REPORT ON EXAMINATION

OF

SERVICE INSURANCE COMPANY

BRADENTON, FLORIDA

AS OF

DECEMBER 31, 2003

BY THE

OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

Tallahassee, Florida

March 11, 2005

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

Honorable Walter Bell
Secretary, Southeastern Zone, NAIC
Commissioner
Alabama Department of Insurance
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104

Honorable John Morrison
Secretary, Western Zone, NAIC
Commissioner
Montana Department of Insurance
840 Helena Avenue
Helena, Montana 59601

Honorable Julie Bowler
Secretary, Northeastern Zone, NAIC
Commissioner
Commonwealth of Massachusetts
One South Station, 5^{th} Floor
Boston Massachusetts 02110

Honorable Jorge Gomez
Secretary, Midwestern Zone, NAIC
Commissioner
Office of the Commissioner of Insurance
State of Wisconsin
P.O. Box 7873
Madison, Wisconsin 53707-7873

Dear Sirs and Madam:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes (FS), and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination of December 31, 2003, of the financial condition and corporate affairs of:

SERVICE INSURANCE COMPANY
4730 STATE ROAD 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, 2001 through December 31, 2003. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2000. This examination commenced, with planning at the Office, on December 6, 2004, to December 10, 2004. The fieldwork commenced on December 13, 2004, and was concluded as of March 11, 2005. 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 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 (FAC), with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant (CPA) were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2003. Transactions subsequent to year-end 2003 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, 2000, along with resulting action taken by the Company in connection therewith.

Conflict of Interest

The Company failed to obtain conflict of interest statements from all officers and/or directors during 1998, 1999 and 2000. **<u>Resolution:</u> The Company obtained conflict of interest statements from all officers and/or directors during 2003 and 2004.**

Custodial Agreement

Merrill Lynch, a securities broker, did not meet the definition of custodian as provided by Rule 69O-143.041(2), FAC, which defines a custodian as a national bank, state bank or trust company. **<u>Resolution:</u> The Company terminated its custodial agreement with Merrill Lynch.**

Bonds

The Company erroneously reported market values obtained from Merrill Lynch for bonds where the NAIC SVO listed no market value. **<u>Resolution:</u> The Company's market values in bonds at December 31, 2003 were listed by the NAIC SVO.**

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), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2003:

Fire	Allied Lines
Homeowners Multi Peril	Commercial Multi Peril
Inland Marine	Other Liability
Commercial Automobile Liability	PPA Physical Damage
Commercial Auto Physical Damage	Fidelity
Surety	Glass
Burglary and Theft	Mobile Home Multi Peril
Mobile Home Physical Damage	Workers Compensation

The Company had not written insurance coverage for Auto Physical Damage and Fidelity during the last two years. In accordance with Section 624.430, FS, the Company is required to request to have these lines of insurance removed from its certificate of authority.

The articles of incorporation were amended on August 13, 2001 to increase the par value of capital stock from $4 per share to $6 per share.

The bylaws were not amended during the period covered by this examination.

Capital Stock

As of December 31, 2003, 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. (BAIS), who owned 100 percent of the stock issued by the Company. BAIS was 36% owned by Mr. & Mrs. John A. Weichel, 26% owned by Mr. Horace M. Johnson and 24% owned by the Strickland Insurance Group.

Profitability of Company

The following table shows the profitability trend (in dollars) of the Company for the period of examination.

	2001	2002	2003
Premiums Earned	$11,053,886	$13,768,410	$15,857,500
Net Underwriting Gain/(Loss)	(690,076)	(832,831)	142,401
Net Income/(Loss)	164,015	(76,182)	703,362
Total Assets	21,751,564	26,146,367	28,355,306
Total Liabilities	13,621,537	17,554,985	20,484,557
Surplus As Regards Policyholders	8,130,027	8,591,383	7,870,749

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, FS. Directors serving as of December 31, 2003, were:

Directors

Name and Location	**Principal Occupation**
David C. Cruikshank Bradenton, Florida	President and CEO Service Insurance Company
John A. Weichel, Sr. Bradenton, Florida	Chairman of the Board Service Insurance Company
Robert W. Strickland Goldsboro, North Carolina	Chairman and CEO Strickland Group
Horace M. Johnson, III Elon College, North Carolina	Vice President, Axiom Intermediaries
John A. Weichel, Jr. Bradenton, Florida	President Bradenton Insurance
Donald A. Scahill Bradenton, Florida	CFO Service Insurance Company

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

Senior Officers

Name	**Title**
David C. Cruikshank	President
Rosetta Waag	Secretary
Donald A. Scahill	CFO
Timothy N. Flynn	Vice President
Michael A. Gurley	Vice President
Carol A. Johnson	Vice President

Roger R. Trottier	Vice President
Ann B. Matras-Hamby	Vice President

The Company's board appointed several internal committees in accordance with Section 607.0825, FS. Following are the principal internal board committees and their members as of December 31, 2003:

Investment Committee	**Audit Committee**
John A. Weichel	David Cruikshank
David C. Cruikshank	J. Alden Weichel, Jr.
Donald A. Scahill	Horace M. Johnson III
	John Rzepinski

Conflict of Interest Procedure

The Company had adopted a policy statement requiring annual disclosure of conflicts of interest, in accordance with Section 607.0832, FS. No exceptions were noted during this examination period.

Corporate Records

The recorded minutes of the Shareholder, Board of Directors, and Investment and Audit Committee meetings were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

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

The Company had no acquisitions, mergers, disposals, dissolutions, and purchases or sales through reinsurance during the period covered by this examination.

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), FAC. The latest holding company registration statement was filed with the State of Florida on September 20, 2004, 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:

Management Agreement

Effective January 1, 2003, the Company entered into a management agreement with its parent, BAIS. Pursuant to the terms of the agreement, the parent received a yearly 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. The Company had no employees, and the directors and officers of the Company were shared with the parent company and it's other affiliated companies.

Managing General Agency Agreement

The Company entered into a managing general agency (MGA) agreement with its affiliate, Pillar Insurance Agency (PIA), a licensed MGA, effective January 1, 2002. The agreement provided PIA 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, FS. In return for these services, PIA received a 22% commission and a $25 per-policy fee.

Consolidated Tax Allocation Agreement

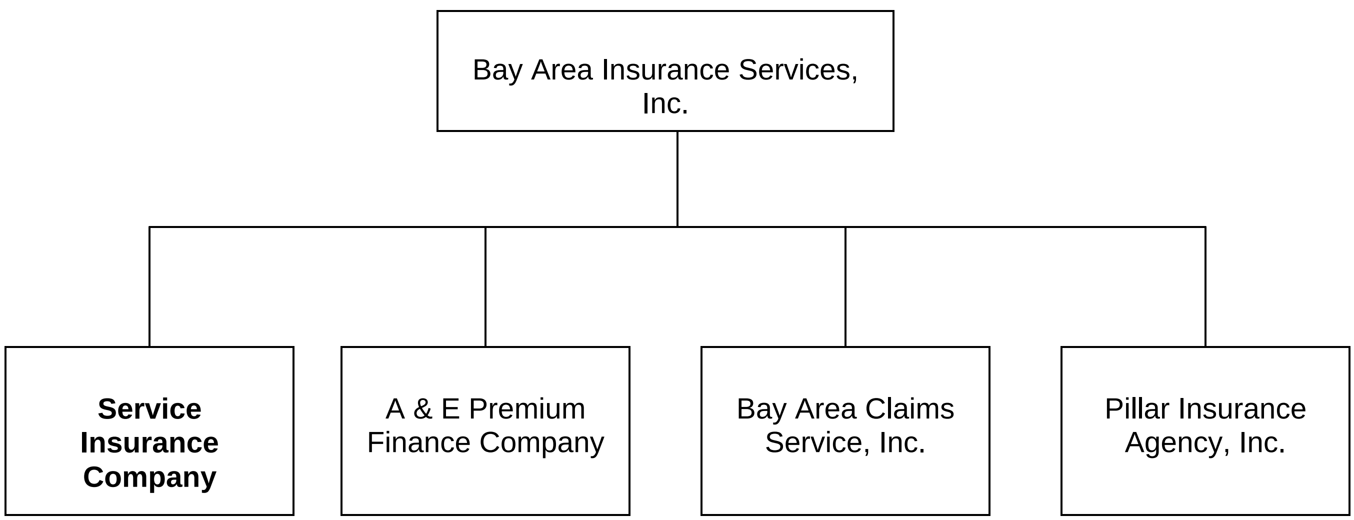
The Company, along with its parent and other affiliated companies, filed a consolidated federal income tax return. The agreement, effective January 1, 2003, provided that the allocation of taxes was based on the company's year-end profit/loss results. The Company was charged for its share of estimated taxes payable on a quarterly basis with a final adjustment made when the tax returns were filed.

Intercompany Expense Charge-back Agreement

The Company had agreements with affiliates, PIA and BAIS, 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.

A simplified organizational chart as of December 31, 2003, reflecting the holding company system, is shown below. Schedule Y of the Company's 2003 annual statement provided a list of all related companies of the holding company group.

SERVICE INSURANCE COMPANY
ORGANIZATIONAL CHART
DECEMBER 31, 2003



FIDELITY BOND AND OTHER INSURANCE

The Company, along with its parent and affiliates, maintained blanket employee dishonesty coverage in the amount of $450,000 with no deductible, which adequately covered the suggested minimum amount of coverage for the Company, its parent and affiliates as recommended by the NAIC.

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. The Company had no employees.

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 by law:

State	Description		Par Value	Market Value
FL	USTN, 7.500%,	11/15/16	$ 100,000	$ 127,313
FL	USTN, 5.500%	02/15/08	$ 500,000	$ 551,250
FL	USTN, 4.750%	11/15/08	$ 100,000	$ 107,063
FL	USTN, 6.000%	08/15/04	$ 125,000	$ 128,789
FL	USTN, 5.875%	11/15/05	$ 400,000	$ 430,376
FL	USTN, 3.250%	08/15/07	$ 50,000	$ 51,000
FL	USTN, 2.625%	11/15/06	$ 500,000	$ 501,879
FL	GMAC, 5.800%	06/15/06	$ 200,000	$ 200,000
FL	GMAC, 6.200%	03/09/05	$ 100,000	$ 100,000
FL	GM, 6.250%	05/01/05	$ 200,000	$ 209,062
FL	PM, 6.375%	02/01/06	$ 200,000	$ 212,230
FL	BA, 7.125%	05/12/05	$ 50,000	$ 50,073
Total Florida Deposits			$2,525,000	$2,669,035
GA	CD, 1.25%	01/07/03	$ 25,000	$ 25,000
IN	MM, 0.000%	00/00/00	$ 250,000	$ 250,000
NC	CNTY, 4.750%	06/01/09	$ 100,000	$ 103,029
NC	USTN, 2.625%	11/15/06	$ 200,000	$ 200,752
NM	Bond, 3.750%	07/01/10	$ 325,000	$ 339,215
NV	FedFM,5.750%	01/25/08	$ 200,000	$ 206,417
OR	Cnty, 4.375%	07/01/05	$ 200,000	$ 199,794
OR	Rev, 5.000%	10/01/06	$ 200,000	$ 205,290
OT	USTN, 0.987%	11/15/04	$ 62,000	$ 61,356
RI	FNMA, 6.000%	12/15/05	$ 200,000	$ 202,302
SC	USTN, 5.875%	02/15/04	$ 100,000	$ 100,594
SC	USTN, 6.250%	02/15/07	$ 100,000	$ 111,469
VA	USTN, 6.500%	05/15/05	$ 250,000	$ 267,187
Total Other Deposits			$2,212,000	$2,272,405
Total Special Deposits			$4,737,000	$4,941,440

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company assumed risk in the lines of flood, commercial multi-peril, and homeowners' multi-peril.

Territory

The Company was authorized to transact insurance in the following states, in accordance with Section 624.401(2), FS.

Alabama	Alaska	Arkansas	Colorado
Delaware	District of Columbia	Florida	Georgia
Indiana	Iowa	Kansas	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			

Treatment of Policyholders

The Company had established procedures for handling written complaints in accordance with Section 626.9541(1)(j), FS.

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

The reinsurance agreements reviewed were found to comply with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines. The reinsurance agreements covered catastrophic exposures as well as ordinary risks.

Assumed

The Company assumed a 2.5% risk of a commercial automobile quota share treaty from Republic Western Insurance Company (RWIC). RWIC had its certificate of authority suspended for financial impairment in Florida during year 2003. The Company terminated the assumed treaty with RWIC on January 1, 2004.

Ceded

The Company ceded risk on a quota share and excess of loss basis to authorized and unauthorized reinsurers. The primary reinsurers were National Flood Insurance Program, GE Reinsurance Corporation, Partners Reinsurance Company of the US, and Lloyds of London Syndicates, which were all authorized reinsurers. The Company also ceded to Partners Reinsurance Company LTD, an unauthorized reinsurer, along with ceding immaterial amounts to several other unauthorized 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 2001, 2002 and 2003, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, FAC.

The Company’s accounting records were maintained on a computerized system. The Company’s balance sheet accounts were verified with the line items of the annual statement submitted to the Office.

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

The Company and non-affiliates had the following agreements:

Managing General Agency Agreement

The Company had an MGA Agreement with West Point Underwriters, LLC (WPU) to market, underwrite, and administer mobile home homeowner programs. The agreement provided WPU with the exclusive authority to market, underwrite, and administer the Company's mobile home homeowner programs. WPU also had authority to negotiate the reinsurance on the mobile home homeowner programs, subject to the Company's approval.

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 had a custodial agreement with Regions Morgan Keegan Trust, which did not include all of the required provisions in accordance with Rule 69O-143.042, FAC. The agreement did not indemnify the insurance company for any loss of custodied securities occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft or mysterious disappearance, including loss by damage or destruction. The agreement also did not require the custodian to enter into an agreement with an agent it uses to gain entry in a clearing corporation which subjected the agent to the same liability for loss of custodied securities as the custodian.

Independent Auditor Agreement

The Company engaged Carter, Cartier, Melby & Guarino, CPA, PA to perform the audits of its 2003, 2002 and 2001 financial statements, as required by Section 624.424(8), FS, and Rule 69O-137.002, 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 December 31, 2003, 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, 2003

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	$18,628,779		$18,628,779
Stocks:			
Preferred	153,660		153,660
Common	1,558,704		1,558,704
Cash & Short-term investments	2,034,107		2,034,107
Investment income due and accrued	225,696		225,696
Agents' Balances:			
Uncollected premium	1,895,962		1,895,962
Deferred premium not due	2,310,150		2,310,150
Reinsurance:			
Recoverable from reinsurers	350,871	135,978	214,893
Other recoverable from reinsurers	455,095		455,095
Net deferred tax asset	856,443		856,443
Receivable from parent, subsidiaries & affiliates	21,817		21,817
Totals	$28,491,284	$135,978	$28,355,306

SERVICE INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2003

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses and loss adjustment expenses	$5,495,307	$2,100,000	$7,595,307
Reinsurance payable on paid loss & lae	86		86
Commissions payable	291,098		291,098
Other expenses	204,281		204,281
Taxes, licenses and fees	180,784		180,784
Unearned premiums	11,586,929		11,586,929
Ceded reinsurance premiums payable	404,330		404,330
Payable to parent, subsidiaries and affiliates	159,084		159,084
Payable for securities	62,658		62,658
Total Liabilities	$18,384,557	$2,100,000	$20,421,899
Common capital stock	$3,000,000		$3,000,000
Gross paid in and contributed surplus	3,346,697		3,346,697
Unassigned funds (surplus)	3,760,030	2,235,978	1,524,052
Surplus as regards policyholders	$10,106,727	$2,235,978	$7,870,749
Total liabilities, capital and surplus	$28,491,284	($135,978)	$28,355,306

SERVICE INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2003

Underwriting Income	
Premiums earned	$15,857,500
DEDUCTIONS:	
Losses incurred	6,339,366
Loss expenses incurred	2,051,716
Other underwriting expenses incurred	7,324,017
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	$15,715,099
Net underwriting gain or (loss)	$142,401
Investment Income	
Net investment income earned	$713,684
Net realized capital gains or (losses)	13,431
Net investment gain or (loss)	$727,115
Other Income	
Net gain or (loss) from agents' or premium balances charged off	$3,132
Finance and service charges not included in premiums	174,425
Aggregate write-ins for miscellaneous income	10,323
Total other income	$187,880
Net income before dividends to policyholders and before federal & foreign income taxes	$1,057,396
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	$1,057,396
Federal & foreign income taxes	354,034
Net Income	$703,362
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	$8,591,383
Gains and (Losses) in Surplus	
Net Income	$703,362
Net unrealized capital gains or losses	177,866
Change in net deferred income tax	86,598
Cumulative effect of changes in accounting principles	0
Change in nonadmitted assets	(206,908)
Surplus adjustments: paid in	754,426
Examination Adjustment	(2,235,978)
Change in surplus as regards policyholders for the year	($720,634)
Surplus as regards policyholders, December 31 current year	$7,870,749

COMMENTS ON FINANCIAL STATEMENTS

Assets

Reinsurance Recoverable from Reinsurers $214,893

The above amount was $135,978 less than the $350,871 reported by the Company. The reduction of the reinsurance recoverable amount was attributable to an error by the Company relating to the year 2002.

Liabilities

Losses and Loss Adjustment Expenses $7,595,307

The above amount was $2,100,000 more than the $5,495,307 reported by the Company. The Office actuary reviewed work papers provided by the Company and rendered an opinion that the amount of $7,595,307 was a more accurate provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

SERVICE INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS

DECEMBER 31, 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 December 31, 2003, Annual Statement				$10,106,727
	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
ASSETS:				
Reinsurance Recoverable	$ 350,871	$ 214,893	$ (135,978)	
LIABILITIES:				
Losses & Loss adj. Expenses	$5,495,307	$7,595,307	$ 2,100,000	
Net Change in Surplus:				(2,235,978)
Surplus as Regards Policyholders December 31, 2003, Per Examination				$7,870,749

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2000 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 December 31, 2003.

General

The Company had not written insurance coverage for Auto Physical Damage and Fidelity during the last two years. **It is recommended that the Company request to have these lines of insurance removed from its certificate of authority, in accordance with Section 624.430, FS. The Company should provide documentation requesting such to the Office within 90 days after the report is issued.**

Custodial Agreement

The Company had a custodial agreement with Regions Morgan Keegan Trust, which did not include certain requirements of Rule 69O-143.042, FAC. **It is recommended that the Company amend its custodial agreement with Regions Morgan Keegan Trust to include the requirements of Rule 69O-143.042, FAC. The Company is to provide documentation of compliance to the Office within 90 days after the report is issued.**

Reinsurance Recoverable from Reinsurers

The Company overstated reinsurance recoverable in the amount of $135,978 in the 2003 annual statement. **It is recommended that the Company correctly report this item in all future annual and quarterly statement filings.**

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. **It is recommended that the Company correctly report this item in all future annual and quarterly statement filings.**

SUBSEQUENT EVENT

During year 2004, the Company increased loss and loss adjustment expenses for insured events of prior years in the amount of $2,100,000. The Company also wrote off the overstated reinsurance recoverable of $135,978 in year 2004.

During 2004, four major hurricanes have impacted the insurance industry in the State of Florida. These hurricanes occurred subsequent to the period of this examination and may have affected the Company's financial position. This examination does not include any assessment of the potential impact on the Company of the hurricanes; however, based upon preliminary information, anticipated losses are not expected to result in regulatory violations.

CONCLUSION

The customary 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, 2003, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was $7,870,749, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Richard Shaffer, Financial Examiner/Analyst, Fred Tarnell, Financial Examiner/Analyst, John Berry, Financial Examiner/Analyst Supervisor and Joe Boor, FCAS, Office Actuary, participated in the examination.

Respectfully submitted,

____
Donna Letterio, CFE, CPA, MS
Financial Specialist
Florida Office of Insurance Regulation