REPORT ON EXAMINATION

OF THE

USAGENCIES DIRECT INSURANCE COMPANY

AS OF

DECEMBER 31, 2012

DATE OF REPORT	JANUARY 15, 2014
EXAMINER	ADEBOLA AWOFESO

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NEW YORK STATE
DEPARTMENT of
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

January 10, 2014

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 31036 dated September 9, 2013, attached hereto, I have made an examination into the condition and affairs of USAgencies Direct Insurance Company as of December 31, 2012, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate USAgencies Direct 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 Department's New York City office located at One State Street, New York, New York 10004.

1. SCOPE OF EXAMINATION

The Department has performed an individual examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2007. This examination covered the five year period from January 1, 2008 through December 31, 2012. 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. The examiners relied upon the work performed by the Illinois Insurance Department during the 2012 examination of the Company's former parent, Affirmative Insurance Company.

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

Significant subsequent events
Company history
Corporate records
Management and control
Fidelity bonds and other insurance
Territory and plan of operation
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 that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on May 7, 1987, as a vehicle for the domestication of the United States Branch of Caledonian Insurance Company of London, England. On July 31, 1995, the Company became Caledonian Insurance Company of America, a domesticated U.S. Company. From 1996 to 1999, all of the outstanding capital stock of the Company was held by Atlas Assurance Company of America ("Atlas"), a subsidiary of GRE-USA Corporation.

On April 30, 1999, USAgencies, L.L.C., a Louisiana insurance holding company, acquired the Company from Atlas. The Company adopted its current name on August 9, 1999.

On January 31, 2007, the Company was acquired by Affirmative Insurance Holdings, Inc. ("Affirmative Holdings"), a Delaware insurance holding company. Upon completion of the acquisition, Affirmative Holdings contributed 100% of the common stock of the Company to its subsidiary, Affirmative Insurance Group, Inc. ("Affirmative Group"), a Texas insurance holding company. On September 30, 2010, Affirmative Group contributed 100% of the common stock of the Company to its subsidiary, Affirmative Insurance Company ("AIC"), an Illinois insurer. On November 14, 2012, AIC sold 100% of the Company's issues and outstanding common stock to its subsidiary, USAgencies Casualty Insurance Company, Inc., a Louisiana insurer.

At December 31, 2012, capital paid in was $2,500,000 consisting of 2,500,000 shares of $1 par value per share common stock. Gross paid in and contributed surplus was $2,689,624. On February 3, 2009, the Company entered into a Stock Redemption and Retirement Plan whereby on March 9, 2009, the Company purchased 1,000,000 of its outstanding shares from its then parent, Affirmative Group, for a purchase price of $2,910,376. On October 19, 2010, the Company received permission from the Department to reissue 1,000,000 shares of its retired $1 par value per share common stock to its then parent, AIC, for a purchase price of $1,000,000. The following chart shows the changes to the Company's capital paid in and its gross paid in and contributed surplus during the examination period:

Date	Description	Capital paid in	Gross paid in and contributed surplus
1/1/2008	Beginning balance	$2,500,000	$4,600,000
3/9/2009	Stock redemption	(1,000,000)	(1,910,376)
11/5/2010	Stock reissue	1,000,000	0
12/31/2012	Ending balance	$2,500,000	$2,689,624

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 members nor more than twenty one members. At December 31, 2012, the board of directors was comprised of the following seven members:

Name and Residence	Principal Business Affiliation
Joseph G. Fisher Chicago, IL	Executive Vice President, General Counsel and Secretary, Affirmative Insurance Holdings, Inc.
Earl R. Fonville Colleyville, TX	Senior Vice President, Chief Accounting Officer, Affirmative Insurance Company
William H. Huff Dallas, TX	Vice President, Regulatory Affairs, Affirmative Insurance Company
John P. Killacky Naperville, IL	Senior Vice President, Associate General Counsel, Affirmative Insurance Holdings, Inc.
Gary Y. Kusumi Oro Valley, AZ	President, Affirmative Insurance Holdings, Inc.
Michael J. McClure Western Springs, IL	Executive Vice President, Chief Financial Officer and Treasurer, Affirmative Insurance Holdings, Inc.
David I. Schamis Sands Point, NY	Managing Director, JC Flowers, LLC.

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance.

As of December 31, 2012, the principal officers of the Company were as follows:

Name	Title
Gary Yoshito Kusumi	President
Michael John McClure	Executive Vice President, Chief Financial Officer and Treasurer
Earl Russell Fonville	Senior Vice President and Chief Accounting Officer
Joseph Gerald Fisher	Executive Vice President, General Counsel and Secretary

B. Territory and Plan of Operation

As of December 31, 2012, the Company was licensed to write business in the following fourteen states: Alabama, Arizona, Illinois, Indiana, Iowa, Kentucky, Louisiana, Montana, Nevada, New York, Ohio, Oregon, Texas and Wisconsin.

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:

Paragraph	Line of Business
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

In addition, the Company is licensed to transact such workers' compensation insurance as may be incident to coverages contemplated under Paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Cong. as amended; 33 USC Section 901 et seq. as amended).

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 $2,500,000.

In June 2007, the Company ceased all underwriting operations. The Company plans on running off its existing business to facilitate the sale of the Company and its licenses.

C. Reinsurance

Effective December 31, 2007, the Company entered into a 100% quota share and a loss portfolio transfer agreement with Affirmative Insurance Company, which were approved by the Department. The quota share agreement ceded 100% of the Company’s liability on insurance policies in force as of year-end 2007 or subsequently written. Pursuant to the loss portfolio transfer agreement, the Company ceded 100% of its outstanding losses and loss adjustment expenses, net of salvage and reinsurance recoverable as of December 31, 2007, for which it paid a reinsurance premium equal to the amount of the loss reserves, including ceding commissions, related to such ceded liabilities. The loss portfolio transfer agreement is not treated as retroactive reinsurance pursuant to paragraph 31(d) of SSAP 62, which exempts “intercompany reinsurance agreements and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction.” The 100% quota share and loss portfolio transfer agreement were reviewed and were found to contain the required standard clauses including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

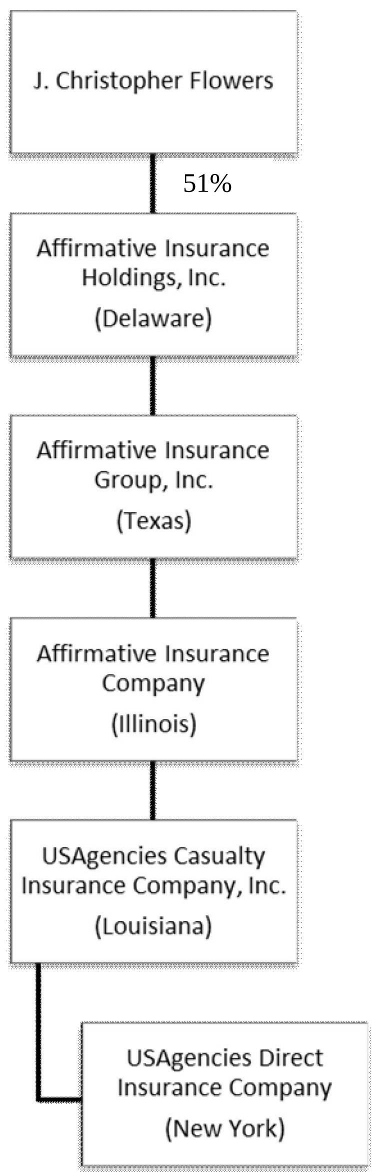
Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62R. 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. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62R.

D. Holding Company System

The Company is 100% owned by USAgencies Casualty Insurance Company Inc., a Louisiana domiciled insurance Company, which is a member of Affirmative Insurance Holdings., Inc., which is ultimately controlled by J. Christopher Flowers.

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 abbreviated chart of the Company holding company system at December 31, 2012:



At December 31, 2012, the Company was party to the following agreements with other members of its holding company system:

Inter-Company Service Agreement

Effective January 31, 2007, the Company became a party to an existing inter-company service agreement with Affirmative Management Services, Inc. and its subsidiaries, Affirmative Services, Inc., Affirmative Services Retail, Inc., Affirmative Property Holdings, Inc. and Affirmative Insurance Company (collectively known as "Service Companies"). Pursuant to the agreement, the Service Companies perform certain administrative and special ministerial services on behalf of the Company.

Tax Allocation Agreement

Effective January 31, 2007, the Company entered into an inter-company tax allocation agreement with its ultimate parent, Affirmative Insurance Holdings, Inc. The agreement specified that the Company and parent, along with the other members of the affiliated group, have elected to file a consolidated federal income tax return. The Company shall compute and pay to the ultimate parent its federal income tax liability as if it were computed on a separate return.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2012, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	N/A
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	1%
Premiums in course of collection to surplus as regards policyholders	N/A

The second ratio falls within the benchmark range set forth in the Insurance Regulatory Information System ("IRIS") of the National Association of Insurance Commissioners.

The premium based IRIS ratios and the underwriting ratios are not applicable due to the Company's run-off status.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2012 as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$4,768,767	$ 0	$4,768,767
Cash, cash equivalents and short-term investments	428,749		428,749
Investment income due and accrued	27,197		27,197
Amounts recoverable from reinsurers	20,463		20,463
Other amounts receivable under reinsurance contracts	4,334		4,334
Net deferred tax asset	55,886	0	55,886
Total assets	$5,305,395	$ 0	$5,305,395

Liabilities and surplus		
Liabilities		
Losses and loss adjustment expenses		$ 0
Other expenses (excluding taxes, licenses and fees)		2,161
Current federal and foreign income taxes		8,573
Ceded reinsurance premiums payable (net of ceding commissions)		(755)
Payable to parent, subsidiaries and affiliates		220
Loss adjustment expense payable to GA		125
Escheated Payable		22,279
Total liabilities		$ 32,603
Common capital stock	$2,500,000	
Gross paid in and contributed surplus	2,689,624	
Unassigned funds (surplus)	83,168	
Surplus as regards policyholders		5,272,792
Total liabilities and surplus		$5,305,395

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2008 through 2012. 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.

B. Statement of Income

Surplus as regards policyholders decreased $4,250,441 during the five-year examination period January 1, 2008 through December 31, 2012, detailed as follows:

Underwriting Income		
Premiums earned		$ 0
Deductions:		
Losses and loss adjustment expenses incurred	$ 0	
Other underwriting expenses incurred	0	
Total underwriting deductions		0
Net underwriting gain		$ 0
Investment Income		
Net investment income earned	$339,201	
Net realized capital gain	42,984	
Net investment gain		382,185
Other Income		
Total other income		0
Net income before federal and foreign income taxes		$382,185
Federal and foreign income taxes incurred		255,452
Net income		$126,733

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 2007			$9,523,233
Net income	$126,733	$	
Change in net deferred income tax	3,802		
Change in non-admitted assets	52,633		
Surplus adjustments paid in		1,910,376	
Dividends to stockholders	________	2,523,233	
Total gains and losses	$183,168	$4,433,609	
Net increase (decrease) in surplus			(4,250,441)
Surplus as regards policyholders per report on examination as of December 31, 2012			$5,272,792

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, 2012. All loss and loss adjustment expense liabilities incurred prior to December 31, 2007 are ceded to Affirmative Insurance Company pursuant to a loss portfolio transfer agreement and all loss and loss adjustment expense liabilities on insurance policies in force as of year-end 2007 or subsequently written are ceded to Affirmative Insurance Company pursuant to a 100% quota share agreement, as more fully explained in item 2C of this report.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained no comments or recommendations.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

This report contains no comments or recommendations.

APPOINTMENT NO. ___*31036*___

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, BENJAMIN M. LAWSKY, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Adebola Awofeso

as a proper person to examine the affairs of the

USAgencies Direct Insurance Company

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

COMPANY

with such other information as he shall deem requisite.

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

this 9th day of September, 2013

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:

Jean Marie Cho
Deputy Superintendent

NEW YORK STATE
EXCELSIOR
DEPARTMENT OF FINANCIAL SERVICES