

REPORT ON EXAMINATION
OF
UNITED AUTOMOBILE INSURANCE
COMPANY

NORTH MIAMI BEACH, FLORIDA

AS OF
JUNE 30, 2003

BY THE
OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

| | |
|--|----|
| LETTER OF TRANSMITTAL | - |
| SCOPE OF EXAMINATION | 1 |
| Statutory Deposits | 2 |
| HISTORY | 4 |
| General | 4 |
| Capital Stock | 4 |
| Profitability of Company | 5 |
| Dividends to Stockholders | 5 |
| Management | 5 |
| Conflict of Interest Procedure | 7 |
| Corporate Records | 7 |
| Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales through Reinsurance | 7 |
| Surplus Debentures | 7 |
| AFFILIATED COMPANIES | 7 |
| Tax Allocation Agreement | 8 |
| Cost Sharing Agreement | 8 |
| Master Lease Agreement | 8 |
| MGA Agreement | 8 |
| Computer Services Agreement | 9 |
| ORGANIZATIONAL CHART | 10 |
| FIDELITY BOND AND OTHER INSURANCE | 11 |
| PENSION, STOCK OWNERSHIP AND INSURANCE PLANS | 11 |
| STATUTORY DEPOSITS | 11 |
| INSURANCE PRODUCTS AND RELATED PRACTICES | 12 |
| Territory and Plan of Operation | 12 |
| Treatment of Policyholders | 12 |

| | |
|--|----|
| REINSURANCE | 13 |
| Assumed | 13 |
| Ceded | 13 |
| ACCOUNTS AND RECORDS | 14 |
| Custodial Agreement | 14 |
| Fronting Arrangement | 14 |
| Risk-Based Capital | 15 |
| FINANCIAL STATEMENTS PER EXAMINATION | 15 |
| Assets | 16 |
| Liabilities, Surplus and Other Funds | 17 |
| Statement of Income | 18 |
| COMMENTS ON FINANCIAL STATEMENTS | 19 |
| Assets | 19 |
| Liabilities | 19 |
| Compliance with previous directives | 21 |
| CONCLUSION | 23 |

Tallahassee, Florida
February 06, 2004

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Dear Sirs:

Pursuant to your instructions, in compliance with Section 641.16, FS, and in accordance with the practices and procedures promulgated by the NAIC, we have conducted an examination of June 30, 2003, of the financial condition and corporate affairs of:

**UNITED AUTOMOBILE INSURANCE COMPANY
3909 NORTHEAST 163RD STREET
NORTH MIAMI BEACH, FLORIDA 33160**

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 June 30, 2003. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 1999. This examination commenced on October 13, 2003, and was concluded as of February 6, 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 an association 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 quarterly statement as of June 30, 2003. Subsequent transactions 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 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.

Statutory Deposits

The Company failed to show the deposits with South Carolina and Louisiana on Schedule E – Part 2 of the 1999 annual statement.

Resolution: The Company was currently including all states on Schedule E – Part 2 as required.

Custodial Agreements

There were three custodians with no custodial agreements in place or whose agreement did not meet the requirements of Rule 69O-143.042, FAC.

Resolution: The Company was currently maintaining custodial agreements which comply with the above Rule.

Agents' Balances

The Company failed to age its agency bills receivable that were formerly on the books of United Midwest that was merged into the Company on December 30, 1999; which was not in accordance with Rule 69O-138.024, FAC.

Resolution: The Company was aging agents' balances as required.

EDP Equipment

The Company did not properly calculate and record accumulated depreciation.

Resolution: The Company was properly calculating and recording accumulated depreciation.

HISTORY

General

The Company was incorporated in Florida on March 2, 1989, and commenced business on July 1, 1990 as United Automobile Insurance Company.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on June 30, 2003:

Private Passenger Auto Physical Damage
Private Passenger Auto Liability
Commercial Automobile Liability
Commercial Auto Physical Damage

The articles of incorporation were amended on October 8, 2002, to include the correct number of common capital stock shares authorized. The bylaws were not amended during the period covered by this examination.

Capital Stock

As of June 30, 2003, the Company's capitalization was as follows:

| | |
|--|-------------|
| Number of authorized common capital shares | 2,750,000 |
| Number of shares issued and outstanding | 2,750,000 |
| Total common capital stock | \$2,750,000 |
| Par value per share | \$1.00 |

As of June 30, 2003, control of the Company was maintained by Richard P. Parrillo, Sr., its major shareholder.

Subsequently, on November 8, 2003, with the unanimous consent of the board of directors, ownership of the Company's stock was transferred 100% to United Automobile Insurance

Group, Inc. (UAIG). The stock was pledged to Amalgatrust Company, Inc. (Amalgamated Bank of Chicago) as part of a loan agreement with the parent Company.

Profitability of Company

The Company reported underwriting gains/(losses) of (\$5.1 million), \$4.9 million, \$9.2 million and \$5.9 million for the periods ended December 31, 2000, 2001, 2002 and June 30, 2003, respectively. Net income reported for the same periods were \$652,000, \$4.6 million, \$6.9 million and \$4.8 million respectively.

Dividends to Stockholders

Dividends were not declared or paid during the examination period.

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 June 30, 2003, were:

Directors

| Name and Location | Principal Occupation |
|--|--|
| Richard P. Parrillo, Sr. Aventura, Florida | President, CEO |
| Richard P. Parrillo, Jr. Sunny Isles, Florida | President; Director of Argus Fire & Casualty Ins. Co. |
| Beau W. Parrillo Hallandale, Florida | Vice President |
| Michael R. Parrillo Hinsdale, Illinois | Executive Vice President |

John Spatuzza
Chicago, Illinois

Attorney at Law

Jean-Guy Rivard
Wilton Manors, Florida

Treasurer

Patrick A. McCarthy
Oakbrook, Illinois

Account Executive at
Mesirow Ins. Services

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

Senior Officers

| Name | Title |
|--------------------------|--------------------------|
| Richard P. Parrillo, Sr. | President, CEO |
| Michael R. Parrillo | Executive Vice President |
| Beau W. Parrillo | Vice President |
| Jean-Guy Rivard | Treasurer |
| Michael W. Whatley | Vice President |
| George Tarsitano | Vice President |
| Charles Grimsley | Secretary |
| Sandra Iglesias | Vice President |
| Juan Ferrer | Vice President |
| Ronald Terzer | Vice President |

The Company's board of directors appointed one internal committee in accordance with Section 607.0825, FS. Following is the principal internal board committee and its members as of June 30, 2003:

Audit Committee

Juan Ferrer
Richard P. Parrillo, Sr.
Richard P. Parrillo, Jr.
Charles J. Grimsley, Esq.

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 and board of directors 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.

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

There were no acquisitions, mergers, disposals, dissolution and purchase or sales through reinsurance during the period of this examination.

Surplus Debentures

The Company had no surplus debentures.

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 January 8, 2003, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

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

Tax Allocation Agreement

The Company, along with its parent, filed a consolidated federal income tax return. On June 30, 2003, the method of allocation between the Company and its parent was for each to pay 100% of its tax liability.

Cost Sharing Agreement

The Company entered into a cost sharing agreement on January 1, 2000, with its affiliates whereby the Company paid all jointly incurred corporate expenses. The affiliates reimbursed the Company on a formula pro-rata basis.

Master Lease Agreement

The Company entered into a master lease agreement whereby the Company leases the office building it occupied from the Par Family Limited Partnership.

MGA Agreement

The Company entered into a managing general agency (MGA) agreement with National Insurance Management Company (NIMC) effective January 1, 2000. The Company appointed NIMC as its MGA in compliance with Section 626.112(1), FS to supervise and manage private passenger

automobile and commercial automobile policies produced by brokering agents. The agreement was in compliance with Sections 626.091 and 626.7451, FS.

Computer Services Agreement

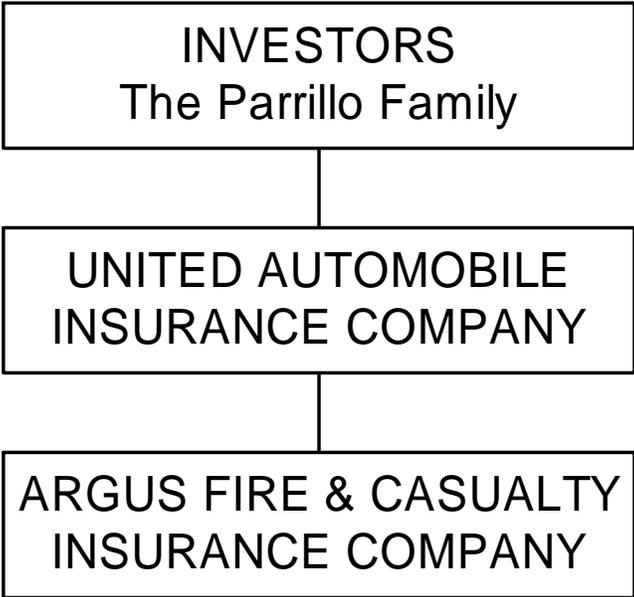
Effective January 1, 2002, the Company entered into a computer services agreement with 3lcomp, Inc. and Argus Fire and Casualty Insurance Company. 3lcomp, Inc., provided the necessary computer services and support for the companies to operate their respective insurance business operations.

Guaranty Agreement

Effective June 1, 2001, the Company entered into a guaranty agreement with Old American County Mutual Fire Insurance Company, an insurance company domiciled in Texas. The purpose of the agreement was to appoint National Insurance Managing Company Insurance Services, Inc. a Texas MGA, to act as the Company's MGA. The Company facilitated such appointment by individually guaranteeing the indebtedness of the MGA to the Company. This agreement works under a fronting arrangement.

A simplified organizational chart as of June 30, 2003 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.

**UNITED AUTOMOBILE INSURANCE COMPANY
ORGANIZATIONAL CHART
JUNE 30, 2003**



On November 8, 2003, the ownership of the Company's stock was transferred 100% to UAIG.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$1,500,000 with a deductible of \$25,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company adopted a qualified 401K retirement plan on July 1, 1997, covering substantially all employees of the Company and its affiliates, subject to certain service requirements and age qualifications. Benefits are matched on the employees' contribution to the percentage approved by the board of directors. The Company had no stock options or other post-retirement plans.

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 | USTNTS | 5.50% | 05/15/09 | \$ 250,000 | \$ 250,000 |
| FL | USTNTS | 3.25% | 08/15/07 | 740,000 | 740,000 |
| FL | CHAT. TN | 5.00% | 09/01/08 | 250,000 | 250,000 |
| FL | REEDY CRK | 4.90% | 06/01/08 | 160,000 | 160,000 |
| FL | WICHITA KS | 4.63% | 09/01/10 | <u>500,000</u> | <u>500,000</u> |
| TOTAL FLORIDA DEPOSITS | | | | \$1,900,000 | \$1,900,000 |
| GA | MMF | 11.50% | 08/15/04 | \$ 36,452 | \$ 36,452 |
| IL | TREAS. STRIP | 7.30% | 06/01/14 | 3,000,000 | 3,000,000 |
| LA | CD | | | 25,000 | 25,000 |
| OK | SUPER WI | 4.00% | 04/01/11 | 300,000 | 300,000 |
| SC | FLORENCE | 5.50% | 11/10/08 | <u>125,000</u> | <u>125,000</u> |
| TOTAL OTHER DEPOSITS | | | | \$3,486,452 | \$3,468,452 |
| Total Special Deposits | | | | <u>\$5,386,452</u> | <u>\$5,386,452</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
South Carolina

Louisiana
Illinois
Mississippi

Oklahoma
Utah

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

As of June 30, 2003, the reinsurance agreements reviewed were found to comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines with the following exception: The Company's 60% finite quota share reinsurance agreement failed to meet the risk transfer requirements of SSAP 62; however, the replacement agreement effective July 1, 2003 was in compliance with SSAP 62.

Assumed

The Company assumed 100% of the business written in Texas from a fronting company, Old American County Mutual Fire Insurance Company. The fronting fee was 4.25% to cover the premium taxes and the ceding margin.

The Company assumed risk on a quota share basis from Star Casualty Insurance Company whereby the Company agreed to accept a 15% share on 100% of all business classified as private passenger automobile business written in the State of Florida.

Ceded

The Company ceded risk on a quota share and excess of loss basis to various reinsurers.

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; however, this examination was conducted as of June 30, 2003. No CPA audited statutory basis financial statements or supporting work papers were available for the interim period beginning January 1, 2003 and ended June 30, 2003.

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 quarterly statement submitted to the Office.

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

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company entered into an agreement with AmalgaTrust Company, Inc., on July 1, 2001, for the purpose of appointing AmalgaTrust Company, Inc. as custodian for securities, cash and other property. The agreement reviewed was in compliance with Rule 69O-143.042, FAC.

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 June 30, 2003, and the results of its operations for the period 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."

UNITED AUTOMOBILE INSURANCE COMPANY
Assets

JUNE 30, 2003

| Classification | Per Company | Examination Adjustments | Per Examination |
|---|---------------|----------------------------|-----------------|
| Bonds | \$179,023,214 | | \$179,023,214 |
| Stocks: | | | |
| Preferred | 2,459,027 | | 2,459,027 |
| Common | 13,142,721 | | 13,142,721 |
| Real Estate: | | | |
| Other properties | 352,215 | | 352,215 |
| Cash: | | | |
| On hand | 52,050 | | 52,050 |
| On deposit | 17,949,658 | | 17,949,658 |
| Other invested assets | 5,669,774 | | 5,669,774 |
| Aggregate write-in for invested assets | 5,000 | | 5,000 |
| Interest and dividend income due & accrued | 1,958,317 | | 1,958,317 |
| Agents' Balances: | | | |
| Uncollected premium | 16,390,298 | | 16,390,298 |
| Deferred premium | 1,893,819 | | 1,893,819 |
| Current federal and foreign | | | |
| Income tax recoverable | 187,321 | | 187,321 |
| Net deferred tax asset | 3,234,413 | | 3,234,413 |
| Receivable from PSA | 308,357 | | 308,357 |
| | <hr/> | | |
| Totals | \$242,626,184 | \$0 | \$242,626,184 |
| | <hr/> <hr/> | | |

UNITED AUTOMOBILE INSURANCE COMPANY
Liabilities, Surplus and Other Funds

JUNE 30, 2003

| Liabilities | Per Company | Examination Adjustments | Per Examination |
|--|----------------------|----------------------------|----------------------|
| Losses | \$47,112,155 | | \$47,112,155 |
| Reinsurance payable on paid losses and loss adjustment expenses | 716 | | 716 |
| Loss adjustment expenses | 18,997,395 | | 18,997,395 |
| Other expenses | 1,132,686 | | 1,132,686 |
| Taxes, licenses and fees | 317,633 | | 317,633 |
| Unearned premium | 55,380,468 | | 55,380,468 |
| Funds held under reinsurance treaties | 72,819,557 | | 72,819,557 |
| Amounts withheld | 5,398 | | 5,398 |
| Drafts outstanding | 5,800,476 | | 5,800,476 |
| Payable to parent, subsidiaries and affiliates | 904,849 | | 904,849 |
| Payable for securities | 33,983 | | 33,983 |
| Aggregate write-ins for liabilities | <u>4,540,319</u> | | <u>4,540,319</u> |
| Total Liabilities | \$207,045,635 | | \$207,045,635 |
| Aggregate write-ins for special surplus funds | 2,000,000 | | 2,000,000 |
| Common capital stock | 2,750,000 | | 2,750,000 |
| Gross paid in and contributed surplus | 29,000,000 | | 29,000,000 |
| Unassigned funds (surplus) | <u>1,830,549</u> | | <u>1,830,549</u> |
| Surplus as regards policyholders | <u>35,580,549</u> | | <u>35,580,549</u> |
| Total liabilities, capital and surplus | <u>\$242,626,184</u> | \$0 | <u>\$242,626,184</u> |

UNITED AUTOMOBILE INSURANCE COMPANY
Statement of Income

JUNE 30, 2003

Underwriting Income

| | |
|---|---------------------|
| Premiums earned | \$64,766,826 |
| DEDUCTIONS: | |
| Losses incurred | 27,700,656 |
| Loss expenses incurred | 9,799,699 |
| Other underwriting expenses incurred | 21,349,025 |
| Aggregate write-ins for underwriting deductions | 0 |
| Total underwriting deductions | <u>\$58,849,380</u> |
| Net underwriting gain or (loss) | \$5,917,446 |

Investment Income

| | |
|--|--------------------|
| Net investment income earned | \$2,428,305 |
| Net realized capital gains or (losses) | 1,195,319 |
| Net investment gain or (loss) | <u>\$3,623,624</u> |

Other Income

| | |
|--|------------------|
| Net gain or (loss) from agents' or premium balances charged off | (\$11,955) |
| Finance and service charges not included in premiums | 67,545 |
| Aggregate write-ins for miscellaneous income | 0 |
| Total other income | <u>\$55,590</u> |
| Net income before dividends to policyholders and before federal & foreign income taxes | \$9,596,660 |
| Dividends to policyholders | 0 |
| Net Income, after dividends to policyholders, but before federal & foreign income taxes | \$9,596,660 |
| Federal & foreign income taxes | <u>4,780,000</u> |
| Net Income | \$4,816,660 |

Capital and Surplus Account

| | |
|--|--------------|
| Surplus as regards policyholders, December 31 prior year | \$28,154,972 |
|--|--------------|

Gains and (Losses) in Surplus

| | |
|--|----------------------------|
| Net Income | \$4,816,660 |
| Change in net unrealized capital gains or losses | 2,179,758 |
| Change in net deferred income tax | 674,871 |
| Change in non-admitted assets | (245,712) |
| Examination Adjustment | 0 |
| Change in surplus as regards policyholders for the year | <u>\$7,425,577</u> |
| Surplus as regards policyholders, December 31 current year | <u><u>\$35,580,549</u></u> |

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

| | |
|--|---------------------|
| Losses and Loss Adjustment Expenses | <u>\$66,109,550</u> |
|--|---------------------|

As of December 31, 2001, the Company's loss and loss adjustment expense reserves were found to be deficient. The Office requested a reserve analysis to be performed by an independent actuary as of June 30, 2003. The actuarial opinion stated that in order for the reserve amounts to be a reasonable provision for all unpaid loss and loss adjustment expense obligations, the Company should do the following:

- A. Put into place a reinsurance agreement, which adequately transfers risk.
- B. Increase the direct loss and loss adjustment expense reserves by at least \$3 million on a net basis.

As of July 1, 2003, the Company entered into a 40% finite quota share reinsurance agreement. An independent review of the agreement under the direction of the Office, determined that the agreement meets the risk transfer criteria of SSAP 62.

In October of 2003, the Company increased its net loss reserves by \$6,729,073. On November 12, 2003, the Company increased its surplus by a capital infusion of \$25,000,000.

UNITED AUTOMOBILE INSURANCE COMPANY
Comparative Analysis of Changes in Surplus

JUNE 30, 2003

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 June 30, 2003, Annual Statement | \$35,580,549 |
|---|--------------|

| | <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: | | | 0 | 0 |
| Surplus as Regards Policyholders June 30, 2003, Per Examination | | | | \$35,580,549 |

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

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 June 30, 2003.

As of June 30, 2003, the Company's 60% finite quota share reinsurance agreement failed to meet the transfer of risk criteria of SSAP 62. As of July 1, 2003, the Company entered into a 40% finite quota share reinsurance agreement. An independent review of the agreement conducted under the direction of the Office, determined that the agreement met the risk transfer criteria of SSAP 62.

As of December 31, 2001, the Company's loss and loss expense reserves were found to be deficient.

In October of 2003, the Company increased its net loss reserves by \$6,729,073. On November 12, 2003, the Company increased its surplus with a capital increase of \$25,000,000.

SUBSEQUENT EVENTS

A 60% finite quota share reinsurance agreement for the policy year 2002 was placed in run-off as of June 30, 2003 and commuted on December 31, 2003. For the policy year 2003, the agreement was terminated as of June 30, 2003 and commuted on December 31, 2003.

On November 8, 2003, the ownership of the Company's stock was transferred 100% to UAIG.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **United Automobile Insurance Company** as of June 30, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$35,580,549, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Vince Dyal, CFE, Financial Specialist, Owen Anderson, Financial Examiner/Analyst II and Veris Consulting, LLC, as Actuary, participated in the examination.

Respectfully submitted,

Mary James, CFE
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation