

REPORT ON EXAMINATION

OF THE

UNITRIN PREFERRED INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

DATE OF REPORT

OCTOBER 3, 2011

EXAMINER

LEON TAMBUE

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

October 3, 2011

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30594 dated September 3, 2010 attached hereto, I have made an examination into the condition and affairs of Unitrin Preferred Insurance Company as of December 31, 2010, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Unitrin Preferred Insurance Company.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company’s administrative offices located at 12926 Gran Bay Parkway West, Jacksonville, Florida 32258.

1. SCOPE OF EXAMINATION

The Department has performed a multi-state examination of Unitrin Preferred Company. The previous examination was conducted as of December 31, 2005. This examination covered the five-year period from January 1, 2006 through December 31, 2010. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment and an evaluation based upon the Company’s Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Pensions, stock ownership and insurance plans
- Territory and plan of operation
- Growth of Company
- Loss experience
- Reinsurance
- Accounts and records

Statutory deposits
Financial statements
Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was incorporated on September 28, 1942, under the laws of the State of New York as The Unity Fire Insurance Corporation to act as the successor to the United States Branch of The Union Fire, Accident & General Insurance Company of Paris, France. The Company was licensed and commenced business on October 13, 1942. In 1950, the Company adopted the name The Unity Fire and General Insurance Company.

Effective July 3, 1990, SCOR U. S. Corporation (“SCOR”) acquired, and absorbed by merger, the Company’s former parent, Rockleigh Management Corporation; therefore, the Company became a subsidiary of SCOR. On April 8, 1996, the Company changed its name to General Security Property and Casualty Company.

Effective December 31, 2002, Unitrin, Inc. (“Unitrin”) acquired 100% of the common stock of the Company from SCOR. As part of the acquisition, the Company ceded on an indemnity basis, all of its insurance related assets and liabilities in force on or before December 31, 2002 to General Security National Insurance Company, pursuant to an indemnity and assumption agreement. Additionally, the stock purchase agreement provided for the return of capital by the Company to SCOR in the amount of \$6,199,470, in order to reduce the net assets of the Company to the amount agreed to in the sale agreement. The acquisition was approved by the Department on December 23, 2002.

On February 18, 2003, the Company’s name was changed to its current title. On December 29, 2003, the Company became a wholly-owned subsidiary of Trinity Universal Insurance Co. (“TUIC”), which is a wholly-owned subsidiary of Unitrin.

On November 19, 2010, the Department approved a Stock Repurchase Plan, pursuant to Section 1411(d) of the New York Insurance Law, whereby the Company repurchased from its Parent, TUIC, 6,000 shares of its \$400 par value per share common stock for consideration in the amount of \$5,931,900. On the same date, the Company paid an extraordinary dividend to its parent in the amount of \$4,057,713, which was approved by the Department pursuant to Section 4105 of the New York Insurance Law. Additionally, on November 12, 2010, the Department approved a change in the par value of the Company's remaining 6,500 shares of common stock from \$400 per share to \$600 per share.

As of December 31, 2010, capital paid in was \$3,900,000 consisting of 6,500 shares of \$600 par value per share of common stock and Gross paid in and contributed surplus was \$2,526,285. During the examination period, common capital stock decreased in the amount of \$1,100,000, and gross paid in and contributed surplus decreased in the amount of \$4,831,900, as follows:

<u>Date</u>	<u>Description</u>	<u>Capital Stock</u>	<u>Gross paid in and Contributed Surplus</u>
12/31/2005	Beginning balance	\$ 5,000,000	\$ 7,358,185
10/19/2010	Stock Repurchase Plan (6,000 shares)	(2,400,000)	(3,531,900)
11/12/2010	Change in par value from \$400 to \$600	<u>1,300,000</u>	<u>(1,300,000)</u>
12/31/2010	Ending balance	\$ <u>3,900,000</u>	\$ <u>2,526,285</u>

It is noted that the Company made a classification error in its filed 2010 annual statement, whereby Common capital stock was understated in the amount of \$2,600,000 and Gross paid in and contributed surplus was overstated by the same amount. This error was corrected by the Company in its quarterly statement as of June 30, 2011. The error had no effect on the Company's surplus as regards policyholders.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than seven or more than thirteen members. The Department approved the Company's amended and reinstated charter and by-laws. At December 31, 2010, the board of directors was comprised of the following seven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
John Michael Boschelli Geneva, IL	Treasurer, Unitrin Services Company
Patrick Brian Gillson DeWitt, NY	Regional Claims Manager, Unitrin Auto & Home Insurance Company
Denise Idell Lynch St. Augustine, FL	President, Kemper, A Unitrin Business
Christopher Lamont Moses Chicago, IL	Vice President and Treasurer, Unitrin Inc
Richard Roeske Naperville, IL	Vice President and Chief Accounting Officer, Unitrin Services Company
James Allen Schulte Jacksonville Beach, FL	President, Milwaukee Safeguard Insurance Company
Francis Joseph Sodaro Park Ridge, IL	Vice President, Unitrin Services Company

As of December 31, 2010, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Denise Idell Lynch	President
Dorothy Ann Langley	Secretary
Clark Hubbard Roberts	Treasurer
Keith Darell Sievers	Senior Vice President

B. Territory and Plan of Operation

As of December 31, 2010, the Company was licensed to write business in twenty states and the District of Columbia.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident & health
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$4,400,000.

The Company primarily writes private passenger auto liability, auto physical damage, and homeowners multiple peril business. The business is produced through independent agents and brokers.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Premiums</u>	<u>Premiums Written in New York State as a Percentage of Total Premium</u>
2006	\$69,441,388	\$110,555,546	62.81%
2007	\$60,285,215	\$ 98,814,057	61.01%
2008	\$51,358,428	\$ 92,124,178	55.75%
2009	\$44,025,372	\$ 86,519,849	50.88%
2010	\$38,351,345	\$ 81,084,231	47.30%

C. Reinsurance

The Company assumes reinsurance only from mandatory pools and associations. During 2010, assumed reinsurance premium from mandatory pools and associations were less than \$100,000.

100% Quota Share Reinsurance Agreement

Effective January 1, 2009, the Company entered into a 100% Quota Share Reinsurance Agreement with Trinity Universal Insurance Company (“TUIC”), whereby TUIC assumes 100% of all insurance business written by the Company. Previously, effective January 1, 2003, TUIC assumed a 90% quota share of the business written by the Company. The 100% Quota Share Reinsurance Agreement was filed with and non-disapproved by the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

All ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

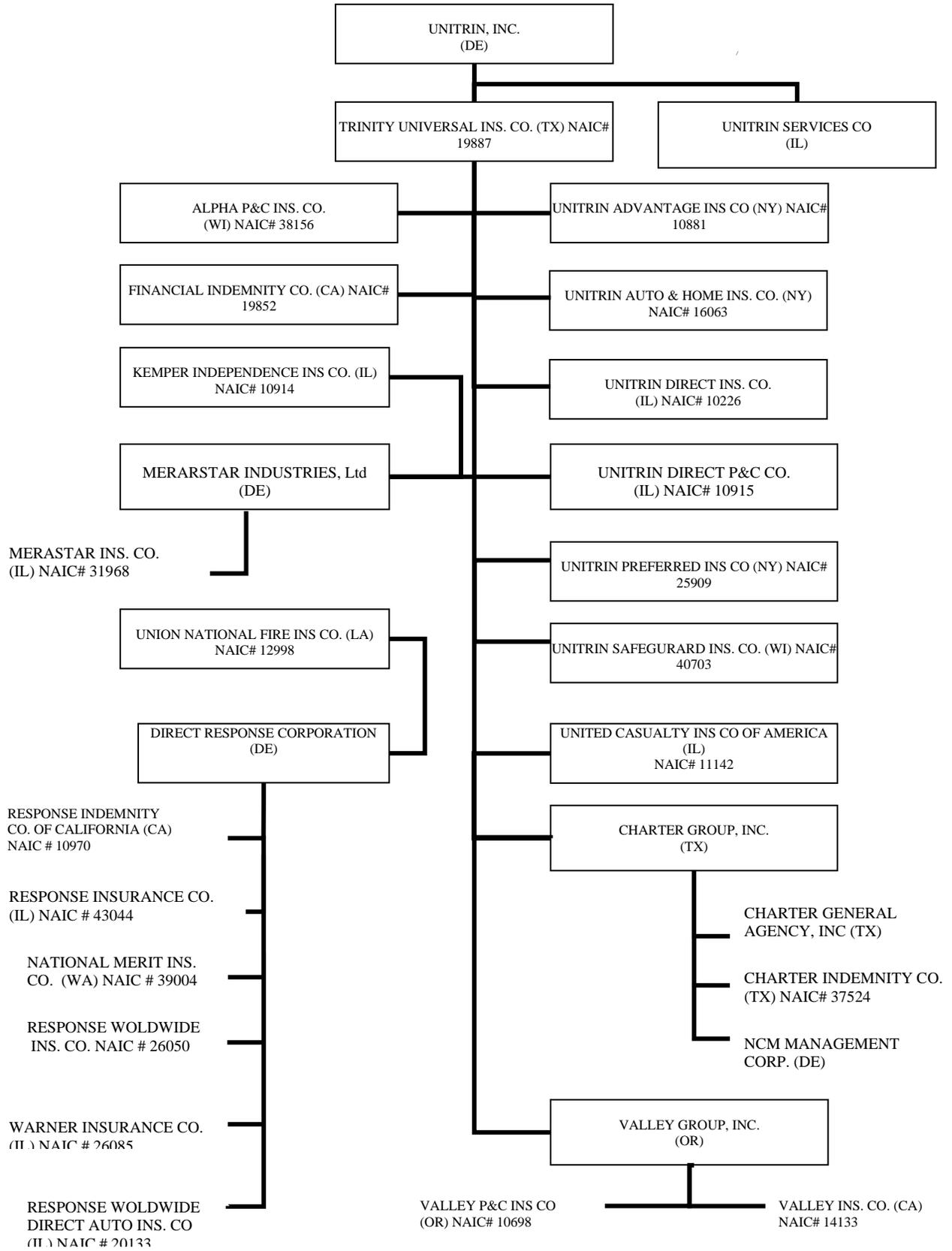
Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, managements has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles (“SSAP”) No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company’s chief executive officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements.

D. Holding Company System

The Company is a member of the Unitrin Group Name of Affiliated Group. The Company is a wholly-owned subsidiary of Trinity Universal Insurance Company, a Texas corporation, which is ultimately controlled by Unitrin, Inc.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an unabridged chart of the holding company system at December 31, 2010:



At December 31, 2010, the Company was party to the following agreements with other members of its holding company system:

General Services - Policy Administration

Effective January 1, 2009, the Company and Merastar Insurance Company (“MIC”), a wholly owned subsidiary of TUIC, entered into a general service agreement whereby MIC shall administer the new and renewal property and casualty lines insurance business of the Company, including marketing; underwriting, subject to the Company’s written guidelines; and claims administration.

General Services

Effective July 1, 2010, USC provides the following services to the Company: trade execution and investment analysis; financial accounting and reporting; purchasing and accounts payable; investment accounting; tax return preparation; tax accounting and tax advice; maintenance and benefits plans; administration of post-retirement medical benefits; benefit plan regulatory reporting and support; risk management; automobile fleet management; internal audit; cash management and bank relations; financial planning and analysis of results of operations; capital project review and evaluation; real estate management; corporate secretarial functions; and legal support and advice.

Information Technology Services Agreement

Effective January 1, 2009, the Company and Unitrin Direct Property & Casualty Company (“UDPC”) entered into an information technology services agreement whereby UDPC shall provide information technology applications and consulting services on technology that is shared among Unitrin, Inc. property and casualty affiliates.

Computer Service Agreement

Effective July 1, 2010, the Company and USC entered into a computer service agreement whereby USC shall provide computer data processing services to the Company using computer systems maintained by USC including: mainframe, midrange and minicomputer and other central processors and controllers; data storage devices, cartridges and tape drives; MVS, UNIX and other operating system software; database management software; CICS and other transaction processing software; groupware, middleware and network software; routers and other network and

telecommunications equipment and lines located at its data center facilities; and internet and intranet access software and systems.

All of the above agreements were submitted to and non-disapproved by the Department.

Tax Allocation Agreement

The Company is included in a consolidated federal income tax return with Unitrin. The tax allocation agreement states that each participant in the agreement shall be allocated tax as if they filed a separate company return.

In 2009 Unitrin amended the agreement to include additional new affiliates. The amendment was filed with the Department and approved by the Company's board of directors pursuant to Department Circular Letter No.33 (1979).

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2010, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	0%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	57%
Premiums in course of collection to surplus as regards policyholders	31%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$16,713,238	55.34%
Other underwriting expenses incurred	9,040,347	29.93
Net underwriting loss	<u>4,449,208</u>	<u>14.73</u>
Premiums earned	<u>\$30,202,793</u>	<u>100.00%</u>

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2005 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$10,787,585	\$ 0	\$10,787,585
Cash, cash equivalents and short-term investments	845,391	0	845,391
Subtotals, cash and invested assets	11,632,976	0	11,632,976
Investment income due and accrued	203,053	0	203,053
Uncollected premiums and agents' balances in the course of collection	2,581,237	2,439	2,578,798
Deferred premiums, agents' balances and installments booked but deferred and not yet due	15,776,974	0	15,776,974
Net deferred tax asset	46,980	0	46,980
Guaranty funds receivable or on deposit	27,637	0	27,637
Receivables from parent, subsidiaries and affiliates	109,279	0	109,279
Aggregate write-ins for other than invested assets	493,679	43,657	450,028
Total assets excluding separate accounts, segregated accounts and protected cell accounts	<u>30,871,815</u>	<u>46,095</u>	<u>30,825,720</u>
Total assets	<u>\$30,871,815</u>	<u>\$46,096</u>	<u>\$30,825,720</u>

Liabilities, Surplus and Other Funds

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase / (Decrease)</u>
Losses and loss adjustment expenses	\$ 0	\$ 0	
Reinsurance payable on paid losses and loss adjustment expenses	0	0	
Commissions payable, contingent commissions and other similar charges	1,668,453	1,668,453	
Other expenses (excluding taxes, licenses and fees)	6,950	6,950	
Taxes, licenses and fees (excluding federal and foreign income taxes)	572,779	572,779	
Current federal and foreign income taxes	852,404	852,404	
Advance premium	1,072,442	1,072,442	
Ceded reinsurance premiums payable (net of ceding commissions)	<u>18,363,173</u>	<u>18,363,173</u>	<u>0</u>
Total liabilities	<u>\$22,536,202</u>	<u>\$22,536,202</u>	<u>\$ 0</u>
<u>Surplus and Other Funds</u>			
Common capital stock	\$2,900,000	\$1,300,000	\$2,600,000
Gross paid in and contributed surplus	2,526,285	5,126,285	(2,600,000)
Unassigned funds (surplus)	<u>1,863,234</u>	<u>1,863,234</u>	<u>0</u>
Surplus as regards policyholders	<u>8,289,518</u>	<u>8,289,518</u>	<u>\$ 0</u>
Total liabilities, surplus and funds	<u>\$30,825,720</u>	<u>\$30,825,720</u>	

NOTE: The Internal Revenue Service has examined Company's consolidated Federal Income Tax returns through tax year 2002. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2003 through 2010. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

It is noted that the Company made a classification error in its filed 2010 annual statement, whereby Common capital stock was understated in the amount of \$2,600,000 and Gross paid in and contributed surplus was overstated by the same amount. This error was corrected by the Company in its quarterly statement as of June 30, 2011. The error had no effect on the Company's surplus as regards policyholders.

B. Statement of Income`

Surplus as regards policyholders increased \$67,354 during the five-year examination period January 1, 2006 through December 31, 2010, detailed as follows:

Underwriting Income

Premiums earned		\$30,202,793
Deductions:		
Losses and loss adjustment expenses incurred	\$16,713,238	
Other underwriting expenses incurred	<u>9,040,347</u>	
Total underwriting deductions		<u>25,753,585</u>
Net underwriting gain or (loss)		\$4,449,208

Investment Income

Net investment income earned	\$4,810,085	
Net realized capital gain	<u>3,195,776</u>	
Net investment gain or (loss)		\$8,005,861

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (74,165)	
Finance and service charges not included in premiums	<u>575,219</u>	
Total other income		<u>501,054</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$12,956,123
Federal and foreign income taxes incurred		<u>974,734</u>
Net income		<u>\$11,981,389</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 2005			\$8,222,164
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$11,981,389	\$ 0	
Change in net deferred income tax		705,539	
Change in nonadmitted assets	927,498		
Change in provision for reinsurance	2,398,619		
Capital changes paid in		3,700,000	
Surplus adjustments paid in		2,231,900	
Dividends to stockholders	<u>0</u>	<u>8,602,713</u>	
Total gains and losses	<u>\$15,307,506</u>	<u>\$15,240,152</u>	
Net increase (decrease) in surplus			<u>67,354</u>
Surplus as regards policyholders per report on examination as of December 31, 2010			<u>\$8,289,518</u>

4. **LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$0 is the same as reported by the Company as of December 31, 2010. Effective January 1, 2009, 100% of the Company's insurance liabilities are ceded to Trinity Universal Insurance Company.

5. **COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

The prior report on examination contained thirteen comments and recommendations as follows (page numbers refer to the prior report):

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Management</u>	
i.	It is recommended that the Company convene regularly scheduled quarterly meetings of its board of directors as stated in its charter and/or by-laws and maintain complete minutes of such proceedings.	5

The Company has complied with this recommendation.

<u>ITEM</u>	<u>PAGE NO.</u>
B. <u>Reinsurance</u>	
ii. It was recommended that the Company comply with Section 1505(d)(2) and submit any reinsurance agreements between related parties to this Department at least 30 days prior to entering into the agreement.	8
The Company has complied with this recommendation.	
iii. It is recommended that all reinsurance agreements entered into by the Company include an entire contract clause.	8
The Company has complied with this recommendation.	
iv. It is recommended that all reinsurance agreements where business is ceded to unauthorized reinsurers, through an intermediary, include a provision requiring the appointment by the reinsurer or reinsurers, of an attorney in this State upon whom all lawful process may be served, pursuant to the provisions of Department Regulation 98, Part 32.1(e).	9
The Company has complied with this recommendation.	
v. It is recommended that the Company comply with SSAP No.62 and report ceded premiums payable on a gross basis.	9
The Company has complied with this recommendation.	
C. <u>Holding Company System</u>	
i. It was recommended that the Company provide notification to the New York State Insurance Department of any amendment to the tax allocation agreement pursuant to Department Circular Letter No. 33 (1979).	13
The Company has complied with this recommendation.	
ii. It was further recommended that the Company's board of directors approve any amendment to the intercompany tax allocation agreement.	13
The Company has complied with this recommendation.	
iii. It is recommended that the Company maintain the required documentation for the allocation of inter-company expenses, pursuant to Parts 106.2 and 109.4 of Department Regulation No. 30.	13
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
D. <u>Account and Records</u>	
i. <u>CPA Engagement Letter</u>	
It is recommended that the Company revise its future contracts with its independent Certified Public Accountant to include such wording as required by Part 89.2 of Department Regulation No. 118.	14
The Company has complied with this recommendation.	
ii. <u>Advance Premiums</u>	
It is recommended that the Company report advance premiums as a separate liability rather than as an offset to “Receivable from parent, subsidiaries and affiliates” pursuant to the provisions of SSAP No. 64.	15
The Company has complied with this recommendation.	
iii. <u>Commissions Payable</u>	
It is recommended that the Company report commissions payable as a separate liability rather than as an offset to “Receivable from parent, subsidiaries and affiliates” pursuant to the provisions of SSAP No. 64.	15
The Company has complied with this recommendation.	
iv. <u>Deferred Premiums, Agents Balances and Installments Booked But Not Yet Due</u>	
It is recommended that the Company comply with SSAP No. 6 in the calculation of not-admitted agents’ balances and installment premiums.	
The Company has complied with this recommendation.	16
v. <u>Remittances and Items Not Allocated</u>	
It is recommended that the Company record suspense items as a liability under the caption “Remittance and items not allocated” pursuant to the provisions of paragraph 9 of SSAP No. 67.	16
The Company has complied with this recommendation.	
6. <u>SUMMARY OF COMMENTS AND RECOMMENDATIONS</u>	
This report contains no comments and recommendations.	

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, James J. Wrynn Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Leon Tambue

as proper person to examine into the affairs of the

UNITRIN PREFERRED INSURANCE COMPANY

and to make a report to me in writing of the condition of the said

Company

with such other information as he shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by the
name and affixed the official Seal of this Department, at
the City of New York,*

this 3rd day of September, 2010



James J. Wrynn

JAMES J. WRINN
Superintendent of Insurance