

REPORT ON EXAMINATION
OF
SERVICE INSURANCE COMPANY
BRADENTON, FLORIDA
AS OF
DECEMBER 31, 2011

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

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March 22, 2013

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, Rule 69O-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, 2011, of the financial condition and corporate affairs of:

**SERVICE INSURANCE COMPANY
4730 SR 64 EAST
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, 2007, through December 31, 2011. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2006. This examination commenced with planning at the Office on December 17, 2012, to December 21, 2012. The fieldwork commenced on January 14, 2013, and concluded as of March 22, 2013.

This financial examination was a multi-state 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

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during this examination. Some of the findings noted during this examination period have been resolved by the Company subsequent to the examination date. However, the findings or exceptions are discussed in detail in the body of the examination report.

Corporate records

The Company removed its corporate records from its Florida office. The Company had not requested an exemption from keeping its records in Florida, pursuant to Section 628.271, Florida Statutes.

Prior Exam Findings

There were no findings, exceptions or corrective action to be taken by the company for the examination as of December 31, 2006.

HISTORY

General

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

On February 1, 2005, Equity American Financial Services, Inc. (Equity American) entered into a purchase and sale agreement with Bay Area Insurance Services, Inc. (Bay Area) and its subsidiaries, including the Company, in which Equity American acquired 45% of Bay Area. On June 11, 2009, Equity American purchased additional shares of Bay Area and as of December 31, 2011 Equity American owned 93.3% of the Company's parent, Bay Area.

The Company was authorized to transact the following insurance coverage in Florida on February 22, 1978 and continued to be authorized as of December 31, 2011:

Allied	Fire
Homeowners multi peril	Glass
Commercial multi peril	Burglary and theft
Inland Marine	Surety
Other liability	Mobile home multi peril
Mobile home physical damage	

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

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, 2011, 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, Bay Area Insurance Services, Inc. (Bay Area), who owned 100% of the stock issued by the Company. Bay Area was 93.3% owned by Equity American Financial Services, Inc. and 6.7% owned by others. Equity American Financial Services, Inc. increased their ownership from 45% to 93.3% on June 11, 2009. The parent contributed \$6,000,000 in cash to the Company in 2010 and \$1,630,356 in cash in 2007.

Surplus Notes

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

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

Equity American Financial Services, Inc. purchased an additional 48.3% of the Company's parent, Bay Area, on June 11, 2009.

CORPORATE RECORDS

The recorded minutes of the Shareholder(s) and Board of Directors (Board) 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 and including the authorization of investments as required by Section 625.304, Florida Statutes. The Company removed its corporate records from its Florida office. The Company had not requested an exemption from keeping its records in Florida and is in violation of Section 628.271(3), 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, 2011, were:

Directors

Name and Location	Principal Occupation
David Cornell Cruikshank Bradenton, Florida	Senior Vice President, Service Insurance Company
Horace Mann Johnson, Jr. Burlington, North Carolina	Retired
Edward Anthony Kerbs Rumson, New Jersey	Vice President, IAT Reinsurance Company, Ltd.
David Gerald Pirrung Wake Forest, North Carolina	Chief Financial Officer, IAT Reinsurance Company, Ltd.
Stephen Louis Stephano Raleigh, North Carolina	President, Service Insurance Company

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

Senior Officers

Name	Title
Stephen Louis Stephano	President
David Cornell Cruikshank	Senior Vice President
David Gerald Pirrung	Treasurer
Michael David Blinson	Secretary
Timothy Flynn	Vice President
Michael Allen Gurley	Vice President
Carol Alison Johnson	Assistant Vice President

Following were the principal internal board committees and their members as of December 31, 2011:

Executive Committee

Stephen L. Stephano ¹
Edward A. Kerbs
Horace M. Johnson III
David G. Pirrung

Audit Committee

Edward A. Kerbs ¹
Horace M. Johnson, Jr.
David G. Pirrung

Risk Management Committee

David G. Pirrung ¹
V. Boyce Oglesby
Horace M. Johnson, Jr.
Stephen L. Stephano

¹ Chairman

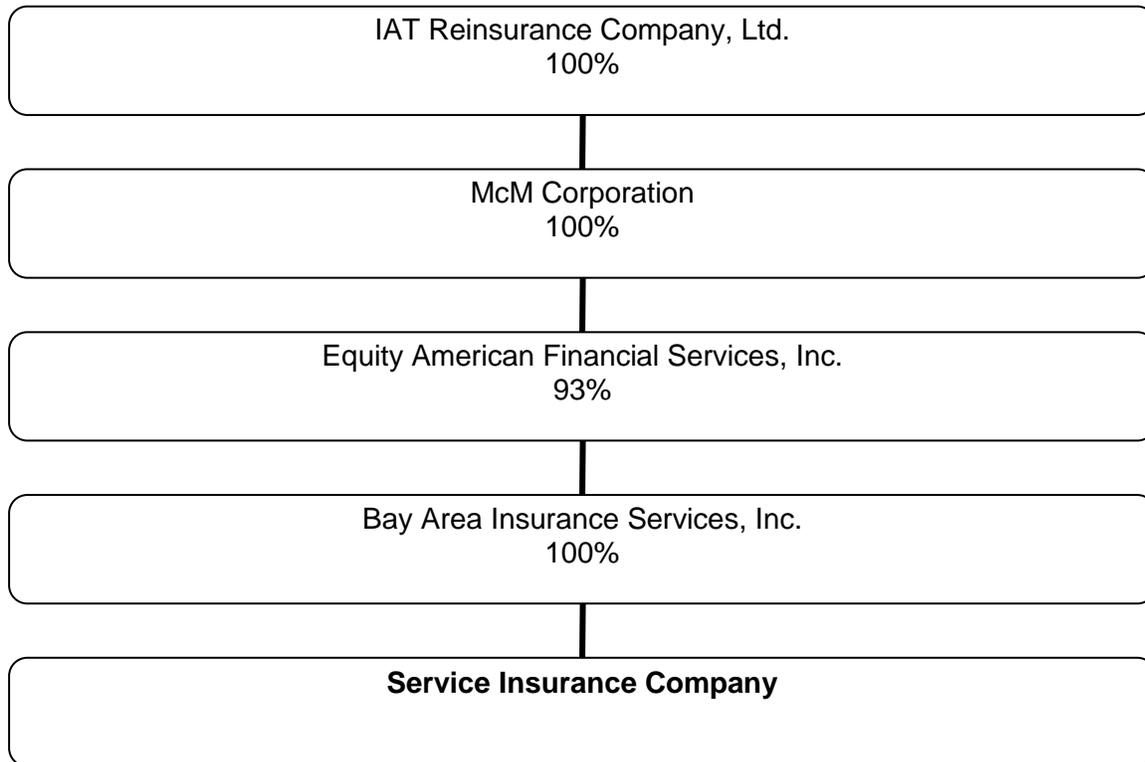
Affiliated Companies

The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on March 1, 2012, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2011, reflecting the holding company system, is shown on the following page. Schedule Y of the Company's 2011 annual statement provided a list of all related companies of the holding company group.

**SERVICE INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2011



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

Tax Allocation Agreement

Effective January 1, 2010, the Company became party to the tax allocation agreement with the IAT Reinsurance Company Ltd. and its affiliates. The Company, along with its parent and affiliates, filed a consolidated federal income tax return. On December 31, 2011, the method of allocation between the Company and its parent was on a separate-entity basis.

Intercompany Transactions

The Company did not obtain the Office's prior approval of intercompany advances provided to affiliates, which exceeded thresholds requiring approval in accordance with Rule 69O-143.047, Florida Administrative Code.

Subsequent Event: The Company ceased its practice of intercompany advances in the second quarter of 2012.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$2,000,000 with a deductible of \$50,000, which is the suggested minimum recommended by the NAIC.

The Company also maintained workers' compensation, general liability, commercial auto, commercial property and commercial umbrella coverages.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The parent company, McM Corporation, offered a 401(k) plan and profit sharing plan in which eligible employees of the Company were able to participate.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance in the following states and the District of Columbia:

Alabama	Alaska	Arizona	Arkansas	California
Colorado	Delaware	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	Wisconsin
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.

COMPANY GROWTH

The Company reduced its homeowners exposure and focused on commercial lines during the examination period. In September 2011, the Company began writing homeowners business again in Texas, which along with the increase in flood business, accounted for the increase in premiums in 2011. The Company experienced a net loss in 2009 due to decreased premium that resulted due to soft market conditions and high reinsurance costs. Since 2009, net income has improved closer to its pre-2009 levels due to increases in premiums and cost savings, including reinsurance costs, within the holding company structure. Surplus remained relatively stable and in-line with net income (loss), with the exception of the increase in 2010 due to the contribution received from the parent in the amount of \$6 million.

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.

	2011	2010	2009	2008	2007
Premiums Earned	2,480,379	2,198,012	1,741,328	5,032,398	7,187,535
Net Underwriting Gain/(Loss)	1,085,856	(208,870)	(1,441,213)	1,196,627	152,733
Net Income	1,252,874	509,598	(965,561)	1,453,533	1,449,864
Total Assets	26,500,165	22,769,807	15,994,889	19,778,117	22,600,756
Total Liabilities	5,285,703	2,735,673	2,573,270	5,410,086	9,255,833
Surplus As Regards Policyholders	21,214,462	20,034,133	13,421,619	14,368,032	13,344,923

LOSS EXPERIENCE

During the current examination period, the Company showed 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 \$0.5 million and \$0.5 million, respectively.

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 any reinsurance during the period of this examination.

Ceded

The Company ceded risk on a quota share, excess of loss basis and property catastrophe excess of loss basis to authorized and unauthorized reinsurers. The IAT Reinsurance holding company purchased property catastrophic excess of loss reinsurance on a group basis.

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.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2007, 2008, 2009, 2010 and 2011 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 books and records are maintained on computerized systems using externally developed software.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with the Regions Morgan Keegan Trust (Regions) amended June 19, 2007. The custodial agreement with Regions did not include Sections (j) and (o) of Rule 69O-143.042, Florida Administrative Code. Specifically, the agreement did not require the custodian to secure and maintain insurance protection in an amount that is adequate to cover the bank's or trust company's duties and activities as custodian for the insurer's assets, and did not state in the custody agreement that protection is in compliance with the requirements of the custodian's banking regulator. The agreement also did not require the custodian to provide written notification to the Office if the custodial agreement with the insurer has been terminated or if 100% of the account assets in any one custody account have been withdrawn within three business days of the receipt by the custodian of the insurer's written notice of termination or within three business days of the withdrawal of 100% of the account assets.

Subsequent Event: The custodial agreement with Regions was replaced with a custodial agreement with U.S. Bank National Association (U.S. Bank) on April 9, 2013. The U.S. Bank agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

The Company maintained a custodial agreement with Morgan Stanley Smith Barney (Morgan Stanley) effective August 26, 2008. The custodial agreement with Morgan Stanley did not contain

any of the provisions of Rule 69O-143.042, Florida Administrative Code. **Subsequent Event:** The Morgan Stanley account was closed in October 2012.

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.

Managing General Agent Agreement

The Company utilized a non-affiliated managing general agent (MGA) to produce personal lines of business. The MGA was responsible for quoting policies to customers, claims administration and billing and collecting premiums on behalf of the insurer. The MGA also had binding authority for policies in accordance with underwriting and pricing standards dictated by the agreement.

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

Scott Langstein, CISA, IT Manager, of Cerebres, 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	USTN, 7.5%, 11/15/16	\$ 100,000	\$ 131,970
FL	USTN, 2.0%, 08/15/12	100,000	101,030
FL	BD, 4.75%, 11/01/14	245,000	266,215
FL	AN, 4.63%, 12/01/15	100,000	103,570
FL	USTN, 2.0%, 08/15/12	650,000	656,604
FL	LTC , 6.88%, 05/01/20	400,000	446,976
FL	AFG, 9.88%, 06/15/19	300,000	348,972
FL	BOA, 5.75%, 08/15/16	300,000	278,679
FL	JGI, 8.5%, 07/15/19	400,000	406,000
FL	USTN, 4.83%, 07/31/12	<u>100,000</u>	<u>102,617</u>
TOTAL FLORIDA DEPOSITS		\$ 2,695,000	\$ 2,842,633
AZ	GS, 7.5%, 02/15/19	\$ 200,000	\$ 220,882
GA	USTN, 0.875%, 11/30/16	25,000	26,079
IN	USTN, 4.625% 07/31/12	250,000	256,543
NV	BOND, 7.5%, 02/15/19	100,000	110,441
NV	BOND, 4.625%, 12/01/15	100,000	103,670
VA	GECAP, 3.35%, 10/17/16	200,000	208,280
NM	GECAP, 5.45%, 01/15/13	325,000	340,035
OR	USTN, 4.75%, 05/31/12	200,000	203,828
OR	USTN, 0.875%, 11/30/16	200,000	200,610
SC	USTN, 4.75%, 05/31/12	200,000	200,000
NC	USTN, 4.625%, 07/31/12	200,000	205,234
NC	USTN, 0.875%, 11/30/16	102,000	102,311
OT	Insurance Corp of NY,		

RI	pledged as colateral for LOCL 071851 USTN, 4.625%, 07/31/12	15,980 <u>200,000</u>	15,980 <u>205,234</u>
TOTAL OTHER DEPOSITS		<u>\$2,317,980</u>	<u>\$ 2,399,127</u>
TOTAL SPECIAL DEPOSITS		<u>\$5,012,980</u>	<u>\$5,241,760</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2011, 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, 2011

	Per Company	Examination Adjustments	Per Examination
Bonds	\$13,108,143	\$0	\$13,108,143
Stocks:			
Preferred	1,179,313		1,179,313
Common	2,547,170		2,547,170
Cash and Short-Term Investments	5,156,662		5,156,662
Agents' Balances:			
Uncollected premium	2,109,003		2,109,003
Deferred premium	691,213		691,213
Reinsurance recoverable	138,302		138,302
Interest and dividend income due & accrued	174,998		174,998
Receivable from parents, subsidiaries and affiliates	885,740		885,740
Net deferred tax asset	456,873		456,873
Aggregate write-in for other than invested assets	52,748		52,748
Totals	<u>\$26,500,165</u>	<u>\$0</u>	<u>\$26,500,165</u>

SERVICE INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2011

	Per Company	Examination Adjustments	Per Examination
Losses	\$555,275		\$555,275
Loss adjustment expenses	136,628		136,628
Other expenses	219,283		219,283
Taxes, licenses and fees	310,083		310,083
Unearned premium	4,939,636		4,939,636
Current Federal and Foreign income taxes	706,978		706,978
Ceded reinsurance premiums payable	(1,662,395)		(1,662,395)
Provision for reinsurance	17,000		17,000
Payable to parent, subsidiaries and affiliates	875		875
Aggregate write-ins for liabilities	62,340		62,340
Total Liabilities	\$5,285,703	\$0	\$5,285,703
Common capital stock	\$3,000,000		\$3,000,000
Gross paid in and contributed surplus	22,438,360		22,438,360
Unassigned funds (surplus)	(4,223,898)		(4,223,898)
Surplus as regards policyholders	\$21,214,462	\$0	\$21,214,462
Total liabilities, surplus and other funds	\$26,500,165	\$0	\$26,500,165

SERVICE INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2011

Underwriting Income

Premiums earned		\$2,480,379
	Deductions:	
Losses incurred		(\$469,329)
Loss expenses incurred		424,331
Other underwriting expenses incurred		1,439,522
Total underwriting deductions		\$1,394,524
Net underwriting gain or (loss)		\$1,085,855

Investment Income

Net investment income earned		\$842,785
Net realized capital gains or (losses)		(48,024)
Net investment gain or (loss)		\$794,761

Other Income

Net gain or (loss) from agents' or premium balances charged off		(\$35)
Finance and service charges not included in premiums		98,367
Aggregate write-ins for miscellaneous income		3,579
Total other income		\$101,911

Net income before dividends to policyholders and before federal & foreign income taxes		\$1,982,528
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$1,982,528
Federal & foreign income taxes		729,654
Net Income		\$1,252,874

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$20,034,133
Net Income		\$1,252,874
Change in net unrealized capital gains or losses		(194,604)
Change in non-admitted assets		13,687
Change in provision for reinsurance		(14,991)
Change in net deferred income taxes		123,363
Examination Adjustment		0
Change in surplus as regards policyholders for the year		\$1,180,329
Surplus as regards policyholders, December 31 current year		\$21,214,462

A comparative analysis of changes in surplus is shown below.

SERVICE INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2011

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, 2011, per Annual Statement	\$21,214,462
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	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS: No Adjustment			
LIABILITIES: No Adjustment			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2011, Per Examination			<u><u>\$21,214,462</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$ 691,903

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, 2011, 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, Greg Wilson, FCAS, MAAA, of Lewis & Ellis, Inc., reviewed the loss and loss adjustment expense work papers provided by the Company and he was in concurrence with this opinion.

Capital and Surplus

The amount of Capital and surplus reported by the Company of \$21,214,462, exceeded the minimum of \$5,000,000 required by Section 624.408, Florida Statutes.

SUMMARY OF RECOMMENDATIONS

Corporate Records

We recommend that the Company formally request approval from the Office to move corporate records to the Raleigh, North Carolina location as required in Section 628.271(3), Florida Statutes.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Service Insurance Company, Inc.** as of December 31, 2011, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$21,214,462, which exceeded the minimum of \$5,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Sarah Lucibello, CPA, CFE, Examiner-In-Charge, and Amy Carter, CPA, Participating Examiner, both of Lewis and Ellis, Inc. participated in the examination. Greg Wilson, FCAS, MAAA, consulting actuary of Lewis & Ellis, Inc., Scott Langstein, CISA, IT Manager of Cerebres, LLC also participated in the examination. In addition, Jonathan Frisard, Financial Examiner/Analyst Supervisor, Connie Hare, CFE (fraud), Financial Examiner/Analyst Supervisor, and Syntia King, APIR, Financial Examiner/Analyst II, of the Office participated in the examination.

Respectfully submitted,

Mary M. James, CFE, CPM
Financial Administrator
Florida Office of Insurance Regulation