

REPORT ON EXAMINATION

OF THE

UNITRIN PREFERRED INSURANCE COMPANY

AS OF

DECEMBER 31, 2005

DATE OF REPORT

JUNE 29, 2007

EXAMINER

LAMIN JAMMEH

TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1	Scope of examination	2
2.	Description of Company	2
	A. Management	4
	B. Territory and plan of operation	6
	C. Reinsurance	7
	D. Holding company system	10
	E. Significant operating ratios	13
	F. Accounts and records	14
3.	Financial statements	17
	A. Balance sheet	17
	B. Underwriting and investment exhibit	19
4	Losses and loss adjustment expenses	21
5	Provision for reinsurance	21
6.	Market conduct activities	21
7.	Compliance with prior report on examination	22
8..	Summary of comments and recommendations	23



STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

June 29, 2007

Honorable Eric R. Dinallo
Superintendent of Insurance
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 22531 dated July 13, 2006 attached hereto, I have made an examination into the condition and affairs of Unitrin Preferred Insurance Company as of December 31, 2005, 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 Insurance Department.

The examination was conducted at the Company's administrative offices located at 5210 Belfort Road, Jacksonville, Florida 32256.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2001. This examination covered the four-year period from January 1, 2002 through December 31, 2005. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a verification of assets and liabilities as of December 31, 2005. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants ("CPA"). A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners ("NAIC"):

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

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

Unity Fire and General Insurance Company (“Unity Fire”). On July 25, 1956, one hundred percent ownership of the Company was acquired by the Rockleigh Management Corporation of Wilmington, Delaware.

Effective July 3, 1990, SCOR U. S. Corporation (“SCOR”) acquired and absorbed by merger Rockleigh Management Corporation, the parent of the Unity Group of Insurance Companies, of which Unity Fire and General Security Assurance Corporation of New York (“General Security”) are members. The Unity Group was then reorganized with Unity Fire becoming a subsidiary of General Security and the business of Unity Fire being assumed by General Security.

Effective January 1, 1994, General Security merged into SCOR Reinsurance Company (“SCOR Re”) with SCOR Re being the surviving corporation and becoming the parent of Unity Fire. On April 8, 1996, Unity Fire changed its name to General Security Property and Casualty Company (“GPAC”).

Pursuant to a stock purchase agreement, effective December 31, 2002, Unitrin, Inc. (“Unitrin”) acquired 100% of the common stock of GPAC from SCOR Re. As part of the acquisition, GPAC 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 GPAC to SCOR Re in the amount of \$6,199,470 in order to reduce the net assets of GPAC to the amount agreed to in the sale agreement. The acquisition was approved by the Department on December 23, 2002.

On February 18, 2003, Unity Fire’s name changed to Unitrin Preferred Insurance Company. 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.

Capital paid in is \$5,000,000 consisting of 12,500 shares of common stock at \$4000 par value per share. Gross paid in and contributed surplus is \$7,358,185. Gross paid in and contributed surplus decreased by \$6,199,470 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
12/31/2001	Beginning gross paid in and contributed surplus	\$13,577,655
2002	Return of Capital to SCOR Re	<u>(6,199,470)</u>
12/31/2005	Ending gross paid in and contributed surplus	<u>\$7,358,185</u>

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 thirteen nor more than twenty-one members. At December 31, 2005, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
David Frederick Bengston Bull Valley, IL	Vice President, Unitrin Services Company
John Michael Boschelli Geneva, IL	Treasurer, Unitrin Services Company
Christine Mary Doherty Syracuse, NY	Human Resource Manager, Kemper Independence Insurance Company
Eric John Draut Arlington Heights, IL	Executive Vice President and Chief Financial Officer, Unitrin Services Company
Rosanne Marie Chanatry Fallon Liverpool, NY	Personal Lines Manager, Kemper Independence Insurance Company
Samuel Lewis Fitzpatrick Burr Ridge, IL	Assistant Vice President, Unitrin Service Company
Patrick Brian Gillson DeWitt, NY	Regional Claims Manager, Unitrin Auto & Home Insurance Company
Edward James Konar St. Charles, IL	Vice President, Unitrin Services Company
Scott Renwick Lake Bluff, IL	Senior Vice President, General Counsel and Secretary, 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
Frank Joseph Sodaro Park Ridge, IL	Assistant Controller, Unitrin Services Company
Donald Gene Southwell Wayne, IL	President and Chief Operating Officer, Unitrin Services Company

The Company's board of directors only held one meeting for the examination period. The management of the Company was conducted by unanimous written consent in lieu of regular board meetings.

Article II, Section 4 of the Company's by-laws states in part:

"Regular meetings of the board of directors shall be held immediately following the annual meeting of shareholders and at such intervals and on such dates as the board may designate."

The Company did not hold the board of directors meetings required pursuant to Article II, Section 4 of the Company's by-laws.

Although the Company's by-laws permit unanimous written consent of the directors in lieu of regular board of directors meetings, Article VIII, Section 7, of the by-laws restricts these meeting to those situations:

"Where time is of the essence, but not in lieu of any regular or special scheduled meeting of the board of directors or any committee thereof . . ."

In addition, it is the Department's position that there should be at least one annual meeting of the Company's board of directors and any "action by unanimous consent of directors without a meeting" should be limited to emergency situations only.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that the board may reach appropriate decisions. 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.

As of December 31, 2005, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
James Allan Schulte	President
Dorothy Ann Langley	Secretary
Clark Hubbard Roberts	Treasurer
Steven Clark Andrews	Senior Vice President

B. Territory and Plan of Operation

As of December 31, 2005, the Company was licensed to write business in 20 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 United States</u>	<u>Premiums Written in New York State as a percentage of United States Premium</u>
2002	\$8,099,818	\$36,050,837	22.47%
2003	\$52,345,462	\$87,437,361	59.87%
2004	\$91,209,164	\$149,258,774	61.11%
2005	\$82,089,879	\$136,926,007	59.95%

C. Reinsurance

The Company assumes reinsurance only from mandatory pools and associations. During 2005, the Company had assumed no premium from any sources.

The company has structured its ceded reinsurance program to limit its maximum exposure to any one risk as follows:

Property Lines

The Company reinsured its property losses with a per risk excess of loss contract for \$9 million per loss in excess of \$1 million retention. Additionally, the Company has a catastrophe program, which provides protection of \$160 million excess of \$20 million per occurrence in three layers. The majority of property reinsurance has been placed with authorized reinsurers with the exception of the first layer of the catastrophe policy which is equally divided between authorized and unauthorized reinsurers. Subsequent to the examination date, the Company amended its catastrophe program to provide coverage of \$210 million excess of \$40 million per occurrence.

Casualty Lines

The Company has reinsured its casualty lines with an excess of loss contract for \$4.75 million excess of \$1.25 million retention. It has also entered into clash coverage of \$19.75 million excess of \$1.25 million retention. Most of the casualty contract and all of the clash cover have been placed with authorized reinsurers.

The reinsurance contracts include all of the Unitrin subsidiary companies as named reinsureds. It is noted that the companies are not parties to an intercompany pooling agreement. None of the reinsurance agreements that included the Unitrin subsidiary companies were submitted to the Department pursuant to Section 1505(d)(2) of the New York Insurance Law.

It is recommended that the Company comply with Section 1505(d)(2) of the New York Insurance Law and submit any reinsurance agreement between related parties to this Department at least thirty days prior to entering into the agreement.

The Company entered into a quota share reinsurance agreement with its affiliate, Trinity Universal Insurance Company (“TUIC”), to assume 90% of its direct written premium not covered by the excess of loss agreements noted above. The reinsurance agreement was reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that the 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.

Pursuant to the stock purchase agreement and as a condition to the purchase of the Company by Unitrin, the Company entered into an indemnity and assumption reinsurance agreement with General Security National Insurance Company, a member of the SCOR holding company. The reinsurance coverage reinsures all losses for contracts in effect at and prior to December 31, 2002. These insurance contracts were novated with the prior approval of the Department. The contracts were accounted for as prospective reinsurance pursuant to NAIC Accounting Practices and Procedures Manual Statements of Statutory Accounting Principles (“SSAP”) No. 62, paragraph 30b.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit and trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations 133 and 114, respectively. Upon review it was determined that the Company entered into letters of credit that were issued subsequent to the examination date, which is contrary to the provisions of Department Regulation 133. An examination adjustment has been made to the liability “Provision for reinsurance” for the non-complying letters of credit, as more fully explained in Item 5 of this report.

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 with the following exceptions:

SSAP No. 62 requires that all reinsurance agreements contain an “entire contract” clause stating that the agreement shall constitute the entire contract between the parties and must provide no guarantee of profit, directly or indirectly, from the reinsurer to the ceding entity or from the ceding entity to the reinsurer. None of the Company’s reinsurance agreements contain such a clause. It is

recommended that all reinsurance agreements entered into by the Company include an entire contract clause.

Part 32.1(e) of Department Regulation No. 98 states:

“No reinsurance intermediary shall procure a reinsurance contract with one or more unauthorized reinsurers, unless there is provision in such agreement for the appointment by the reinsurer or reinsurers of an attorney in this State, as the true and lawful attorney of each such insurer, upon whom all lawful process may be served in any action, suit or proceeding instituted in this State by or on behalf of a licensed ceding insurer, arising out of the contract of reinsurance.”

During the course of this examination, it was noted that the provision required by Part 32.1(e) of Department Regulation No. 98 for the appointment of an attorney in this state did not appear in the reinsurance agreements placed through one reinsurance intermediary.

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).

Examination review of the Schedule F data reported by the Company in its filed 2005 Eannual statement was found to accurately reflect its reinsurance transactions with the exception of the reporting of the liability for “Ceded reinsurance premiums payable”. The Company netted the balances in the liability account "Reinsurance premiums payable" against the balances in the asset account "Premiums and considerations" account in its filed annual statements. SSAP No. 64 paragraph 3 states:

“Assets and liabilities that meet the criteria for offset shall not be netted when prohibited by specific statements of statutory accounting principles. An example of such is in the case of reinsurance recoverables on paid losses and ceded premiums payable as provided for in SSAP No. 62—Property and Casualty Reinsurance.”

It is recommended that the Company comply with SSAP No. 62 and report ceded premiums payable on a gross basis.

Management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by an

attestation from the Company's chief executive officer pursuant to Department Circular Letter No. 8 (2005).

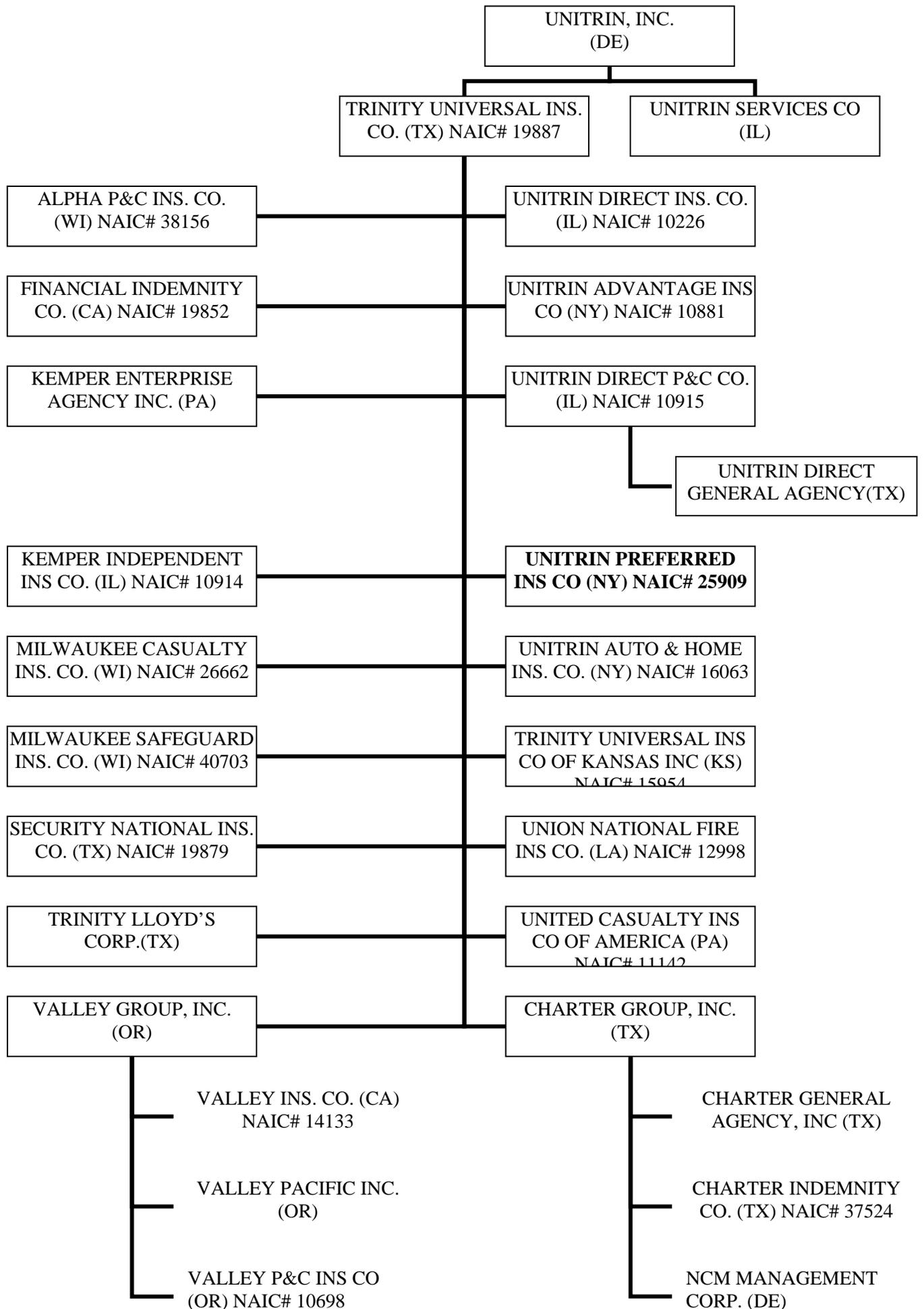
Except as previously noted, all ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraphs 17 through 24 of SSAP No. 62.

D. Holding Company System

The Company is a member of the Unitrin Group. The Company is a wholly-owned subsidiary of Trinity Universal Insurance Company ("TUIC"), 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 abridged chart of the holding company system at December 31, 2005:



At December 31, 2005, the Company was party to the following agreements with other members of its holding company system:

General Service Agreement

Effective June 17, 2003, the Company and Kemper Independence Insurance Company (“KIIC”), a wholly owned subsidiary of TUIC entered into a general service agreement whereby KIIC shall administer the personal lines business of the Company including new and renewal business.

Effective June 17, 2003 the Company and Unitrin Services Company (“USC”) entered into a general service agreement whereby USC will provide certain management services, group medical insurance and other insurance to the Company. Effective July 1, 2004 the agreement was amended and restated.

Effective January 1, 2004, the Company entered into a general service agreement with Unitrin Auto and Home Insurance Company (“UAHIC”) whereby UAHIC shall administer the agency based business of the Company administered out of North Carolina.

These contracts were non-disapproved by the Department pursuant to Section 1505 of the New York Insurance Law.

Computer Service Agreement

Effective June 17, 2003, the Company and USC entered into a computer service agreement whereby USC shall provide computer data processing using computer systems maintained by USC. This agreement was amended and restated effective July 1, 2004, and was non-disapproved by the Department pursuant to Section 1505 of the New York Insurance Law.

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 2005 Unitrin amended the agreement to include additional new affiliates, but the 2005 amendment was not filed with the Department or approved by the Company's board of directors pursuant to Department Circular Letter No.33 (1979).

It is recommended that the Company provide notification to Department of any amendment to the tax allocation agreement pursuant to Department Circular Letter No. 33 (1979).

It is further recommended that the Company's board of directors approve any amendment to the inter-company tax allocation agreement.

Intercompany Expense Allocations

During the review of the implementation of the various service agreements described above, it was noted that the Company did not maintain the documentation required pursuant to Department Regulation 30 for the allocation of inter-company expenses. Specifically, the Company could not provide documentation supporting the bases for allocation of joint expenses to companies pursuant to Part 106.2 of Department Regulation 30. Additionally, the Company could not provide the special statements and records required pursuant to Part 109.4 of Department Regulation 30, including the "allocation of salaries" and "recapitulation of salaries" schedules.

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 30.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2005, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	126%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	77%
Premiums in course of collection to surplus as regards policyholders	24%

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 four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$21,208,963	69.84%
Other underwriting expenses incurred	11,802,798	38.87
Net underwriting loss	<u>(2,644,253)</u>	<u>(8.71)</u>
Premiums earned	<u>\$30,367,508</u>	<u>100.00%</u>

F. Accounts and Records

i. Custodian Agreements

The review the Company's custodial agreements indicate that the custodial agreements do not contain the requisite safeguards and controls listed in the NAIC Financial Condition Examiners Handbook, Part 1, Section IV, J, 2.

The Company subsequently entered into amendments to the custodial agreements that comply with the safeguards and controls required by the NAIC's Financial Condition Examiners Handbook, Part 1, Section IV, J, 2.

ii. CPA Engagement Letter

A review of the 2005 and 2004 engagement letters with its independent CPA revealed that the letter did not include any of the language as required by Department Regulation 118, Part 89.2.

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.

iii. Advance Premiums

Upon review of the Company's filed annual statements for 2003 and 2004, it was noted that the Company did not report any liability under the caption "Advance premium." The review revealed that such balances were included as an offset against amounts receivable from the Company's parent, TUIC, through the admitted asset "Receivable from parent, subsidiaries and affiliates." SSAP No. 64 prohibits the offsetting of assets and liabilities when no valid right of off-set exists and only allows the offset where specifically permitted by specific statements of statutory accounting principles.

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.

iv. Commissions Payable

Upon review of the Company's filed annual statements for 2003 through 2005, it was noted that the Company did not report any liability under the caption "Commissions payable, contingent commissions and other similar charges." The review revealed that commissions payable were included as an offset against amounts receivable from the Company's parent, TUIC, through the admitted asset "Receivable from parent, subsidiaries and affiliates." SSAP No. 64 prohibits the offsetting of assets and liabilities when no valid right of off-set exists and only allows the offset where specifically permitted by specific statements of statutory accounting principles.

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.

v. Deferred Premiums, Agents Balances and Installments Booked But Not Yet Due

The Companies' policy is to write-off all premium balances of less than \$500 when the receivable is more than 6 months past due; however, the Company allows a "partial payment" of

an installment as long as there is "equity" in the policy. Due to the method used by the Company to age their premium receivables in 2005, the Company could not reconcile the non-admitted uncollected premium in the course of collection from its data to the annual statement. As a result the examiners could not determine if the not-admitted portion of Agent's Balances in course of collection were reported in compliance with SSAP No. 6. Also, as a result of the method used by the Company to age their premium receivables in 2005, the Company cannot determine the amount of "Deferred premiums, agents' balances and installments booked but deferred and not yet due (Page 2, Line 13.2) as required by the annual statement instructions.

It is recommended that the Company comply with SSAP No. 6 in the calculation of not-admitted agents' balances and installment premiums.

vi. Remittances and Items Not Allocated

Pursuant to paragraph 9 of SSAP No. 67, when cash receipts cannot be identified for a specific purpose or applied to a specific account when received, such items shall be recorded as a liability under the caption "Remittances and items not allocated." Upon review it was noted that the Company reported such suspense items as an offset to the asset "Receivable from parent, subsidiaries and affiliates."

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.

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	\$23,297,691	\$ 0	\$23,297,691
Cash, cash equivalents and short-term investments	328,184	0	328,184
Investment income due and accrued	347,808	0	347,808
Uncollected premiums and agents' balances in the course of collection	2,782,194	221,075	2,561,119
Net deferred tax asset	752,519	752,519	0
Guaranty funds receivable or on deposit	17,059	0	17,059
Receivables from parent, subsidiaries and affiliates	2,241,004	0	2,241,004
Prepaid Reinsurance	<u>164,183</u>	<u>0</u>	<u>164,183</u>
Total assets	<u>\$29,930,642</u>	<u>\$973,594</u>	<u>\$28,957,048</u>

Liabilities, Surplus and Other Funds

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	Surplus Increase <u>(Decrease)</u>
Losses	\$ 6,040,693	\$ 6,040,693	\$ 0
Loss adjustment expenses	1,405,636	1,405,636	0
Other expenses (excluding taxes, licenses and fees)	11,564	11,564	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	446,218	446,218	0
Current federal and foreign income taxes	105,256	105,256	0
Unearned premiums	5,665,185	5,665,185	0
Advance premium	1,550,531	1,550,531	0
Ceded reinsurance premiums payable (net of ceding commissions)	2,386,234	2,386,234	0
Provision for reinsurance	2,398,619	86,619	(2,312,000)
Payable for securities	1	1	0
SCOR Payable	<u>724,947</u>	<u>724,947</u>	<u>0</u>
Total liabilities	<u>\$20,734,884</u>	<u>\$18,422,884</u>	<u>\$(2,312,000)</u>
<u>Surplus and Other Funds</u>			
Common capital stock	\$ 5,000,000	5,000,000	\$ 0
Gross paid in and contributed surplus	7,358,185	7,358,185	0
Unassigned funds (surplus)	<u>(4,136,021)</u>	<u>(1,824,021)</u>	<u>(2,312,000)</u>
Surplus as regards policyholders	<u>\$ 8,222,164</u>	<u>\$10,534,164</u>	<u>\$(2,312,000)</u>
Total liabilities, surplus and other funds	<u>\$28,957,048</u>	<u>\$28,957,048</u>	

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2002. No material adjustments were made subsequent to the date of examination and arising from said audits, in the financial statements included in this report. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2003 through 2005. 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. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$8,252,379 during the four-year examination period January 1, 2002 through December 31, 2005, detailed as follows:

Underwriting Income

Premiums earned		\$30,367,508
Deductions:		
Losses incurred	\$17,174,342	
Loss adjustment expenses incurred	4,034,621	
Other underwriting expenses incurred	<u>11,802,798</u>	
Total underwriting deductions		<u>33,011,761</u>
Net underwriting gain or (loss)		\$(2,644,253)

Investment Income

Net investment income earned	\$ 2,716,050	
Net realized capital gain	<u>165,906</u>	
Net investment gain or (loss)		2,881,956

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (22,207)	
Finance and service charges not included in premiums	647,644	
Other income(loss)	<u>(280,980)</u>	
Total other income		<u>344,457</u>
Net income before federal and foreign income taxes		\$ 582,160
Federal and foreign income taxes incurred		<u>15,733</u>
Net Income		\$ <u>566,427</u>

Capital and Surplus Accounts

Surplus as regards policyholders per report on examination as of December 31, 2001			\$16,474,905
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$ 566,427		
Change in net deferred income tax	752,519		
Change in nonadmitted assets		\$ 973,598	
Change in provision for reinsurance		2,101,397	
Surplus adjustments paid in		6,199,470	
Transfer of 2001 provision for reinsurance		<u>297,222</u>	
Total gains and losses	<u>\$1,318,946</u>	<u>\$9,571,687</u>	
Net increase (decrease) in surplus			<u>(8,252,741)</u>
Surplus as regards policyholders per report on examination as of December 31, 2005			<u>\$ 8,222,164</u>

4. **LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$7,446,329 is the same as reported by the Company as of December 31, 2005. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statements.

5. **PROVISION FOR REINSURANCE**

The examination liability for the captioned item of \$2,398,619 is \$2,312,000 more than the \$86,619 reported by the Company in its 2005 Annual Statement.

The examination change represents the disallowance of letters of credit that were effective December 31, 2005, but were not issued until January 2006, in violation of Part 79.6 of Department Regulation No. 133, which states, in part:

(a) A letter of credit may not be used to reduce any liability for reinsurance ceded to an unauthorized reinsurer in financial statements required to be filed with this department unless:

(1) a letter of credit, in compliance with the provisions of this Part with the filing ceding insurer as beneficiary, has been issued on or before the "as of" date of the financial statement of the ceding insurer;

6. **MARKET CONDUCT ACTIVITIES**

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed to the Company's practices of claims and complaint handling.

The review noted that the Company did not have a corporate officer empowered to institute the Department's directives pursuant to Department Regulation No. 64. The name and pertinent information are required by Department Circular Letter No. 2 (1995) to be reported to the Department on a specific form.

Subsequent to the examination period, the Company appointed a consumer service officer and made the requisite filings to the Department.

7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination did not contain any recommendations.

8. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
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
B. <u>Reinsurance</u>	
ii. It is recommended that the Company comply with Section 1505(d)(2) and submit any reinsurance agreement between related parties to this Department at least thirty days prior to entering into the agreement.	8
iii. It is recommended that all reinsurance agreements entered into by the Company include an entire contract clause.	8
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
v. It is recommended that the Company comply with SSAP No.62 and report ceded premiums payable on a gross basis.	9
C. <u>Holding Company System</u>	
i. It is recommended that the Company provide notification to the New Department of any amendment to the tax allocation agreement pursuant to Department Circular Letter No. 33 (1979).	13
ii. It is further recommended that the Company's board of directors approve any amendment to the inter-company tax allocation agreement.	13
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
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	14

<u>ITEM</u>	<u>PAGE NO.</u>
required by Part 89.2 of Department Regulation No. 118.	
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
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
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.	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

Respectfully submitted,

_____/S/
Lamin Jammeh,
Senior Insurance Examiner

STATE OF NEW YORK)
)SS:
)
COUNTY OF NEW YORK)

LAMIN JAMMEH, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

_____/S/
Lamin Jammeh,

Subscribed and sworn to before me
this _____ day of _____, 2007.

Appointment No 22531

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, HOWARD MILLS, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Lamin Jammeh

as proper person to examine into the affairs of the

UNITRIN PREFERRED INSURANCE COMPANY

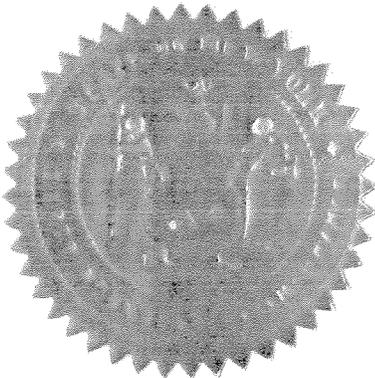
and to make a report to me in writing of the condition of the said

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 13th day of July, 2006



A handwritten signature in dark ink, appearing to read "Howard Mills", written over a horizontal line.

HOWARD MILLS
Superintendent of Insurance