

REPORT ON EXAMINATION
OF
TOWER HILL PREFERRED INSURANCE
COMPANY
GAINESVILLE, FLORIDA

AS OF
DECEMBER 31, 2004

BY THE
OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

March 31, 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:

TOWER HILL PREFERRED INSURANCE COMPANY
7201 N.W. 11th Place
Gainesville, Florida 32605

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, 2004. The Company redomesticated from North Carolina on January 13, 2004 and the prior examination as of December 31, 2000, was performed by the North Carolina Department of Insurance. This examination commenced with planning at the Office, on August 29, 2005, to August 31, 2005. The fieldwork commenced on December 27, 2005, and was concluded as of March 31, 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, 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, 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.

HISTORY

General

The Company is a domestic insurer that was licensed to write insurance in four states. It incorporated on November 26, 1986 and commenced writing business on January 1, 1987 as Regency Insurance Company, domiciled in North Carolina. The certificate of domestication and articles of incorporation were approved effective January 13, 2004, upon transfer of domicile from the State of North Carolina to the State of Florida. A name change from Regency Insurance Company to Tower Hill Preferred Insurance Company was filed and approved on March 19, 2004. The Company has written business only in the State of Florida since the end of 2003. The Company primarily wrote insurance coverage for Fire, Allied Lines, Private Passenger Auto Liability, Mobile Home Physical Damage Homeowners Multi-Peril, Mobile Home Multi-Peril, Inland Marine, Other Liability, and Private Passenger Automobile Physical Damage.

The Company's current A.M. Best rating is A- and it has a "NR" rating by Standard & Poors.

Capital Stock

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

Number of authorized common capital shares	100,000
Number of shares issued and outstanding	100,000
Total common capital stock	100,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, Tomoka Re Holdings, Inc. (Tomoka), who owned 100% of the stock issued by the Company. Tomoka was 100% owned by William J. Shively.

Profitability of Company

The following table shows the probability trend (in dollars) of the Company for the period of examination, as reported in the filed annual statement of the Company.

	2004	2003	2002	2001
Premiums Earned	18,821,148	20,957,615	15,150,892	6,654,820
Net Underwriting Gain/(Loss)	(4,734,453)	3,064,628	(3,136,764)	341,554
Net Income	(2,243,838)	2,385,254	(2,765,935)	599,089
Total Assets	50,695,458	43,625,993	31,250,942	23,187,520
Total Liabilities	36,978,031	30,301,242	20,168,651	13,212,724
Surplus As Regards Policyholders	13,717,427	13,324,751	11,082,291	9,974,796

Dividends to Policyholders

There were no dividends to policyholders reported by the Company during the period of examination.

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2004, were:

Directors

Name and Location	Principal Occupation
William John Shively, Chairman Gainesville, FL	Tower Hill Insurance Group
Phillip Martin Thomasson Gainesville, FL	Tower Hill Insurance Group
Donald Carl Matz, Jr. Gainesville, FL	Tower Hill Insurance Group
Jonathan Brent Palmquist Gainesville, FL	Tower Hill Insurance Group
Brian Thomas Sheekey Gainesville, FL	Tower Hill Insurance Group

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

Senior Officers

Name	Title
Phillip Martin Thomasson	President
Jonathan Brent Palmquist	Secretary
Brian Thomas Sheekey	Treasurer
William John Shively	CEO
Donald Carl Matz, Jr.	COO

The Company's board appointed an audit committee in accordance with Section 607.0825, Florida Statutes, as follows:

Audit Committee

Phillip Martin Thomasson, Chairman

Donald Carl Matz, Jr.

William John Shively

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 shareholders, Board of Directors and audit committee meeting 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.

The minutes of the board of directors recorded that the board established an audit committee as provided by Section 624.424(8)(c), Florida Statutes, and approved the Company's investments as required by Section 625.304, Florida Statutes.

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

There were no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance during the period under examination.

Surplus Debentures

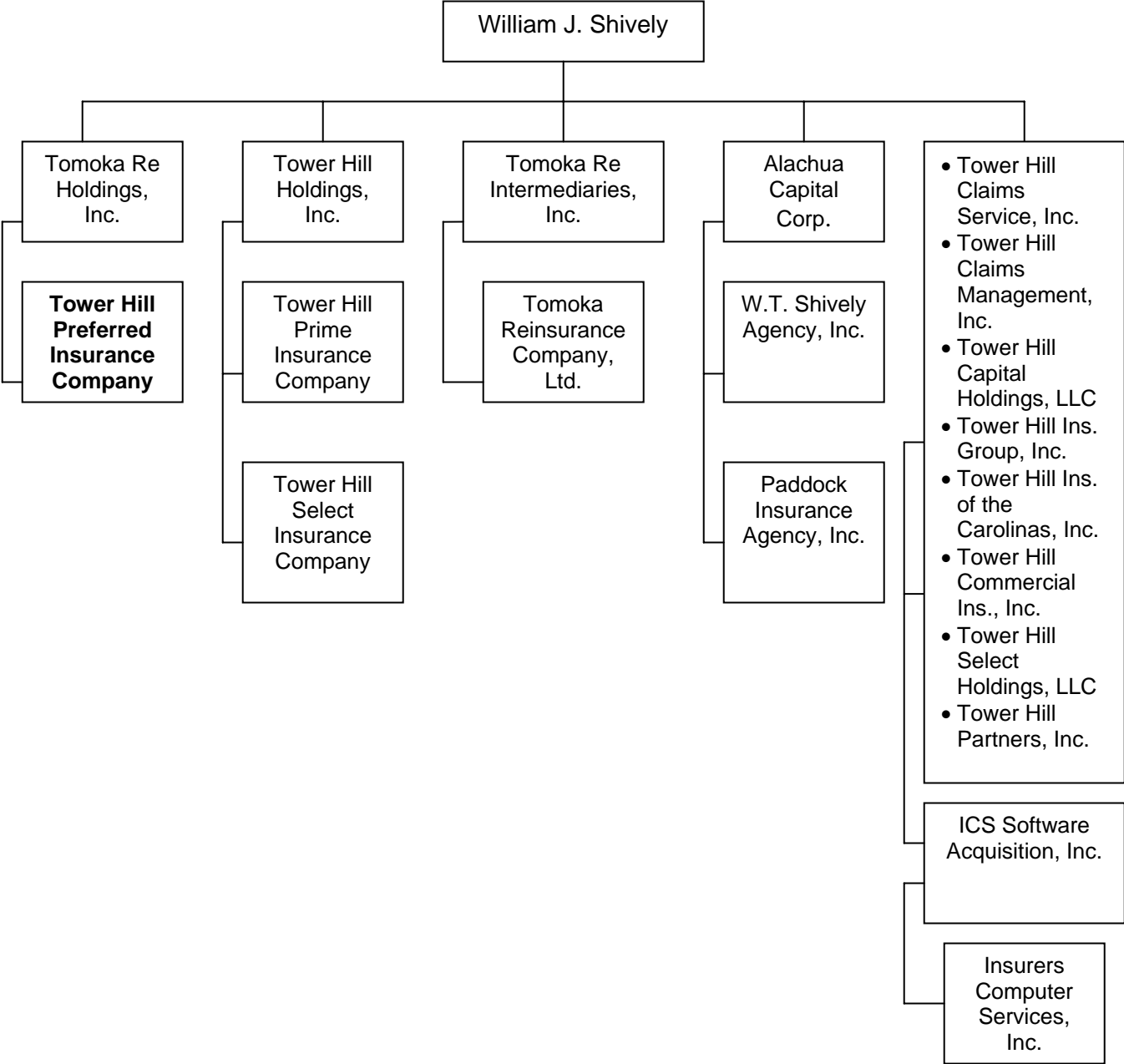
As of December 31, 2004, there were no outstanding surplus debentures of the Company.

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 November 29, 2004, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

An 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.

**TOWER HILL PREFERRED INSURANCE COMPANY
ORGANIZATIONAL CHART
DECEMBER 31, 2004**



FIDELITY BOND

The Company maintained fidelity bond coverage of \$3,100,000 with a \$50,000 deductible per occurrence. The Company was a named insured on the fidelity bond and included all companies owned by William J. Shively. Considering the financial information of all companies, this policy adequately covered the \$1,000,000 suggested minimum amount of coverage for the Company recommended by the NAIC.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no employees and therefore had no pension, stock ownership or insurance plans.

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	Cash	<u>\$ 350,000</u>	<u>\$ 350,000</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 350,000</u>	<u>\$ 350,000</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

The Company was licensed to transact insurance coverage in the following states:

Florida Mississippi North Carolina South Carolina

The business plan of the Company was to concentrate primarily on writing insurance in the State of Florida.

Treatment of Policyholders

The Company established procedures for handling written complaints and maintained a record of all complaints received in accordance with Section 626.9541(1) (j), Florida Statutes.

The claims services company, Tower Hill Claims Services, Inc., maintained a claims procedure manual that included detailed procedures for handling both property and liability claims.

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 assumed private passenger automobile insurance from AXA Re Property and Casualty Insurance Company and mobile home insurance from Omega Insurance Company, during the period covered by this examination. The assumed business was not impacted by the 2004 hurricane experience in Florida. The reinsurance agreement covering the property exposure with Omega Insurance Company was terminated prior to the first hurricane.

Ceded

The Company ceded risk on both a quota share and an excess basis. The cash flow analysis performed on the quota share agreement indicated that there was transfer of risk within the terms of the reinsurance contract.

The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion.

ACCOUNTS AND RECORDS

KPMG, an independent CPA firm, audited the Company's statutory basis financial statements annually for all years under review, in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

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

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

The Company and non-affiliates had the following agreements in place at December 31, 2004:

Tax Allocation Agreement

The Company, along with its parent, filed a consolidated federal income tax return. The Company was party to consolidated tax agreement which met the requirements of SSAP No. 10. The tax return was prepared as if each individual corporation filed a separate return, based on income, losses, deductions and credits of each corporation. Tax payments by the Company were made to the parent.

Managing General Agency Agreement

The managing general agency (MGA) agreement was with Tower Hill Insurance Group, Inc. (THIG), the MGA. The agreement included the management and direct oversight of the production of business for the underwriting and policy administration functions. Additionally, THIG facilitated the payment of claims and other various accounting, reporting and administrative functions.

Claims Services Agreement

The claims services agreement was with Tower Hill Claims Service, Inc. (THCS). The agreement included the management, adjustment, payment requests and other various claims administrative duties as necessary, other than those services administered by the MGA.

Managing Services Agreement

The management services agreement was with Tomoka. The agreement included the coordination of the activities of the Company, development of corporate plans, legal counsel, executive management, internal auditing management, contract negotiation/approval and other such services as deemed necessary.

Tax Sharing Agreement

The tax sharing agreement was with Tomoka. The agreement stipulated that the parent file a consolidated federal income tax return and pay any taxes, including interest, penalties and/or additions to taxes on behalf of the holding Company. The tax amount paid by the Company to the parent shall be equal to the amount the Company would have paid had the Company filed an independent tax return.

Custodial Agreement

The Company's custodial agreement did not contain all the required terms of Rule 69O-143.042(2), Florida Administrative Code. The following terms are required in the agreement and are referenced by the appropriate subsection of the Rule:

- (a) Certificated securities held by the custodian shall be held either separate from the securities of the custodian or in a fungible bulk of securities
- (d) Custodied securities shall be held subject to the instruction of the Company and shall withdrawable upon the demand of the Company, except that custodied securities used to meet the deposit requirements of the State shall be under the control of the Director and not be withdrawn by the Company without the approval of the Director
- (g) During the course of the custodian's regular business hours, any representative of the Company or an appropriate regulatory body shall be entitled to examine the custodian records relating to the custodied securities
- (h) Upon request, the custodian shall send to the Company all reports received from a clearing corporation or the Federal Reserve book-entry system
- (i) The custodian shall maintain sufficient records to determine and verify information relating to the custody securities
- (k) The custodian shall be obligated to indemnify the Company for any loss of custody securities
- (l) In the event of (k) above, the custodian shall promptly replace the securities or the value thereof and the value of any loss of rights or privileges resulting from said loss of securities
- (m) The agreement may provide that the custodian will not be liable for any failure to take any action required to be taken under the agreement in the event that such action is prevented or delayed by causes beyond its reasonable control

In addition to the terms required above, the agreement should be amended to update the current names of the parties to the custodial agreement. The agreement on file specified the former names of First Union Bank and Regency Insurance Company, rather than the current names of Wachovia Bank and Tower Hill Preferred Insurance Company.

Risk-Based Capital

Risk-based capital was reported by the Company at an adequate level.

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."

TOWER HILL PREFERRED INSURANCE COMPANY
Assets

DECEMBER 31, 2004

Classification	Per Company	Adjustments	Per Examination
Bonds & Stock	\$ 9,007,249		\$ 9,007,249
Cash & Short-term investments	678,330		678,330
Investment income due and accrued	87,400		87,400
Agents' balances in the course of collection	22,126,454		22,126,454
Reinsurance recoverable	10,628,234		10,628,234
Funds held by or deposited with reinsured companies	4,905,392		4,905,392
Current federal & foreign income tax recoverable	1,600,000		1,600,000
Net deferred tax asset	1,602,400		1,602,400
Aggregate write-ins for other than invested assets	59,999		59,999
Totals	<u>\$ 50,695,458</u>		<u>\$ 50,695,458</u>

TOWER HILL PREFERRED INSURANCE COMPANY
Liabilities, Surplus and Other Funds

DECEMBER 31, 2004

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$ 7,776,706		\$ 7,776,706
Reinsurance payable	966,777		966,777
Loss adjustment expenses	540,027		540,027
Other expenses	95,129		95,129
Taxes, licenses, and fees	547,160		547,160
Unearned premiums	8,835,585		8,835,585
Ceded reinsurance premiums payable	10,190,464		10,190,464
Funds held by company under reinsurance treaties	7,861,137		7,861,137
Amounts withheld or retained by company for account of others	35,525		35,525
Payable to parent, subsidiaries and affiliates	<u>129,521</u>		<u>129,521</u>
Total liabilities	\$ 36,978,031		\$ 36,978,031
Common capital stock	\$ 100,000		\$ 100,000
Gross paid in and contributed surplus	12,768,328		12,768,328
Unassigned surplus	849,099		849,099
Surplus as regards policyholders	<u>13,717,427</u>		<u>13,717,427</u>
Total liabilities, capital and surplus	<u>\$ 50,695,458</u>		<u>\$ 50,695,458</u>

TOWER HILL PREFERRED INSURANCE COMPANY
Statement of Income

DECEMBER 31, 2004

Underwriting Income

Premiums earned	\$18,821,148
DEDUCTIONS:	
Losses incurred	21,830,267
Loss expenses incurred	2,333,372
Other underwriting expenses incurred	(608,038)
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$23,555,601</u>
Net underwriting gain or (loss)	(\$4,734,453)

Investment Income

Net investment income earned	\$454,893
Net realized capital gains or (losses)	456
Net investment gain or (loss)	<u>\$455,349</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$0
Aggregate write-ins for miscellaneous income	90,191
Total other income	<u>\$90,191</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$4,188,913)
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$4,188,913)
Federal & foreign income taxes	<u>(1,945,075)</u>
Net Income	(\$2,243,838)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$13,324,751
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Gains and (Losses) in Surplus

Net Income	(\$2,243,838)
Change in net deferred income tax	(376,900)
Change in non-admitted assets	13,414
Capital changes: Paid in	(1,700,000)
Surplus adjustments: Paid in	3,000,000
Surplus adjustments: Transferred from capital	1,700,000
Examination Adjustment	<u>0</u>
Change in surplus as regards policyholders for the year	<u>\$392,676</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$13,717,427</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses

\$8,316,733

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, make a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

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

**TOWER HILL PREFERRED 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	\$13,717,427
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:	No adjustments needed		
LIABILITIES:	No adjustments needed		
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2004, Per Examination			\$13,717,427

SUMMARY OF FINDINGS

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.

Custodial Agreement

The custodial agreement between First Union Bank (now Wachovia Bank) and Regency Insurance Company (now Tower Hill Preferred Insurance Company) was not in compliance with Rule 69O-143.042 (2), (a)(d)(g)(h)(i)(k)(l) and (m), Florida Administrative Code.

SUBSEQUENT EVENTS

In early 2006, two board members, Jonathan B. Palmquist and Brian T. Sheekey, resigned.

The net effect of four hurricanes in 2005 (Dennis, Katrina, Rita & Wilma) decreased Surplus by approximately \$3M. However, this negative impact was more than offset by Paid-in Surplus of \$9M, which, along with other changes, effectively increased the 2005 Surplus by approximately \$5.4M.

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Tower Hill Preferred Insurance Company, Inc.** 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 \$13,717,427, which was in compliance with Section 624.408, Florida Statutes.

In addition to the undersigned, Stephen Feliu, Financial Examiner/Analyst II; John C. Berry, Financial Examiner/Analyst Supervisor; and Joseph Boor, FCAS, Actuary, participated in the examination.

Respectfully submitted,

Richard A. Shaffer
Financial Examiner/Analyst II
Florida Office of Insurance Regulation