

REPORT ON EXAMINATION

OF

SERVICE INSURANCE COMPANY

BRADENTON, FLORIDA

AS OF

DECEMBER 31, 2006

BY THE

OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION	1
STATUS OF ADVERSE FINDINGS FROM PRIOR EXAMINATION	2
HISTORY	4
GENERAL	4
CAPITAL STOCK	5
PROFITABILITY OF COMPANY	5
DIVIDENDS TO STOCKHOLDERS	6
MANAGEMENT	6
CONFLICT OF INTEREST PROCEDURE.....	7
CORPORATE RECORDS	8
ACQUISITIONS, MERGERS, DISPOSALS, DISSOLUTIONS, AND PURCHASE OR SALES THROUGH REINSURANCE	8
SURPLUS DEBENTURES	8
AFFILIATED COMPANIES	8
ORGANIZATIONAL CHART	9
MANAGEMENT AGREEMENT	9
MANAGING GENERAL AGENCY AGREEMENT.....	10
CONSOLIDATED TAX ALLOCATION AGREEMENT	10
INTERCOMPANY EXPENSE CHARGE-BACK AGREEMENT	10
FIDELITY BOND AND OTHER INSURANCE.....	11
PENSION, STOCK OWNERSHIP AND INSURANCE PLANS	11
STATUTORY DEPOSITS.....	12
INSURANCE PRODUCTS AND RELATED PRACTICES.....	13
TERRITORY	13
TREATMENT OF POLICYHOLDERS.....	13
REINSURANCE	13
ASSUMED.....	14
CEDED	14
ACCOUNTS AND RECORDS.....	14
CUSTODIAL AGREEMENT	15
MANAGING GENERAL AGENCY AGREEMENT.....	15
FULL SERVICE VENDOR AGREEMENT	16
FINANCIAL STATEMENTS PER EXAMINATION.....	16

ASSETS	17
LIABILITIES, SURPLUS AND OTHER FUNDS	18
STATEMENT OF INCOME	19
COMMENTS ON FINANCIAL STATEMENTS.....	20
LIABILITIES	20
CAPITAL AND SURPLUS	20
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS.....	21
SUMMARY OF FINDINGS	22
CONCLUSION	23

Tallahassee, Florida

June 22, 2007

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Dear Sirs and Madam:

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, 2006, of the financial condition and corporate affairs of:

SERVICE INSURANCE COMPANY
4730 SR 64 E
BRADENTON, FLORIDA 34208

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, 2006. 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 March 28, 2007, to March 30, 2007. The fieldwork commenced on April 4, 2007, and was concluded as of June 22, 2007.

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.

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, 2006. Transactions subsequent to year-end 2006 were reviewed where relevant and deemed significant to the Company's financial condition.

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 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 account:

Uncollected Premiums in the course of collection

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, 2003, along with resulting action taken by the Company in connection therewith.

General

The Company had not written insurance coverage for auto physical damage and fidelity during the last two years. **Resolution: Effective August 4, 2005, the Company removed auto physical damage and fidelity from their certificate of authority.**

Custodial Agreement

The Company had a custodial agreement with Regions Morgan Keegan Trust, which did not include certain requirements of Rule 69O-143.042, Florida Administrative Code. **Resolution: The Company revised its custodial agreement with Regions Morgan Keegan Trust on February 13, 2004. The revised custodial agreement did not meet all of the requirements of Rule 69O-143.042, Florida Administrative Code as of December 31, 2006. On June 19, 2007, the**

custodial agreement was amended to meet all of the requirements of Rule 69O-143.042, Florida Administrative Code.

Reinsurance Recoverable from Reinsurers

The Company overstated reinsurance recoverable in the amount of \$135,978 in the 2003 annual statement. **Resolution: The Company wrote off the overstated amount in 2004.**

Losses and Loss Adjustment Expenses

The Company understated losses and loss adjustment expenses in the amount of \$2,100,000 in the balance sheet as of December 31, 2003. **Resolution: As of December 31, 2006, the Company accurately established losses and loss adjustment expense reserves.**

HISTORY

General

The Company was incorporated in Florida on December 16, 1977 and commenced business on February 22, 1978 as Service Insurance Company.

In accordance with Section 624.401(1), Florida Statutes, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2006:

Fire	Allied lines
Homeowners multi peril	Commercial multi peril
Inland marine	Other liability
Surety	Glass
Burglary and Theft	Mobile home multi peril
Mobile home physical damage	

The Company was a party to Consent Order 81307-05-CO filed May 26, 2005, with the Office regarding removal of selected policies from Citizens Property Insurance Corporation at specific intervals pursuant to a depopulation plan. The Company was in compliance with the provisions of this Consent Order at December 31, 2006.

Effective February 18, 2005, the Company entered into a Consent Order 80174-05 with the Office for approval of the application by Equity American Financial Services, Inc. to acquire 45% of the outstanding voting securities of Service Insurance Company from Bay area Insurance Services, Inc. (BAIS). The Company was in compliance with the provisions of this consent order at December 31, 2006.

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

The Company amended paragraph 12 of the bylaws on February 7, 2005 to add the voting provisions of shareholders. Under the voting provisions, a total of 60% of all shareholder votes is required for matters requiring shareholder approval. Effective December 31, 2008, 40% or more of the affirmative vote of the holders of common stock is required for a sale of the Corporation.

Capital Stock

As of December 31, 2006, the Company's capitalization was as follows:

Number of authorized common capital shares	500,000
Number of shares issued and outstanding	500,000
Total common capital stock	\$3,000,000
Par value per share	\$6.00

Control of the Company was maintained by its parent, BAIS, which owned 100% of the stock issued by the Company. BAIS was 21% owned by Mr. & Mrs. John A. Weichel, 16% owned by Mr. Horace M. Johnson, 13% owned by Strickland Insurance Group and 45% owned by Equity American Financial Services, Inc. Equity American Financial Services, Inc. purchased and retained 45% of the stock from BAIS on March 23, 2005. BAIS contributed the Funds received from the sale to the capital of the Company.

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.

	2006	2005	2004
Premiums Earned	8,134,621	12,308,185	15,833,409
Net Underwriting Gain/(Loss)	(1,157,951)	(2,242,958)	(11,465,026)

Net Income	(19,008)	(1,261,097)	(9,924,230)
Total Assets	23,152,361	26,920,844	40,240,373
Total Liabilities	13,133,119	16,466,157	28,240,373
Surplus As Regards Policyholders	10,019,241	10,454,687	12,000,000

Dividends to Stockholders

The Company did not pay dividends to its stockholder 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, 2006, were:

Directors

Name and Location

Principal Occupation

Edward A. Kerbs
Rumson, NJ

Managing Director
IAT Reinsurance Co., Ltd

Horace M. Johnson
Burlington, NC

President
Axiom Intermediaries

Robert W. Strickland
Goldsboro, NC

Chairman & CEO
Strickland Group

John A. Weichel, Sr.
Bradenton, FL

Chairman of the Board
Service Insurance Company

Stephen L. Stephano
Raleigh, NC

President & CEO
IAT Group

David G. Pirrung
Raleigh, NC

Vice President/Treasurer
McM Corporation

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

Senior Officers

Name	Title
David C. Cruikshank	President and CEO
Rosetta Waag	Secretary
David G. Pirrung	Treasurer
Timothy N. Flynn	Vice President
Michael A. Gurley	Vice President
Carol A. Johnson	Vice President

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, 2006:

Executive Committee

Stephen L. Stephano
Edward A. Kerbs
Robert W. Strickland
Horace M. Johnson

¹ Chairman of the Board of Directors

Audit Committee

Robert W. Strickland
David G. Pirrung
Horace M. Johnson

Investment Committee

Edward A. Kerbs
David G. Pirrung
¹ John A. Weichel Sr

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 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 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

Equity American Financial Services, Inc. purchased 45% of the Company Stock from BAIS on March 23, 2005.

Surplus Debentures

The Company had no outstanding surplus debentures.

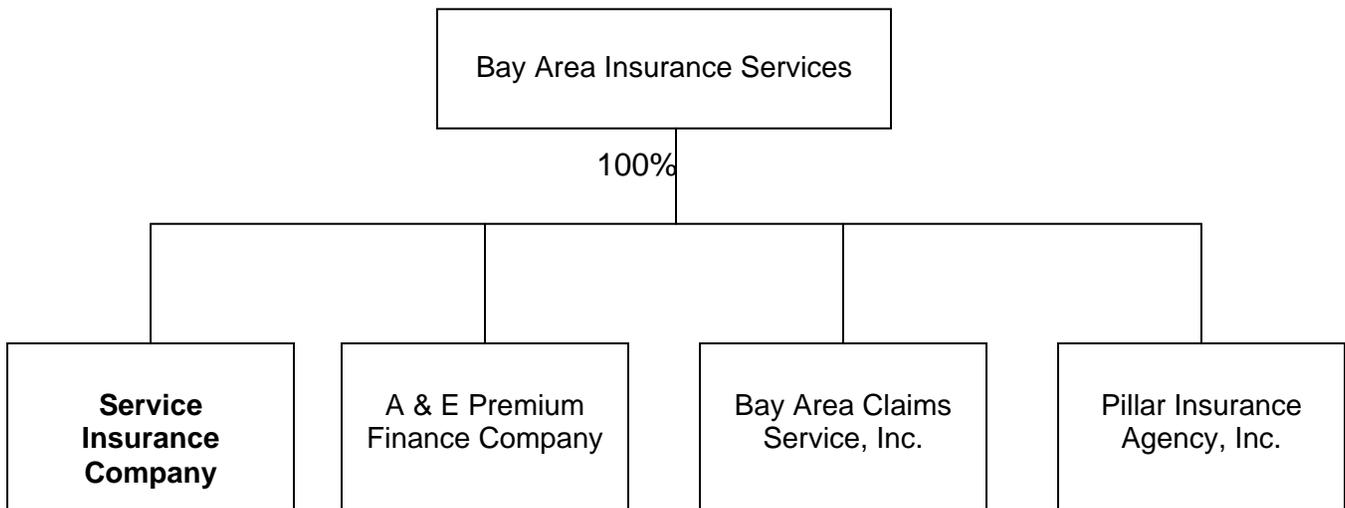
AFFILIATED COMPANIES

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 20, 2006, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2006, reflecting the holding company system, is shown below. Schedule Y of the Company's 2006 annual statement provided a list of all related companies of the holding company group.

**SERVICE INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2006



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

Management Agreement

Effective January 1, 2003, the Company entered into a management agreement with its parent, Bay Area Insurance Services, Inc. Pursuant to the terms of the agreement, the parent received an annual fee in return for providing administrative services for the Company sufficient to carry on the normal business functions of a property and casualty insurance company.

Managing General Agency Agreement

The Company entered into a managing general agency (MGA) agreement with its affiliate, Pillar Insurance Agency (Pillar), a licensed MGA, effective January 1, 2002. The agreement provided Pillar the authority to accept and bind insurance policies in certain lines of business, the authority to administer claims and the authority to negotiate reinsurance on behalf of the company as provided by Sections 626.091(1)(b) and 626.7451, Florida Statutes. In return for these services, Pillar received a 22% commission and a \$25 per-policy fee.

Consolidated Tax Allocation Agreement

The Company, along with its parent and other affiliated companies, filed a consolidated federal income tax return. The agreement, effective January 1, 2006, provided that the allocation of taxes is based on the Company's year-end profit/loss results. The Company was charged for its share of estimated taxes payable on a quarterly basis with a final adjustment made when the tax returns are filed.

Intercompany Expense Charge-back Agreement

The Company had agreements with affiliates, Pillar and Bay Area Claims Service, Inc., to provide management and administrative support, which included administering salaries, maintaining books and records, and providing professional expertise and services relative to computers and technology.

FIDELITY BOND AND OTHER INSURANCE

The Company, along with its parent and affiliates, maintained financial institution bond coverage in the amount of \$450,000 with a deductible of \$25,000, which adequately covered the suggested minimum amount of coverage for the Company, its parent and affiliates as recommended by the NAIC.

The Company also maintained workers' compensation, commercial property, automobile, commercial liability, crime policy, commercial umbrella, professional liability, and management liability insurance coverages.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The parent company offered a 401(K) retirement plan and a deferred compensation plan for its employees. The parent company also provided group life insurance and health coverage.

STATUTORY DEPOSITS

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

Florida Statutes:

STATE	Description	Par Value	Market Value
FL	US Treasury Note, 7.5%, 11/15/16	\$ 100,000	\$ 121,590
FL	US Treasury Note, 4.75%, 11/15/08	100,000	99,910
FL	US Treasury Note, 3.5%, 08/15/09	125,000	121,250
FL	US Treasury Note, 5.5%, 02/15/08	500,000	502,850
FL	US Treasury Note, 3.25%, 08/15/07	300,000	296,820
FL	US Treasury Note, 2.625%, 05/15/08	200,000	194,060
FL	US Treasury Note, 3.125%, 09/15/08	150,000	145,845
FL	US Treasury Note, 3.625%, 08/15/07	120,000	116,868
FL	US Treasury Note, 3.5%, 02/15/10	100,000	96,520
FL	US Treasury Note, 4.875%, 08/15/09	200,000	200,660
FL	US Treasury Note, 4.625%, 11/15/09	500,000	498,500
FL	US Treasury Note, 3.%, 02/15/09	<u>150,000</u>	<u>144,675</u>
TOTAL FLORIDA DEPOSITS		\$ 2,545,000	\$2,539,548
AR	Money Market	\$ 111,693	\$ 111,693
GA	Money Market	26,000	26,396
IN	Money Market	250,000	250,000
NV	Federal Farm Credit Banks, 5.75%, 01/25/08	200,000	201,126
NM	Bond, 3.75%, 07/01/10	325,000	326,160
NC	Money Market	204,871	204,871
NC	US Treasury Note, 2.75%, 08/15/07	100,000	100,000
OR	US Treasury Note, 3.375%, 05/15/08	200,000	196,938
RI	Cash	203,612	203,302
SC	US Treasury Note, 6.25%, 02/15/07	100,000	100,000
SC	US Treasury Note, 2.625%, 11/15/06	100,000	100,000
VA	US Treasury Money Market	250,000	250,000
-	Insurance Corp. of NY, pledged as collateral for LOCL 071851	<u>49,035</u>	<u>49,035</u>
TOTAL OTHER DEPOSITS		<u>\$ 2,120,211</u>	<u>\$ 2,119,521</u>
TOTAL SPECIAL DEPOSITS		<u>\$ 4,665,211</u>	<u>\$ 4,659,069</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

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

Alabama	Alaska	Arkansas	Arizona
California	Colorado	Delaware	District of Columbia
Florida	Georgia	Hawaii	Idaho
Illinois	Indiana	Iowa	Kansas
Kentucky	Louisiana	Maine	Michigan
Mississippi	Missouri	Montana	Nebraska
Nevada	New Mexico	North Carolina	North Dakota
Oklahoma	Oregon	Pennsylvania	Rhode Island
South Carolina	South Dakota	Tennessee	Texas
Utah	Virginia	Washington	West Virginia
Wyoming			

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 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 risk during 2006.

Ceded

The Company ceded risk on a quota share, excess of loss and property catastrophe excess of loss basis to authorized and unauthorized reinsurers. The primary reinsurers were National Flood Insurance Program, Florida Hurricane Catastrophe Fund, GE Reinsurance Corporation, QBE Reinsurance Corporation and Lloyds of London Syndicates. All were authorized reinsurers. The Company properly established provision for unauthorized reinsurers as of December 31, 2006.

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 Bradenton, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2004, 2005 and 2006, 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 utilized the investment and custodial services of Regions Bank, an Alabama corporation, who was doing business as Regions Morgan Keegan Trust. The Company revised the custodial agreement with Regions Morgan Keegan Trust on February 13, 2004 and added an amendment to the agreement during 2005. The revised custodial agreement did not include Sections (a) (b) (i) (m) and (o) of Rule 69O-143.042, Florida Administrative Code. Specifically, the agreement did not require the Company to terminate the agreement by giving a 30 day notice to the custodian. The agreement also did not require the custodian to hold securities separate from the securities of the custodian and of all of its other customers in a fungible bulk or securities as part of a Filing Securities by Issue arrangement.

Subsequent Event: The Company amended its custodial agreement with Regions Morgan Keegan Trust on June 19, 2007. The amended agreement met all of the requirements of Rule 690-143.042, Florida Administrative Code.

Managing General Agency Agreement

The Company had a managing general agency agreement with West Point Underwriters, LLC (West Point) to market, underwrite, and administer mobile home homeowner programs. The agreement provided West Point with the exclusive authority to market, underwrite, and

administer the Company's mobile home homeowner programs. West Point also had authority to negotiate the reinsurance on the mobile home homeowner programs, subject to the Company's approval. The Company was in the process of withdrawing from the mobile home business by non-renewal. The withdrawal of this line was approved by the Office in a letter dated March 31, 2006.

Full Service Vendor Agreement

Effective October 10, 1998, the Company entered into a full service vendor agreement with National Flood Service, Inc. to supervise and administer the Write Your Own (WYO) Flood Insurance Program for certain states. Under the terms of this agreement, the vendor provided policy administration, claims processing, financial reporting, premiums collections and banking arrangement in accordance with the National Flood Services Policies and Procedures and guidelines established by the WYO Financial Control Plan. The Company compensated the vendor by an annual servicing fee equal to the specified percentages of net premiums written for performing the duties.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2006, 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."

SERVICE INSURANCE COMPANY
Assets

DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Bonds	\$10,633,834		\$10,633,834
Stocks:			
Common	643,040		643,040
Cash:	3,412,419		3,412,419
Receivable for securities	316,387		316,387
Interest income due	156,061		156,061
Agents' Balances:			
Uncollected premium	1,327,172		1,327,172
Deferred premium	3,088,246		3,088,246
Reinsurance recoverable	2,135,866		2,135,866
Net deferred tax asset	760,024		760,024
Receivable from parents, subsidiaries and affiliates	20,590		20,590
Aggregate write-in for other than invested assets	658,723		658,723
Totals	\$23,152,362	\$0	\$23,152,362

SERVICE INSURANCE COMPANY
Liabilities, Surplus and Other Funds
DECEMBER 31, 2006

	Per Company	Examination Adjustments	Per Examination
Losses	\$5,673,640		\$5,673,640
Reinsurance payable on paid losses & loss adjustment expenses	9,744		9,744
Loss adjustment expenses	984,031		984,031
Commissions payable	(1,729)		(1,729)
Other expenses	662,276		662,276
Taxes, licenses and fees	666,640		666,640
Unearned premium	6,294,738		6,294,738
Ceded reinsurance premiums payable	(2,169,077)		(2,169,077)
Provision for reinsurance	334,893		334,893
Payable to parent, subsidiaries and affiliates	63,846		63,846
Aggregate write-ins for liabilities	614,117		614,117
Total Liabilities	\$13,133,119		\$13,133,119
Common capital stock	\$3,000,000		\$3,000,000
Gross paid in and contributed surplus	14,808,004		14,808,004
Unassigned funds (surplus)	(7,788,762)		(7,788,762)
Surplus as regards policyholders	\$10,019,242		\$10,019,242
Total liabilities, surplus and other funds	\$23,152,361	\$0	\$23,152,361

SERVICE INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2006

Underwriting Income	
Premiums earned	\$8,134,621
Deductions:	
Losses incurred	1,776,451
Loss expenses incurred	1,732,155
Other underwriting expenses incurred	5,783,966
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$9,292,572</u>
Net underwriting gain or (loss)	(\$1,157,951)
Investment Income	
Net investment income earned	\$701,122
Net realized capital gains or (losses)	117,324
Net investment gain or (loss)	<u>\$818,446</u>
Other Income	
Net gain or (loss) from agents' or premium balances charged off	\$10
Finance and service charges not included in premiums	320,458
Aggregate write-ins for miscellaneous income	29
Total other income	<u>\$320,497</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$19,008)
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$19,008)
Federal & foreign income taxes	<u>0</u>
Net Income	(\$19,008)
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	\$10,454,687
Net Income	(\$19,008)
Net unrealized capital gains or losses	(9,400)
Change in non-admitted assets	(60,447)
Change in provision for reinsurance	(334,893)
Change in deferred income tax	(11,699)
Surplus adjustments: Paid in	0
Aggregate write-ins for gains and losses in surplus	0
Examination adjustment	<u>0</u>
Change in surplus as regards policyholders for the year	(\$435,447)
Surplus as regards policyholders, December 31 current year	<u><u>\$10,019,240</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses

\$6,657,671

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, 2006, 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.

Capital and Surplus

The amount reported by the Company of \$10,019,241 exceeds the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

A comparative analysis of changes in surplus is shown below.

**SERVICE INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2006

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, 2006, per Annual Statement	\$10,019,241
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment needed.			
LIABILITIES:			
No adjustment needed.			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2006, Per Examination			\$10,019,241

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2003 examination report issued by the Office.

Current examination comments and corrective action

There were no exam findings during this examination.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Service Insurance Company** as of December 31, 2006, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$10,019,241, in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned Joe Boor, FCAS, Office Actuary, participated in the examination.

Respectfully submitted,

Samita Lamsal
Financial Examiner/Analyst II
Florida Office of Insurance Regulation

Michael Hampton, CPA, CFE, DABFA, CFE, CPM
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation