

REPORT ON EXAMINATION
OF
STATE FARM FLORIDA INSURANCE
COMPANY
WINTER HAVEN, FLORIDA

AS OF
DECEMBER 31, 2004

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

March 3, 2006

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

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2004, of the financial condition and corporate affairs of:

**STATE FARM FLORIDA INSURANCE COMPANY
7401 CYPRESS GARDENS BOULEVARD
WINTER HAVEN, FLORIDA 33888**

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, 2002 through December 31, 2004. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2001. This examination commenced with planning at the Office on October 31, 2005, to November 4, 2005. The fieldwork commenced on November 7, 2005, and was concluded as of March 3, 2006. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This financial examination was a statutory financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

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

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report and 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, 2004. Transactions subsequent to year-end 2004 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, 2001, along with resulting action taken by the Company in connection therewith.

Consent Order to hold office, records and assets out of state

The Company's Consent Order with the Office was amended on November 30, 2001, to allow the Company to request permission to hold its office, records, and assets out of state. The Company was required to make the request annually. **Resolution:** The Company requested and received permission to maintain its accounts and records out of the State of Florida for the years 2002, 2003 and 2004.

Physically held assets out of state

The Company held six bonds, totaling \$20,362,429 in a vault at Mellon Bank in New York City. This was a violation of Section 628.271, Florida Statutes, which requires every domestic insurer to maintain its assets in the State of Florida. **Resolution:** The Company moved the bonds to a custodian in Florida on December 27, 2002.

HISTORY

General

The Company was incorporated in Florida on December 7, 1998 and commenced business on December 30, 1998 as State Farm Florida 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, 2004:

Homeowners Multi Peril	Medical Malpractice
Commercial Multi Peril	Earthquake
Inland Marine	Other Liability

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

Capital Stock

As of December 31, 2004, the Company's capitalization was as follows:

Number of authorized common capital shares	8,000,000
Number of shares issued and outstanding	6,075,000
Total common capital stock	\$516,375,000
Par value per share	\$85.00

Control of the Company was maintained by its parent, State Farm Mutual Automobile Insurance Company (parent) who owned 100 percent of the stock issued by 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 statement.

	2004	2003	2002
Premiums Earned	823,935,010	789,023,364	664,189,003
Net Underwriting Gain/(Loss)	(1,242,161,180)	65,574,849	(30,242,626)
Net Income	(771,252,906)	86,542,007	51,541,950
Total Assets	2,465,985,315	1,662,292,940	1,447,884,198
Total Liabilities	1,922,035,200	1,114,537,866	999,183,314
Surplus As Regards Policyholders	543,950,115	547,755,074	448,700,884

Dividends to Stockholders

The Company did not declare or pay dividends to its stockholder in 2002, 2003 or 2004.

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, 2004, were:

Directors

Name and Location

Principal Occupation

Brian V. Boyden
Bloomington, IL

Executive, State Farm Companies

Harold D. Covey
Windermere, FL

Retired State Farm Executive

Joseph P. Formusa
Tampa, FL

State Farm Executive

Adam W. Herbert, Jr.
Bloomington, IN

President, Indiana University

Leon C. Maxwell
Colleyville, TX

Retired State Farm Executive

Laura P. Sullivan
Bloomington, IL

Retired State Farm Executive

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

Senior Officers

Name	Title
Joseph P. Formusa	President & CEO
Kim M. Brunner	Vice President, Secretary, & General Counsel
John J. Killian	Vice President & Treasurer

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, 2004:

Executive Committee	Audit Committee*	Investment Committee
Joseph Formusa ¹	Gerald M. Czarnecki ¹	Joseph Formusa ¹
Laura Sullivan	Susan Phillips	Laura Sullivan
Brian Boyden	John D. Zeglis	Brian Boyden

¹ Chairman

*The Company did not maintain an audit committee. The audit committee of its parent was utilized, which was in compliance with Section 624.424 (8), Florida Statutes.

Conflict of Interest Procedure

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

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 in accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

Surplus Debentures

The Company issued two surplus debentures to its parent in 2004. One surplus note was in the amount of \$250 Million and the other surplus note was in the amount of \$500 Million.

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 April 27, 2004, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

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

Short-term Investment Pooling Agreement

The parent, along with some of its affiliates and the Company, created a limited liability company under the name State Farm Liquidity Pool, LLC, so that each affiliated company may participate as a member in a short-term investment pool. The pool reduced the need for transactions between affiliates and reduced transaction costs.

Operating Agreement – Liquidity Pool

The Company, and other affiliate members of the State Farm Liquidity Pool, LLC, had an agreement to transact all lawful business related to participation in permitted investments as specified in the pooling agreement in accordance with applicable laws, providing all necessary and appropriate financial and administrative services and support for such activities and other powers as necessary.

Federal Income Tax Allocation Agreement

The Company and its affiliates had an agreement to file a consolidated federal income tax return and allocate the total consolidated federal income tax liability in accordance with Section 1552(a)(2) of the Internal Revenue Code.

Florida Corporate Income Tax Allocation Agreement

The Company and its affiliates had an agreement to file a consolidated Florida corporation income tax return. The total Florida income tax was allocated as follows: the estimated annual individual company income tax was divided by the sum of all the estimated annual combined company income taxes.

Illinois Insurance Corporation Income Tax Allocation Agreement

The Company and its affiliates had an agreement to file a combined Illinois corporation income tax return as part of an Illinois unitary business group that apportioned Illinois base income according to insurance premiums. The total tax was allocated as follows: the estimated annual individual company income tax was divided by the sum of all the estimated annual combined company income taxes. The Company was party to the agreement for the purpose of the tax computation.

New York Franchise Tax Allocation Agreement

The Company and its affiliates had an agreement to file a combined New York franchise tax return and a combined New York Metropolitan Transportation Business Tax Surcharge Return. The total tax was allocated to each corporation based upon the ratio of each corporation's taxable New York premiums to the sum of all of the taxable New York premiums. The Company was party to the agreement for the purpose of the tax computation.

Trainee Agent Cost Allocation Agreement

The Company and its parent had an agreement which itemized the cost and value of services rendered by the parent to the Company for the compensation of trainee agents. The parent provided for the developmental financing costs and compensation of the trainee agents selling and servicing State Farm products under the provision of the applicable trainee agents agreement between the parent and the trainee agents. The Company agreed to pay the parent an amount equal to all compensation of trainee agents with respect to the Company's business which would have been paid these agents as if they were non-trainee agents.

Affiliate Service Agreement

The Company and its parent had an agreement whereby the parent renders the following services and provide facilities for the Company to the extent not provided by the Company itself or other service agents: underwriting services, policy issuing and billing services, auditing and record keeping, preparation of reports to governmental agencies, collection of premiums, provision of policies and other printed supplies, and office space and accommodations, etc. The Company agreed to reimburse all reasonable expenses incurred and allocated by the parent to the performance and provision of such services and facilities on an equitable and reasonable basis in conformity with customary insurance accounting principles consistently applied. The Company also had an affiliate service agreement with State Farm Fire and Casualty Company and another service agreement with State Farm Fire and Casualty Company, State Farm Mutual, and State Farm General Company, all of whom are affiliates.

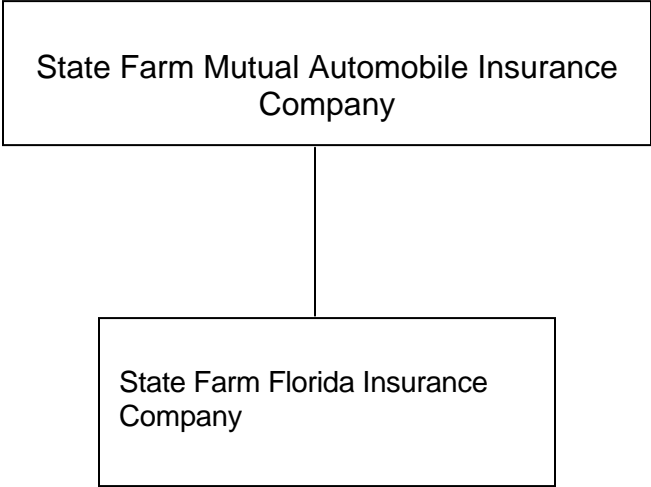
Common Clearing Account Agreement

The Company and its affiliates had an agreement where the companies implemented a comprehensive cash balance system whereby premium payments and other cash receipts were deposited into one or more deposit clearing accounts pending transmittal by electronic funds transfer to the operating bank account of the Company to whom the funds belong. The companies also implemented a comprehensive cash disbursement system whereby disbursements were processed through one or more common disbursement clearing accounts. The operating bank account of the Company on whose behalf the disbursement was made was adjusted accordingly.

A simplified organizational chart as of December 31, 2004, reflecting the holding company system, is shown below. Schedule Y of the Company's 2004 annual statement provided a list of all related companies of the holding company group.

**STATE FARM FLORIDA INSURANCE COMPANY
ORGANIZATIONAL CHART**

DECEMBER 31, 2004



FIDELITY BOND

The Company and its affiliates maintained fidelity bond coverage of \$5,000,000 with a deductible of \$500,000 which adequately covered the suggested minimum amount of coverage for the Company and its affiliates as recommended by the NAIC.

PENSION PLANS

The Company participated in a qualified defined benefit pension plan which covered all employees. Pension costs were allocated among participating companies based on plan provisions.

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, 6.125%, 08/15/07	<u>\$2,750,000</u>	<u>\$2,951,300</u>
	TOTAL FLORIDA DEPOSITS	<u>\$2,750,000</u>	<u>\$2,951,300</u>
	TOTAL SPECIAL DEPOSITS	<u>\$2,750,000</u>	<u>\$2,951,300</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

The Company did not have any other insurance policies.

Territory

The Company was authorized to transact insurance in the States of Florida and Illinois. Although licensed in Illinois, it only wrote insurance in the State of Florida.

Treatment of Policyholders

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

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

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.

Assumed

The Company did not assume any risk during the period of this examination.

Ceded

The Company had a property reinsurance program to protect the loss impact of large single risks. General Reinsurance Corporation reinsured the Company for property coverage for

commercial property risks exceeding \$1 Million and for homeowners' risks exceeding \$1.5 Million, to a maximum of \$25 Million on each risk. Loss recoveries for a single occurrence were limited to 120% of the previous contract year's gross ceded premium. Pursuant to this agreement, 65.655% of each risk was ceded to General Reinsurance Corporation.

Hartford Steam Boiler Inspection and Insurance Company reinsured 100% of the boiler and machinery risks. Personal and commercial umbrella exposures greater than \$5 Million up to \$10 Million were reinsured through State Farm Fire and Casualty Company and exposures in excess of \$10 Million were reinsured through General Reinsurance Corporation.

The Company had excess of loss reinsurance agreements with the parent and other external reinsurers to manage the catastrophe exposure within the Company. The agreements provided \$5.8 Billion of coverage for loss occurrences. The Company retained the first \$200 Million. The parent company would 100% reinsure the next \$412 Million exceeding \$200 Million up to \$612 Million. After the \$612 Million threshold, the parent reinsured 100% of \$230 Million, and the Florida Hurricane Catastrophe Fund reinsured \$2.068 Billion. The parent company reinsured 90% of 2.89 Billion and several other authorized reinsurers had the remaining 10% of \$2.89 Billion above the \$2.91 Billion threshold. This provided the Company coverage up to \$5.8 Billion in catastrophe excess reinsurance.

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 2002, 2003 and 2004, 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.

Although the Company maintained its principal operational offices in Winter Haven, Florida this examination was conducted in Bloomington, Illinois at the corporate headquarters. The Company had a consent order with the Office which required the Company to maintain its records in the State of Florida. This order was amended on November 30, 2001, to allow the Company to request permission on an annual basis to hold its office, records, and assets out of state. Requests were granted to the Company for the years 2002, 2003 and 2004.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company had a custody agreement with Mellon Trust of Florida, N.A., dated December 10, 1998 for the safekeeping of its securities at December 31, 2004. This agreement was not in compliance with Rule 69O-143.042 (2) (o), Florida Administrative Code. Additionally, the Company did not submit a copy of the agreement to the Office. The Company was required to submit a copy of custodial agreements to the Office in accordance with Section 625.55(3), Florida Statutes.

Independent Auditor Agreement

The Company engaged PriceWaterhouseCoopers LLP, for the purpose of auditing and reporting on the statutory financial statements of the Company.

Risk-Based Capital

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

Information Technology (IT) Report

The Company did not have an information technology examination performed during the period of this examination.

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2004, 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."

STATE FARM FLORIDA INSURANCE COMPANY
Assets
DECEMBER 31, 2004

Assets	Per Company	Examination Adjustments	Per Examination
Bonds	\$1,641,034,693		\$1,641,034,693
Cash			
On hand	(59,949)		(59,949)
On deposit	66,157,605		66,157,605
Short-term investments	1,898,173		1,898,173
Receivable for securities	166,534		166,534
Investment income due and accrued	21,988,402		21,988,402
Agents balances			
Uncollected premiums	26,958,588		26,958,588
Deferred premiums	171,206,990		171,206,990
Amounts recoverable from reinsurers	73,185,477		73,185,477
Federal income tax recoverable	393,691,130		393,691,130
Net deferred tax asset	69,321,109		69,321,109
Receivable from parent, subsidiaries and affiliates	239		239
Aggregate write-ins for other than invested assets	436,323		436,323
Total Assets	<u>\$2,465,985,314</u>	<u>\$0</u>	<u>\$2,465,985,314</u>

STATE FARM FLORIDA INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2004

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$618,744,782		\$618,744,782
Loss adjustment expenses	148,087,063		148,087,063
Other expenses	163,784,928		163,784,928
Taxes, licenses and fees	3,814,566		3,814,566
Borrowed money	9,493,151		9,493,151
Unearned premium	585,507,009		585,507,009
Advance premiums	94,633,939		94,633,939
Ceded reinsurance premiums payable	10,482,549		10,482,549
Amounts withheld	756,553		756,553
Remittances and items not allocated	4,396,795		4,396,795
Drafts outstanding	226,400,220		226,400,220
Payable to parent, subsidiaries and affiliates	54,312,059		54,312,059
Payable for securities	1,531,460		1,531,460
Aggregate write-ins for liabilities	<u>90,127</u>		<u>90,127</u>
Total Liabilities	\$1,922,035,201		\$1,922,035,201
Common capital stock	\$516,375,000		\$516,375,000
Surplus notes	750,000,000		750,000,000
Gross paid in and contributed surplus	91,125,000		91,125,000
Unassigned funds (surplus)	<u>(813,549,885)</u>		<u>(813,549,885)</u>
Surplus as regards policyholders	<u>\$543,950,115</u>		<u>\$543,950,115</u>
Total liabilities, capital and surplus	<u>\$2,465,985,316</u>	<u>\$0</u>	<u>\$2,465,985,316</u>

STATE FARM FLORIDA INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2004

Underwriting Income

Premiums earned	\$823,935,010
DEDUCTIONS:	
Losses incurred	\$1,458,653,958
Loss expenses incurred	321,286,399
Other underwriting expenses incurred	286,155,833
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$2,066,096,190</u>
Net underwriting gain or (loss)	(\$1,242,161,180)

Investment Income

Net investment income earned	\$70,208,544
Net realized capital gains or (losses)	1,478,625
Net investment gain or (loss)	<u>\$71,687,169</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off	(\$67,701)
Finance and service charges not included in premiums	3,603,104
Aggregate write-ins for miscellaneous income	(27,630)
Total other income	<u>\$3,507,773</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$1,166,966,238)
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$1,166,966,238)
Federal & foreign income taxes	<u>(395,713,333)</u>
Net Income	(\$771,252,905)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$547,755,074
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Gains and (Losses) in Surplus

Net Income	(\$771,252,906)
Net unrealized capital gains or losses	(15,137)
Change in non-admitted assets	(2,409,931)
Change in provision for reinsurance	0
Change in net deferred taxes	19,873,015
Change in Surplus Notes	750,000,000
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>(\$3,804,959)</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$543,950,115</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses

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, 2004, 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 actuary reviewed work papers provided by the Company and was in concurrence with this opinion.

**STATE FARM FLORIDA INSURANCE COMPANY
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS**

DECEMBER 31, 2004

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, 2004, Annual Statement	\$543,950,115
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment			
LIABILITIES:			
No adjustment			
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2004, Per Examination			\$543,950,115

SUMMARY OF FINDINGS

Compliance with previous directives

The Company has taken the necessary actions to comply with the comments made in the 2001 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, 2004.

General

The Company's custodial agreement did not meet the requirements of Rule 69O-143.042, (2)(o) Florida Administrative Code. **We recommend that the Company amend its custodial agreement to comply with Rule 69O-143.042, (2)(o), Florida Administrative Code.**

The Company did not submit a copy of its custodial agreement to the Office. **We recommend that the Company submit a copy of its custodial agreement to the Office in accordance with Section 625.55 (3), Florida Statutes.**

SUBSEQUENT EVENTS

Changes have been made to the management of the Company subsequent to the examination date. The following is a listing of directors and officers serving as of February 27, 2006.

Joseph P. Formusa	President & CEO
Kim M. Brunner	Vice President, Secretary, and General Counsel
John J. Killian	Vice President, Treasurer
Richard C. Cain	Vice President, Operations
Dale R. Egeberg	VP & Controller
Cheryl R. Herrin	Operations Vice President
George G. King	Vice President, Agency
Kathleen M. Pechan	VP and Actuary
Rickey K. Wilson	Vice President, Operations
Barbara R. Carr	Vice President, Agency
Charles R. Gomez	Vice President, Agency
Susan Q. Hood	Vice President, Claims
Roderick M. Matthews	Underwriting Vice President
Clarence M. Poston	Agency Vice President

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **State Farm Florida Insurance Company** as of December 31, 2004, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$543,950,115 which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Michael Hampton, CPA, CFE, DABFA, CFE, CPM, Financial Examiner/Analyst Supervisor and Joe Boor, FCAS, Office Actuary participated in the examination.

Respectfully submitted,

Maurice Fuller
Financial Examiner/Analyst II
Florida Office of Insurance Regulation