

REPORT ON EXAMINATION

OF

UNITED PROPERTY & CASUALTY

INSURANCE COMPANY

ST. PETERSBURG, FLORIDA

AS OF

DECEMBER 31, 2004

BY THE

OFFICE OF INSURANCE REGULATION

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Tallahassee, Florida

June 17, 2005

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 (FS), 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:

**UNITED PROPERTY & CASUALTY INSURANCE COMPANY
700 CENTRAL AVENUE, SUITE 302
ST. PETERSBURG, FLORIDA 33701**

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 March 30, 2005 through April 1, 2005. The fieldwork commenced on April 4, 2005, and was concluded as of June 17, 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 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 (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 and the A.M. Best Report 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 was confined to financial statements and comments on matters that involved departures from laws, regulations or rules, or which were 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.

Custodial Agreement

The Company's custodial agreement failed to include a required clause to be in compliance with Rule 69O-143.042, FAC.

Resolution: The Company provided an amended custodial agreement on June 14, 2005, in compliance with Rule 69O-143.042(2) (n), FAC.

Affiliated Parties

The Company was not reporting all payments to affiliates on Schedule Y, Part 2 of their annual statement.

Resolution: Pursuant to the Annual Statement as of December 31, 2004, the Company reported all affiliated payments in Schedule Y, Part 2; however, the Company identified the wrong affiliated

party in one instance. This error was corrected by the filing of an amendment to the 2004 annual statement.

Accrued Liabilities

At December 31, 2001, the Company failed to accrue liabilities for advance premiums, unclaimed property, and premium taxes, as required by Section 625.041, FS.

Resolution: Beginning with the June 30, 2005 quarterly statement, the Company had a liability accrued for advance premiums, as well as the other necessary accrued liabilities.

MGA

The Company made an advance to their affiliated Managing General Agent (MGA) without prior approval of the Office.

Resolution: The Company's MGA repaid the advance to the Company.

HISTORY

General

The Company was incorporated in Florida on February 25, 1999 and commenced business on April 2, 1999 as United Property & Casualty Insurance Company, Inc.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following types of insurance coverage in Florida on December 31, 2004:

Homeowners Multi Peril
Commercial Multi Peril
Inland Marine

Fire
Commercial Auto Physical Damage
Allied Lines

The Company has not written Commercial Multi Peril and Commercial Auto Physical Damage in over a year. The Company was licensed for Commercial Multi-Peril and Commercial Auto Physical Damage on July 25, 2003. However, the Company did not have all the lines necessary to write its new programs. The Company obtained the additional lines of Commercial Auto Liability and Other Liability on March 28, 2005 and plans to write these lines in 2005.

The Company, pursuant to Consent Order, Case 71231-03-CO, dated December 3, 2003, removed selected policies from Citizens Property Insurance Company (Citizens). The Company submitted a plan for the removal of up to 50,000 policies from Citizens at specific intervals. The plan was approved by Citizens by September 30, 2003. Initially, the Company assumed 23,000 policies. In 2004, the Company assumed 40,295 policies from Citizens.

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	1,000
Number of shares issued and outstanding	1,000
Total common capital stock	\$10,000
Par value per share	\$10.00

Control of the Company was maintained by its parent, United Insurance Holdings, LC (UIH), 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.

	2002	2003	2004
Premiums Earned	20,230,685	19,810,681	56,652,691
Net Underwriting Gain/(Loss)	1,263,215	329,190	(2,531,616)
Net Income/(Loss)	2,027,825	1,470,411	(2,634,408)
Total Assets	31,728,472	22,744,684	68,122,184
Total Liabilities	23,737,959	18,069,605	55,522,689
Surplus As Regards Policyholders	7,990,512	9,690,862	12,599,495

Dividends to Stockholders

In accordance with Section 628.371, FS, the Company neither declared nor paid dividends to its stockholder in 2004.

Management

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

Directors

Name and Location

Mark Steven Berset
St. Petersburg, Florida

Principal Occupation

Comegys Insurance Corner

William Hall Hood III Clearwater, Florida	Special Data Processing, CEO
Donald Jeffrey Cronin Bradenton, Florida	President/Treasurer, United P&C United Insurance Management
Gregory Crosswell Branch Ocala, Florida	Chairman Seminole Feed, CEO
Ian Fredick Irwin St. Petersburg, Florida	Southeast Companies, CEO
Patrick Timothy Delacey Lagrange, Illinois	Raymond James & Associates Managing Director
Alec Loyd Poitevint II Bainbridge, Georgia	Southeastern Minerals Chairman/President
Fazal Abbas Fazlin St. Petersburg, Florida	SmartShadow Software, CEO
Kent Guy Whittemore St. Petersburg, Florida	Whittemore Denson PA President

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

Senior Officers

Name	Title
Donald Jeffrey Cronin	President/Treasurer
Melvin Atwood Russell II	Vice President/Secretary

The Company's Board of Directors appointed two committees in accordance with Section 607.0825, FS. The following are the elected committee members as of December 31, 2004:

Audit Committee

Gregory Branch
Patrick Delacey, Chairman
Nicholas Griffin
Duncan Aitken
Donald Cronin

Investment Committee

Gregory Branch
Nicholas Griffin
Fazal Fazlin
William Hood
Alec Poitevint, II, Chairman

Conflict of Interest Procedure

The Company 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 Company management provided unsigned minutes of the Board of Directors and the audit committee for the period under examination. On June 28, 2005, signed copies of the recorded minutes of the Board were provided.

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

The Company had no acquisitions, mergers, disposals, dissolutions, and purchase or sales through reinsurance.

Surplus Debentures

The Company had a surplus debenture of \$4,000,000 issued in 2004, to its parent, UIH. The Company failed to obtain prior approval from the Office for the issuance of the surplus debenture in accordance with Section 628.401, FS; however, Office approval was obtained shortly after the issuance of the surplus debenture.

The Company failed to correctly report United Insurance Management (UIM) as the provider of the funds on Schedule Y, Part 2 of the annual statement. The Company filed an amended 2004 annual statement to correct this error.

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 February 24, 2005, as required by Section 628.801, FS, and Rule 69O-143.046, FAC.

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

Managing General Agency (MGA) Agreement

The Company had an MGA agreement with UIM dated March 12, 1999 wherein UIM was responsible for policy and claims servicing. The MGA subcontracted policy servicing to West Point Underwriters, LLC.

During 2004, the MGA rebated approximately \$5,000,000 in fees. The MGA stated that the Company has no future obligation to repay those fees.

Investment Management Agreement

The Company maintained an investment management agreement with Synovus Trust Company, NA (Synovus).

Custodial Agreement

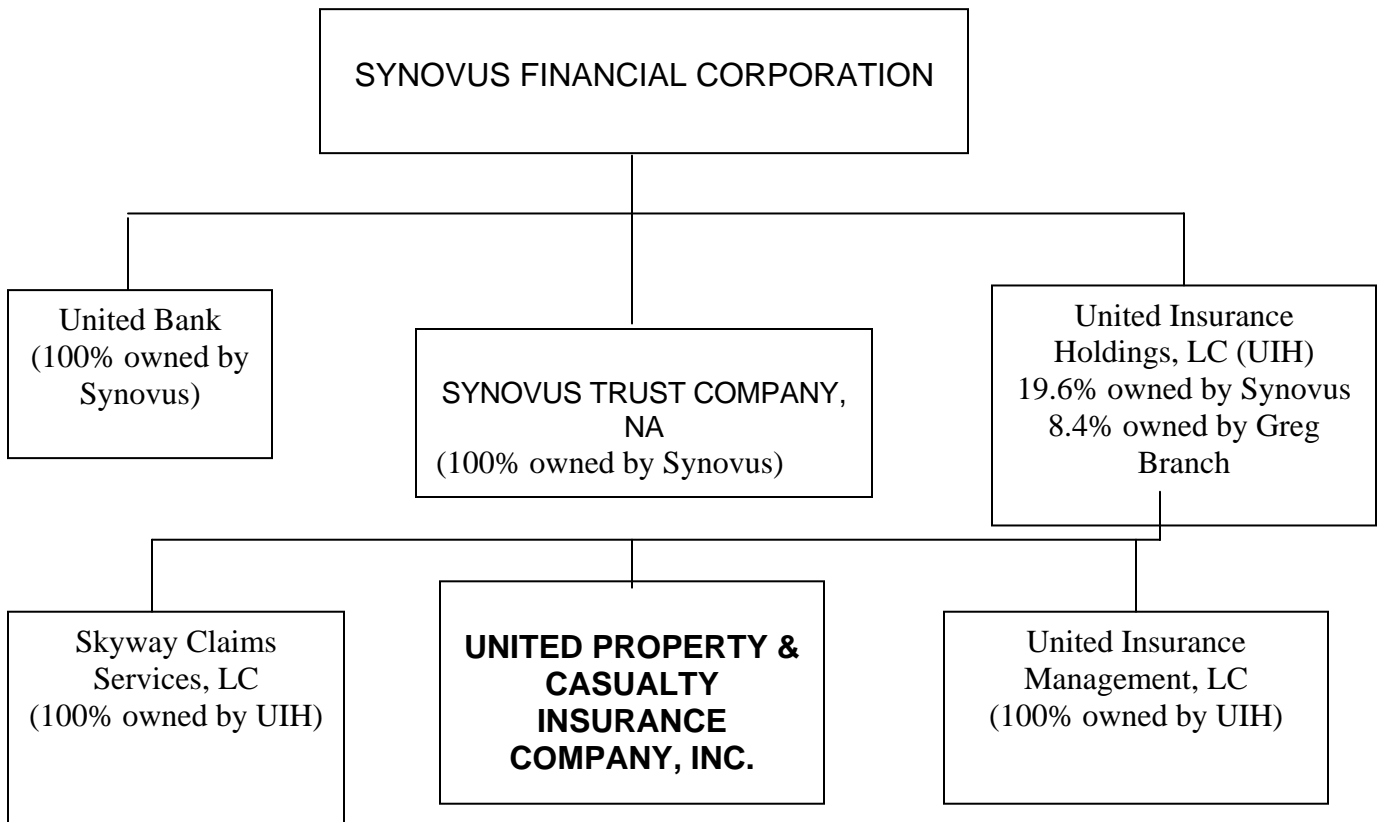
The Company maintained a custodial agreement with Synovus.

Initially, the Company's custodial agreement was not in compliance with Rule 69O-143.042(2)(n), FAC. On June 14, 2005, the Company provided an amended custodial agreement in compliance with Rule 69O-143.042, FAC.

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. The Company did not complete Schedule Y, Part 1 in their annual statement. The Company later filed an amended annual statement to include Schedule Y, Part 1.

**UNITED PROPERTY & CASUALTY INSURANCE COMPANY, INC.
ORGANIZATIONAL CHART**

DECEMBER 31, 2004



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$1,000,000 with a deductible of \$150,000, which adequately covered the suggested minimum amount of coverage of \$700,000 for the Company as recommended by the NAIC.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

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

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS, and with Florida officials as required or permitted by law:

State	Description	Par Value	Market Value
FL	CD 1.38%, 1 yr	<u>\$ 300,000</u>	<u>\$ 300,000</u>
TOTAL DEPOSITS		<u>\$ 300,000</u>	<u>\$ 300,000</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory

The Company was authorized to transact insurance in Florida only, in accordance with Section 624.401(2), FS. The Company had an exclusive MGA writing all business for the Company.

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 in compliance with NAIC standards with respect to the standard insolvency clause, transfer of risk, reporting and settlement information deadlines.

Assumed

The Company assumed business from Citizens Property Insurance Corporation.

The Company failed to complete Schedule F, Part 1 for assumed reinsurance. The Company subsequently filed an amended annual statement to include Schedule F, Part 1.

Ceded

The Company ceded risk on an excess of loss basis to multiple reinsurers as listed on Schedule F, Part 3 of the annual statement.

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

The Company reported an "unauthorized" reinsurer as "authorized" on Schedule F, Part 3 of the annual statement. The Company subsequently filed an amended annual statement reclassifying the reported "authorized" reinsurer as "unauthorized".

ACCOUNTS AND RECORDS

An independent certified public accountant (CPA) audited the Company's statutory basis financial statements annually for the years 2002, 2003 and 2004, in accordance with Section 624.424(8), FS.

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 had a total of 5 IRIS ratio failures, including the net writing ratio which was not in compliance of Section 624.4095, FS; primarily as a result of the hurricanes during 2004.

The Company maintained its office in St. Petersburg, Florida, at the location of its MGA, where this examination was conducted.

The Company and non-affiliates had the following agreement:

Independent Auditor Agreement

The Company maintained an agreement with a CPA firm to provide auditing services.

Risk-Based Capital

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

Information Technology (IT) Evaluation

The IT evaluation performed by Computer Aid, Inc. noted that the Company's policy and claims systems had very little user documentation and also limited technical documentation. The Company should require the provider to develop formal documentation and place the documentation in escrow with the source code. The Company should have a written agreement with the Local Access Network and desktop service provider, even though it has a long but informal relationship with them. Also the backup strategy for the local servers should be enhanced.

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."

UNITED PROPERTY & CASUALTY INSURANCE COMPANY, INC.
Assets

DECEMBER 31, 2004

Classification	Per Company	Examination Adjustments	Per Examination
Bonds	\$29,218,418	\$0	\$29,218,418
Stocks:			
Preferred	469,379		469,379
Common	2,004,999		2,004,999
Cash:			
On hand	15,742,472		15,742,472
Short-term investments	12,880,521		12,880,521
Interest and dividend income due & accrued	385,259		385,259
Agents' Balances:			
Uncollected premium	2,271,208		2,271,208
FIT Recoverable	2,683,853		2,683,853
Net Deferred Tax	2,466,075		2,466,075
<hr/>			
Totals	\$68,122,184	\$0	\$68,122,184

UNITED PROPERTY & CASUALTY INSURANCE COMPANY, INC.
Liabilities, Surplus and Other Funds

DECEMBER 31, 2004

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$7,272,499		\$7,272,499
Loss adjustment expenses	1,174,853		1,174,853
Other expenses	702,750		702,750
Taxes, licenses and fees	534,428		534,428
Unearned premium	34,777,721		34,777,721
Ceded reinsurance premiums payable	10,028,423		10,028,423
Funds held under reinsurance treaties	317,571		317,571
Payable to parent, subsidiaries and affiliates	714,444		714,444
	<hr/>		<hr/>
Total Liabilities	\$55,522,689		\$55,522,689
Common capital stock	\$10,000		\$10,000
Surplus Notes	4,000,000		4,000,000
Gross paid in and contributed surplus	5,990,000		5,990,000
Unassigned funds (surplus)	<u>2,599,495</u>		<u>2,599,495</u>
Surplus as regards policyholders	<u>\$12,599,495</u>		<u>\$12,599,495</u>
Total liabilities, capital and surplus	<u>\$68,122,184</u>	<u>\$0</u>	<u>\$68,122,184</u>

UNITED PROPERTY & CASUALTY INSURANCE COMPANY, INC.
Statement of Income

DECEMBER 31, 2004

Underwriting Income

Premiums earned	\$56,652,691
DEDUCTIONS:	
Losses incurred	38,163,146
Loss expenses incurred	3,900,852
Other underwriting expenses incurred	17,120,309
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$59,184,307</u>
Net underwriting gain or (loss)	(\$2,531,616)

Investment Income

Net investment income earned	\$1,269,872
Net realized capital gains or (losses)	420,907
Net investment gain or (loss)	<u>\$1,690,779</u>

Other Income

Net gain or (loss) from agents' or premium balances charged off	(\$345,472)
Finance and service charges not included in premiums	0
Aggregate write-ins for miscellaneous income	0
Total other income	<u>(\$345,472)</u>
Net income before dividends to policyholders and before federal & foreign income taxes	(\$1,186,309)
Dividends to policyholders	<u>0</u>
Net Income, after dividends to policyholders, but before federal & foreign income taxes	(\$1,186,309)
Federal & foreign income taxes	<u>1,448,099</u>
Net Income	(\$2,634,408)

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year	\$9,690,862
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Gains and (Losses) in Surplus

Net Income	(\$2,634,408)
Net unrealized capital gains or losses	(209,712)
Change in net deferred income taxes	1,902,082
Change in non-admitted assets	(149,329)
Change in provision for reinsurance	0
Change in surplus note	4,000,000
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$2,908,633</u>
Surplus as regards policyholders, December 31 current year	<u><u>\$12,599,495</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Bonds

\$29,218,418

Two bonds were reported on the annual statement as designation "2FE" and "1FE". The Securities and Valuation Office (SVO) rated these bonds as "NR" (not rated).

Cash

\$29,218,418

Checks dated as old as 1999 were listed on the Company's bank reconciliation; however, they were not reported to the Department of Financial Services pursuant to Section 717.117, FS. The Company subsequently filed their Report for Unclaimed Property with the Department of Financial Services on May 1, 2005.

Agents' Balances

\$2,271,208

The Company was unable to provide an aging balance on a policy by policy basis for Agents' Balances which is required by Rule 69O-138.024, FAC, and Section 625.012(5) (a), FS.

The Company's MGA was keeping premiums collected in an unapproved trust account. The trust account must be filed and approved by the Office. Disbursements from the MGA's depository accounts were not in compliance with Section 625.012, (5) (a) (1), FS. These disbursements were deposited into the MGA's money market account and earning interest income. The interest may be allocated pursuant to written agreement by the Company, however, no written agreement was noted as required by Section 625.012(5)(a)(1), FS. Pursuant to Section 625.012(5)(a)(4)(b)(3), FS,

the MGA is a “controlled” or “controlled person” because the MGA generates more than 50 percent of the insurer’s total premiums in the course of collection.

The Company was not accounting for Premium receivable due for deferred premiums on Line 12.2, page 2 of the annual statement. The entire balance was recorded on Line 12.1 for Premium in course of collection.

The Company did not pay premium taxes on MGA fees or assessments as required by Section 627.403, FS and Section 624.509, FS. The Company refiled their 2004 Premium Tax Return with the Florida Department of Revenue at the close of this examination.

Liabilities

Losses and Loss Adjustment Expenses \$8,447,352

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.

Advance Premiums \$0

The Company was not reporting Advance premiums collected from policyholders and received from UIM, as a separate liability in their annual statement.

**UNITED PROPERTY & CASUALTY INSURANCE COMPANY, INC.
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	\$12,599,495
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	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No adjustment needed		\$0	\$0
LIABILITIES:			
No adjustment needed		\$0	\$0
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2004, Per Examination			\$12,599,495

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 issued a surplus debenture to UIH for \$4,000,000 in 2004, without prior approval from the Office. **It is recommended that the Company obtain prior approval from the Office for all future issuances of surplus debentures and subsequent payment of interest or principal.**

Bonds

The Company reported two bonds on Schedule D as "exempt", which were actually "not rated" by the NAIC SVO. **It is recommended that the Company correctly report all investments as valued by the NAIC SVO in all future annual and quarterly state filings.**

Agents' Balances

The Company's annual statement did not account separately for Agents balances deferred and advance premiums, rather the premiums receivable were grouped in total as Agents' Balances in the Course of Collection. Premiums collected and deposited by the MGA were not in compliance with "trust account" requirements required by Section 625.012, FS. **It is recommended that the Company correctly report premiums due in accordance with the NAIC Annual Statement Instructions; and that the Company file a trust agreement with the Office for approval to disburse premiums collected to the Company and deposited into this trust account by the MGA. The Company should provide documentation of compliance to the Office within 90 days after the report is issued.**

Subsequent event:

Company management stated in a letter dated October 10, 2005, that the premium receivable, deferred premium and advance premium were reported separately in the June 30, 2005 quarterly statement and that premiums and fees are now collected directly by the Company rather than from the MGA.

IT Evaluation

The Company's claims and policy systems had minimal user documentation and technical documentation. The Company did not have a written agreement with the Local Access Network and desktop service provider. The Backup strategy for the local servers needs to be enhanced. **It is recommended that the Company address these weaknesses and provide documentation to the Office within 90 days after the report is issued that such weaknesses were corrected.**

CONCLUSION

The customary insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **United Property & Casualty 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 \$12,599,495, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Michael Hampton, CPA, CFE, DABFA, CFE, CPM Financial Examiner/Analyst Supervisor, Joe Boor, FCAS, Office Actuary, participated in the examination. We also recognize Computer Aid, Inc. participation in the IT portion of this examination.

Respectfully submitted,

Miriam C. Bleakley
Financial Examiner/Analyst II
Florida Office of Insurance Regulation