	President
William Henry Wiggs	Chief Financial Officer
Robert Allen Liggett	Controller
Walter Vernon Rice	Vice President
Peter Joseph Corrigan	Chief Underwriting Officer
Diane Marie O'Connor	Vice President
Jamie Victoria Hobbs	Assistant Secretary
Lydia Gale Creydt	Chief Information Officer
Anthony Obie McCarty	Vice President
Catherine Anderson	Secretary

The Company's board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. Following are the principal internal board committees and their members as of December 31, 2005:

Executive Committee

Walter D. Hardy
William H. Wiggs
William T. Montei

Audit Committee

David P. Behnke
William T. Montei
Timothy J. McKay
Amy H. Bash

Investment Committee

William T. Montei
Walter D. Hardy
William H. Wiggs
David P. Behnke

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 shareholders, board of directors and audit committee meeting 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, Florida Statutes.

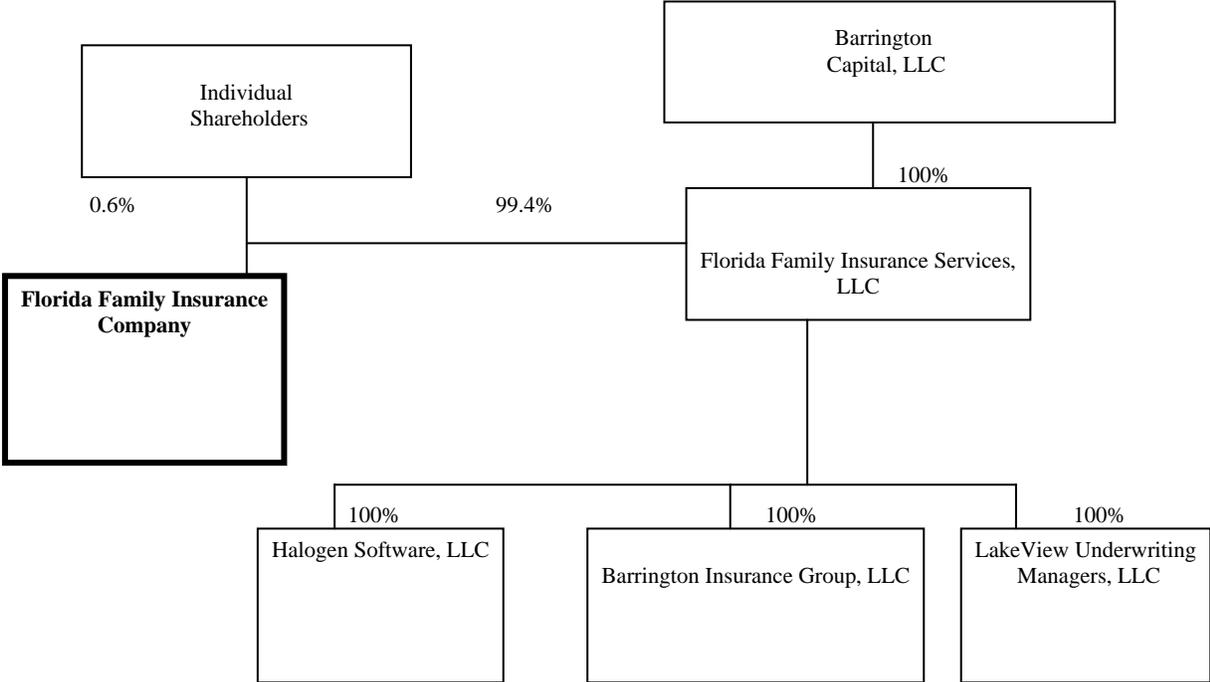
The minutes of the board of directors recorded that the board established an audit committee as provided by Section 624.424(8) (c), Florida Statutes, and approved the Company's investments as required by Section 625.304, Florida Statutes.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on June 15, 2005, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

An organizational chart as of December 31, 2005, reflecting the holding company system, is shown below. Schedule Y of the Company's 2005 annual statement provided a list of all related companies of the holding company group.

**FLORIDA FAMILY INSURANCE COMPANY
ORGANIZATIONAL CHART
DECEMBER 31, 2005**



FIDELITY BOND

The Company maintained fidelity bond coverage up to \$5,000,000 with a deductible of \$50,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC. Additional financial institution bond coverage of \$2,000,000 was held, covering the Company for computer systems fraud, trading loss coverage and forgery or alteration of the insuring agreement.

The Company also had property contents coverage for their business locations in Naples and Jacksonville, Florida.

PENSION PLANS

The Company had a qualified defined contribution plan (401K) sponsored by the parent. The Company's contribution to the plan was noted in the notes to the financial statements.

STATUTORY DEPOSITS

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

<u>STATE</u>	<u>DESCRIPTION</u>	<u>RATE</u>	<u>MATURITY DATE</u>	<u>PAR VALUE</u>	<u>MARKET VALUE</u>
FLORIDA	CD with Wachovia Bank, National Assoc.	4.8%	04/07/07	\$ 300,000	\$ 300,000
TOTAL FL DEPOSITS				<u>\$ 300,000</u>	<u>\$ 300,000</u>
TOTAL OTHER DEPOSITS				<u>\$ -</u>	<u>\$ -</u>
TOTAL SPECIAL DEPOSITS				<u>\$ 300,000</u>	<u>\$ 300,000</u>

Territory

The Company was authorized to write business only in the State of Florida.

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 626.954(1)(i)3,a, Florida Statutes.

REINSURANCE

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

The above mentioned contracts complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

Ceded

The Company ceded risk on a quota share and excess of loss basis through an intermediary, Barrington Insurance Group, LLC, an affiliate. The quota share reinsurance contracts were with Hannover Re Ltd. and E & S Re Ltd., both located in Ireland.

ACCOUNTS AND RECORDS

PriceWaterhouseCoopers, an independent CPA firm, audited the Company's statutory basis financial statements annually for all years under review, 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 maintained its principal operational offices in Naples, Florida, where this examination was conducted.

The Company had the following agreements in place at December 31, 2005:

Custodial Agreement

The Company had a custodial agreement with Wachovia Bank, NA dated November 30, 2004. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

Managing General Agent Agreement

The Company entered into a managing general agent (MGA) agreement with an affiliate, FFIS, on September 1, 2000. There have been no amendments to the contract since that date.

Cost Sharing Agreement

The Company entered into a cost sharing agreement with their parent, FFIS, and its subsidiaries, Halogen Software, LLC, Barrington Insurance Group, LLC and Lakeview Underwriting Managers, LLC,

on January 1, 1999. The agreement was for certain operations and their costs, when it was deemed financially advantageous for them to be incurred by one entity, and was allocated to the other affiliates on a percent of use basis.

Investment Management Agreement

The Company entered into an investment management agreement with the manager, APS Financial Corporation, on January 1, 2003. The agreement specified that the manager may buy, sell, convert and otherwise trade in securities which met the Company's investment guidelines.

Risk-Based Capital

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

Information Technology (IT) Report

James Graeff, senior consultant with Computer Aid, Inc. performed a computer systems evaluation on the Company. Results of the evaluation were noted in the IT report provided to the Company. There were no significant findings noted by the IT examiner, however there were four minor recommendations.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2005, 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."

FLORIDA FAMILY INSURANCE COMPANY
Assets
DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Bonds	\$26,555,224		\$26,555,224
Cash and short-term investments	12,471,366		12,471,366
Aggregate write-in for invested assets	130,743		130,743
Uncollected premiums and agents balances in the course of collection	1,778,293		1,778,293
Amounts recoverable from reinsurers	343,473		343,473
Current federal and foreign income tax recoverable and interest thereon	283,638		283,638
Net deferred tax asset	577,078		577,078
Electronic data processing equipment and software	41,712		41,712
Aggregate write-in for other than invested assets	322,400		322,400
Totals	<u>\$42,503,927</u>		<u>\$42,503,927</u>

FLORIDA FAMILY INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2005

	Per Company	Examination Adjustments	Per Examination
Losses	\$ 1,996,035		\$ 1,996,035
Loss adjustment expenses	195,028		195,028
Other expenses	742,015		742,015
Taxes, licenses, and fees	254,228		254,228
Unearned premiums	7,927,707		7,927,707
Ceded reinsurance premiums payable	2,484,043		2,484,043
Funds held by company under reinsurance treaties	15,062,272		15,062,272
Provision for reinsurance	325,823		325,823
Payable to parent, subsidiaries and affiliates	2,209,659		2,209,659
Total liabilities	\$ 31,196,810		\$ 31,196,810
Common capital stock	\$ 4,497,370		\$ 4,497,370
Gross paid in and contributed surplus	8,058,922		8,058,922
Unassigned surplus	(1,249,175)		(1,249,175)
Surplus as regards policyholders	11,307,117		11,307,117
Total liabilities, capital and surplus	\$ 42,503,927		\$ 42,503,927

FLORIDA FAMILY INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2005

	Underwriting Income	
Premiums earned		\$12,646,199
DEDUCTIONS:		
Losses incurred		6,363,628
Loss expenses incurred		1,627,712
Other underwriting expenses incurred		8,310,529
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		<u>\$16,301,869</u>
Net underwriting gain or (loss)		(\$3,655,670)
	Investment Income	
Net investment income earned		\$1,067,044
Net realized capital gains or (losses)		0
Net investment gain or (loss)		<u>\$1,067,044</u>
	Other Income	
Net gain or (loss) from agents' or premium balances charged off		(\$4,156)
Finance and service charges not included in premiums		28,555
Aggregate write-ins for miscellaneous income		0
Total other income		<u>\$24,399</u>
Net income before dividends to policyholders and before federal & foreign income taxes		(\$2,564,227)
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		(\$2,564,227)
Federal & foreign income taxes		<u>19,970</u>
Net Income		(\$2,584,197)
	Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year		\$9,204,905
	Gains and (Losses) in Surplus	
Net Income		(\$2,584,197)
Change in net deferred income tax		932,027
Change in non-admitted assets		(924,565)
Change in provision for reinsurance		(321,052)
Capital changes: Paid in		1,561,330
Surplus adjustments: Paid in		3,438,670
Surplus adjustments: Transferred from capital		0
Examination Adjustment		0
Change in surplus as regards policyholders for the year		<u>\$2,102,213</u>
Surplus as regards policyholders, December 31 current year		<u><u>\$11,307,118</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Electronic data processing equipment and software \$41,712

The computer software and hardware purchased in 2005 was less than \$25,000 in value and did not meet the criteria of an asset in accordance with Section 625.012(11), Florida Statutes. Due to the immateriality of the asset, no adjustment was made to the financial statement.

Liabilities

Losses and Loss Adjustment Expenses \$2,191,063

A Company employee, the actuary appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2005, 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; however, the Company incorrectly recorded outside adjuster costs paid to an affiliate as Defense Cost Containment (DCC) rather than Adjusting and Other Expense (AOE) costs. That practice was not in compliance with Rule 69O-137.001, Florida Administrative Code.

**FLORIDA FAMILY INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2005

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, 2005, Annual Statement	\$11,307,118
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:	No adjustments.		
LIABILITIES:	No adjustments.		
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2005, Per Examination			\$11,307,118

SUMMARY OF FINDINGS

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, 2005.

Losses and Loss Adjustment Expenses

The Company was recording outside adjuster costs paid to an affiliate as DCC rather than AOE costs. This was not in compliance with the Annual Statement Instructions that are adopted by Rule 69O-137.001, Florida Administrative Code; and it is recommended that the Company properly record these costs in all future filings.

Electronic data processing equipment and software

The computer software and hardware purchased in 2005 was less than \$25,000 in value and did not meet the criteria of an asset in accordance with Section 625.012 (11), Florida Statutes; and it is recommended that the Company non-admit this item in all future filings.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of Florida Family Insurance Company as of December 31, 2005, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$11,307,118, which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, the following individuals participated in the examination, John C. Berry, Financial Examiner/Analyst Supervisor, Stephen Feliu, Financial Examiner/Analyst II and Joseph Boor, FCAS, Office Actuary. We also recognize the participation of Computer Aid Inc. with the IT examination.

Respectfully submitted,

Richard A. Shaffer
Financial Specialist
Florida Office of Insurance Regulation