



## MISSISSIPPI INSURANCE DEPARTMENT

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WOOLFOLK BUILDING  
JACKSON, MISSISSIPPI 39201  
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MIKE CHANEY  
Commissioner of Insurance  
State Fire Marshal

February 3, 2009

**CERTIFIED MAIL**  
**RETURN RECEIPT REQUESTED**

Mr. James Leland Martin, Jr., President  
American Federated Insurance Company  
Post Office Box 321422  
Flowood, MS 39232-1422

**RE: Report of Examination as of December 31, 2007**

Dear Mr. Martin:

In accordance with Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999), an examination of your Company has been completed. Enclosed herewith is the Order adopting the report and a copy of the final report as adopted.

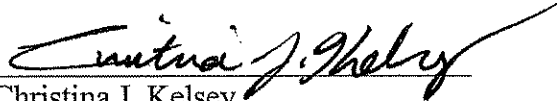
Pursuant to Miss. Code Ann. § 83-5-209(6)(a) (Rev. 1999), the Mississippi Department of Insurance shall continue to hold the content of said report as private and confidential for a period of ten (10) days from the date of the Order. After the expiration of the aforementioned 10-day period, the Department will open the report for public inspection.

If you have any questions or comments, please feel free to contact me.

Sincerely,

MIKE CHANEY  
COMMISSIONER OF INSURANCE

BY

  
Christina J. Kelsey  
Senior Attorney

MC/CJK/bs  
Encls. Order w/exhibit

**BEFORE THE COMMISSIONER OF INSURANCE  
OF THE STATE OF MISSISSIPPI**

**IN RE: REPORT OF EXAMINATION OF  
AMERICAN FEDERATED INSURANCE COMPANY      CAUSE NO. 09-5861**

**ORDER**

**THIS CAUSE** came on for consideration before the Commissioner of Insurance of the State of Mississippi ("Commissioner"), or his designated appointee, in the Offices of the Commissioner, 1001 Woolfolk Building, 501 North West Street, 10th Floor, Jackson, Hinds County, Mississippi, pursuant to Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999). The Commissioner, having fully considered and reviewed the Report of Examination, together with any submissions or rebuttals and any relevant portions of the examiner's work papers, makes the following findings of fact and conclusions of law, to-wit:

**JURISDICTION**

**I.**

That the Commissioner has jurisdiction over this matter pursuant to the provisions of Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999).

**II.**

That American Federated Insurance Company is a Mississippi-domiciled company licensed to write Accident & Health; Casualty/Liability; Fidelity; Fire/Allied Lines; Inland Marine; Surety; and Workers' Compensation coverages.

## FINDINGS OF FACT

### III.

That the Commissioner, or his appointee, pursuant to Miss. Code Ann. § 83-5-201 et seq. (Rev. 1999), called for an examination of American Federated Insurance Company and appointed Mitch Rayborn, Examiner-In-Charge, to conduct said examination.

### IV.

That on or about December 30, 2008, the draft Report of Examination concerning American Federated Insurance Company for the period of January 1, 2005, through December 31, 2007, was submitted to the Department by the Examiner-In-Charge, Mitch Rayborn.

### V.

That on or about January 9, 2009, pursuant to Miss. Code Ann. § 83-5-209(2) (Rev. 1999), the Department forwarded to the Company a copy of the draft report and allowed the Company a 15-day period to submit any rebuttal to the draft report. The Company had no issues with the draft report.

## CONCLUSIONS OF LAW

### VI.

The Commissioner, pursuant to Miss. Code Ann. § 83-5-209(3) (Rev. 1999), must consider and review the report along with any submissions or rebuttals and all relevant portions of examiner work papers and enter an Order: (1) adopting the Report of Examination as final or with modifications or corrections; (2) rejecting the Report of Examination with directions to reopen; or (3) calling for an investigatory hearing.

**IT IS, THEREFORE, ORDERED**, after reviewing the Report of Examination, and all relevant examiner work papers, that the Report of Examination of American Federated Insurance Company, attached hereto as Exhibit "A", should be and same is hereby adopted as final.


**IT IS FURTHER ORDERED** that a copy of the adopted Report of Examination, accompanied with this Order, shall be served upon the Company by certified mail, postage pre-paid, return receipt requested.

**IT IS FURTHER ORDERED** that the Mississippi Department of Insurance shall continue to hold the content of this report as private and confidential information for a period of ten (10) days from the date of this Order, pursuant to Miss. Code Ann. § 83-5-209(6)(a) (Rev. 1999).

**IT IS FURTHER ORDERED**, pursuant to Miss. Code Ann. § 83-5-209(4) (Rev. 1999), that within thirty (30) days of the issuance of the adopted report, American Federated Insurance Company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related orders.

**IT IS FURTHER ORDERED** that American Federated Insurance Company shall take the necessary actions and implement the necessary procedures to properly and promptly comply with all recommendations contained in the Report of Examination.


**SO ORDERED**, this the 3<sup>rd</sup> day of February, 2009.

  
MIKE CHANEY  
COMMISSIONER OF INSURANCE  
STATE OF MISSISSIPPI

**CERTIFICATE OF MAILING**

I hereby certify that a true and correct copy of the above and foregoing Order and a copy of the final Report of Examination, as adopted by the Mississippi Department of Insurance, was sent by certified mail, postage pre-paid, return receipt requested, on this the 3<sup>rd</sup> day of February, 2009, to:

**Mr. James Leland Martin, Jr., President  
American Federated Insurance Company  
Post Office Box 321422  
Flowood, MS 39232-1422**

  
Christina J. Kelsey  
Senior Attorney

Christina J. Kelsey  
Senior Attorney  
Counsel for the Mississippi Department of Insurance  
Post Office Box 79  
Jackson, MS 39205-0079  
(601) 359-3577  
Miss. Bar No. 9853



# **Mississippi Insurance Department**

**Report of Examination**

**of**

## **AMERICAN FEDERATED INSURANCE COMPANY**

**406 Liberty Park Court  
Flowood, Mississippi 39232**

**As of December 31, 2007**


**NAIC Company Code 10170  
NAIC ETS No. MS029-C46**

STATE OF LOUISIANA  
PARISH OF JEFFERSON

Mitch Rayborn, CFE, CIE, FLMI, being duly sworn, states as follows:


1. I have authority to represent the Commissioner of Insurance of the State of Mississippi in the examination of American Federated Insurance Company.
2. The Mississippi Insurance Department is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
3. I have prepared the examination work papers and examination report, and the examination of American Federated Insurance Company as of December 31, 2007, was performed in a manner consistent with the standards and procedures required by the Commissioner of Insurance of the State of Mississippi.

The affidavit says nothing further.

  
\_\_\_\_\_  
Mitch Rayborn, CFE, CIE, FLMI  
Examiner

Subscribed and sworn before me this 26th day of January, 2009.

(SEAL)

  
\_\_\_\_\_  
Notary Public

**Deborah I. Schroeder, Notary # 1589**  
**My Commission is for Life**

My commission expires \_\_\_\_\_.

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October 10, 2008

Honorable Mike Chaney  
Commissioner of Insurance  
State Fire Marshal  
Mississippi Insurance Department  
501 N. West Street  
1001 Woolfolk Building (39201)  
Post Office Box 79  
Jackson, Mississippi 39205-0079

Honorable Alfred W. Gross  
Chair, Financial Condition (E) Subcommittee  
Bureau of Insurance  
Commonwealth of Virginia  
Post Office Box 1157  
Richmond, Virginia 23218

Dear Sirs:

Pursuant to Commissioner Chaney's instructions and authorization and in compliance with statutory provisions, an examination has been conducted, as of December 31, 2007, of the affairs and financial condition of:

**AMERICAN FEDERATED INSURANCE COMPANY**  
**(NAIC COMPANY CODE 10170)**  
406 Liberty Park Court  
Flowood, Mississippi 39232

This examination was commenced in accordance with Miss. Code Ann. § 83-5-201 et seq. and was performed in Jackson, Mississippi at the statutory home office of the Company. The report of examination is herewith submitted.

## **INTRODUCTION**

This examination was performed by examiners representing the Mississippi Insurance Department ("MID") and covered American Federated Insurance Company ("AFIC" or "the Company") operations and financial condition from January 1, 2005, through December 31, 2007, including material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

For purposes of this examination report, the examination period is defined as January 1, 2005, through December 31, 2007, and the examination date is defined as December 31, 2007.

## **SCOPE OF EXAMINATION**

This examination was a full scope financial examination that included assessing the Company's financial condition, its ability to fulfill and manner of fulfillment of its obligations, the nature of its operations, and compliance with the law. A full scope market conduct examination was not performed; however, limited procedures were performed on specific areas of the Company's market conduct.

This examination was conducted in accordance with procedures recommended by the National Association of Insurance Commissioners ("NAIC") *Financial Condition Examiners Handbook*.

Reporting in the comments and recommendations section of this report was by exception; therefore, items that were tested and deemed acceptable by the examiners without material change receive little or no comment.

## **HISTORY OF THE COMPANY**

In February, 1983, with authorized capital of \$1,000,000, the Company was incorporated as a property and casualty insurer under the laws of the State of Mississippi. The Company's initial capitalization consisted of \$500,000 and included the issuance of 200,000 shares of \$1 par common stock. In December, 1987, the Company increased its outstanding capital stock to 600,000 shares of \$1 par common stock. In April, 2006, the Company increased its outstanding capital stock to its current position of 1,200,000 shares of \$1 par common stock.

## **CORPORATE RECORDS**

The minutes of the meetings of the Stockholder and Board of Directors, taken during the period covered by the examination, were reviewed and appeared to be complete and in order with regard to recording action on matters brought up at these meetings for deliberation, which included the approval and support of the Company's transactions and events.

## **FIDELITY BONDS AND OTHER INSURANCE**

The Company maintained a commercial insurance policy for employee theft with a limit of \$250,000. This amount meets the NAIC suggested minimum fidelity coverage for a company of its size. The Company also maintained an insurance program that appeared to provide adequate coverage to protect it from hazards that it may encounter.

## **DIRECTORS', OFFICERS', EMPLOYEES', AND AGENTS' WELFARE**

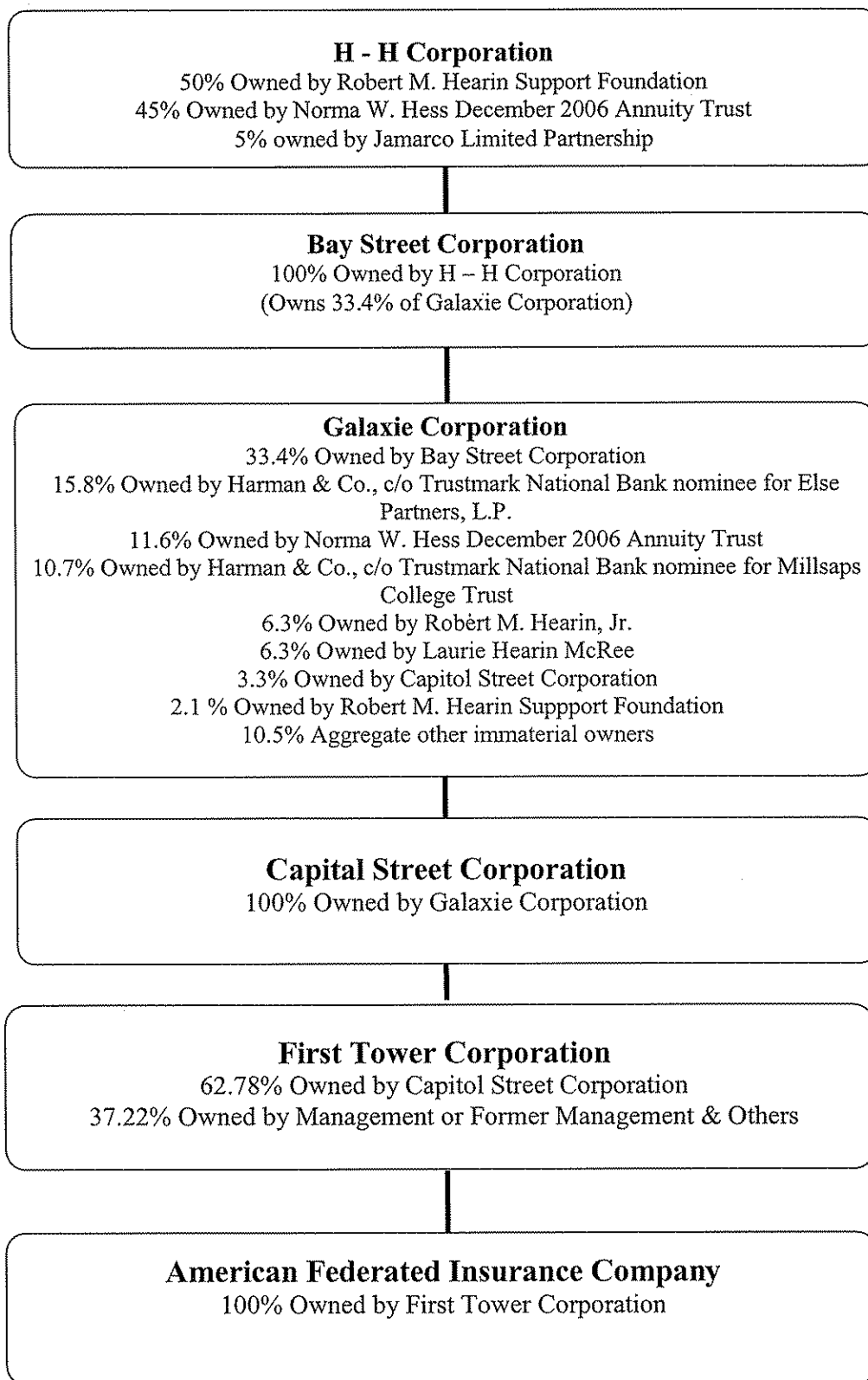
The Company provided a generally complete health and welfare program for all eligible employees through its parent company, First Tower Corporation. All of the Company's directors, officers, and agents are employees of First Tower Corporation and are also provided a generally complete health and welfare program by First Tower Corporation.

## **HOLDING COMPANY STRUCTURE**

The Company was a member of an insurance holding company system as defined within Miss. Code Ann. § 83-6-1. Holding Company Registration Statements were filed during the examination period with the Mississippi Insurance Department in accordance with Miss. Code Ann. § 83-6-5 and § 83-6-9. The statements and applicable amendments that were filed with the Mississippi Insurance Department during the examination period were reviewed and it appeared that any changes and material transactions by and between the Company and its affiliates were disclosed appropriately.

### **Organizational Chart**

The following organizational chart displays the direct line of ownership, along with a brief description of each member:



**H – H Corporation:** This company was a holding company which owned KR Holdings, Inc., a Mississippi corporation, and Bay Street Corporation, a Mississippi corporation. KR Holdings, Inc. was engaged in the business of real estate leasing and investments. KR Holdings, Inc. was not in the direct line of ownership for American Federated Insurance Company.

**Bay Street Corporation:** This company was engaged in the business of investments and owns Auto Electric & Carburetor, Inc., a distributor of automobile parts and accessories. Auto Electric & Carburetor, Inc. was not in the direct line of ownership for American Federated Insurance Company.

**Galaxie Corporation:** This company was a holding company with significant investments in debt and equity securities.

**Capitol Street Corporation:** This company was a holding company with significant investments in debt and equity securities.

**First Tower Corporation:** This company was engaged in consumer lending and related insurance activities through its wholly owned finance subsidiaries, Tower Loan of Mississippi, First Tower Loan, Inc., Gulfco of Mississippi, Inc., Gulfco of Louisiana, Inc., Gulfco of Alabama, Inc., Tower Loan of Missouri, Inc. and its wholly owned insurance subsidiaries American Federated Insurance Company and American Federated Life Insurance Company.

### **Related Party Transactions**

The Parent company provided certain corporate level administrative support services at no cost to the Company. Certain officers of the Company are paid directly by the Parent. As of the examination date, subsidiaries of the Company's Parent, owed the Company approximately \$1,287,000 for insurance premiums collected during the month of December, 2007.

During the examination period, the Company paid dividends to stockholders in the amount of \$7,159,877 during 2005, \$3,492,344 during 2006 and \$5,966,522 in 2007. The payments were paid to the Company's parent in lieu of commissions and were approved by the MID.

## **MANAGEMENT AND CONTROL**

### **Stockholder**

As of December 31, 2007, the Company had issued and outstanding 1,200,000 shares of common capital stock with a par value of \$1. First Tower Corporation owned 100% of the outstanding shares.

## **Board of Directors**

The Articles of Association and Bylaws vest the management and control of the Company's business affairs with the Board of Directors. At December 31, 2007, the members of the duly elected Board of Directors along with their place of residence and principal occupation were as follows:

<u>Name and Place of Residence</u>	<u>Principal Occupation</u>
Francis Clark Lee Brandon, Mississippi	President First Tower Corporation
Jack Ray Lee Brandon, Mississippi	Retired
James Leland Martin, Jr. Jackson, Mississippi	Secretary/Treasurer First Tower Corporation

## **Officers**

The officers duly elected by the Board of Directors and holding office at December 31, 2007 were as follows:

James Leland Martin, Jr.	President
Francis Clark Lee	Secretary/Treasurer

## **Conflict of Interest**

The Company had a formal policy whereby disclosure was made to the Board of Directors of any material interest or affiliation on the part of any officer or director that was, or would likely be, a conflict with the official duties of such persons. These procedures were reviewed and no exceptions to the Company's policy were noted.

## **ACCOUNTS AND RECORDS**

The 2007 trial balance of the Company's accounts was traced to the balance sheet of the Company's statutory annual statement filed with the Mississippi Insurance Department, with no exceptions noted. The Company was audited annually by an independent CPA firm.

## STATUTORY DEPOSITS

The Company's statutory deposits with the State of Mississippi complied with Miss. Code Ann. § 83-19-31 (2). The following chart displays the Company's deposits as of December 31, 2007:

<u>Type of Security</u>	<u>State Deposited</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Fair Value</u>
Certificate of Deposit	Louisiana	\$ 36,395	\$ 36,395	\$ 36,395
US Treasury Note	Mississippi	100,000	100,229	101,773
US Treasury Note	Mississippi	100,000	98,387	100,844
FMNA Bond	Mississippi	310,000	314,139	327,633
FHLB Bond	Mississippi	100,000	99,997	100,188
FHLB Bond	Mississippi	310,000	318,470	325,404
FHLB Bond	Mississippi	325,000	318,478	326,931
Totals		<u>\$ 1,281,395</u>	<u>\$ 1,286,095</u>	<u>\$ 1,319,168</u>

## **INTRODUCTION TO THE FINANCIAL STATEMENTS**

The following financial statements consist of a Statement of Admitted Assets, Liabilities, Surplus and Other Funds at December 31, 2007, a Statement of Income for year ended December 31, 2007, a Reconciliation of Capital and Surplus for the examination period ended December 31, 2007, and a Reconciliation of Examination Adjustments to Surplus.



**AMERICAN FEDERATED INSURANCE COMPANY**  
**STATEMENT OF ADMITTED ASSETS, LIABILITIES, SURPLUS AND**  
**OTHER FUNDS**  
**DECEMBER 31, 2007**

**ADMITTED ASSETS**

Bonds	\$16,897,710
Common stocks	1,160,171
Cash and short-term investments	1,887,248
Investment income due and accrued	235,311
Uncollected premiums	1,287,288
Net deferred tax asset	995,377
Receivable from parent, subsidiaries and affiliates	<u>11,056</u>
 Total admitted assets	 <u>\$22,474,161</u>

**LIABILITIES, SURPLUS AND OTHER FUNDS**

Losses	\$ 280,906
Loss Adjustment Expenses	8,847
Taxes, licenses and fees	144,469
Current federal income taxes payable	146,087
Unearned premiums	14,160,859
Payable for securities	328,733
Aggregate write-ins for liabilities	<u>26,460</u>
Total Liabilities	<u>15,096,361</u>
 Common capital stock	 1,200,000
Gross paid in and contributed surplus	300,000
Unassigned funds	<u>5,877,800</u>
Surplus as regards policyholders	<u>7,377,800</u>
 Total liabilities, surplus and other funds	 <u>\$22,474,161</u>

**AMERICAN FEDERATED INSURANCE COMPANY**  
**STATEMENT OF INCOME**  
**FOR YEAR ENDED DECEMBER 31, 2007**

<b>Underwriting Income</b>	
Premiums earned	\$ 9,476,047
<u>Deductions</u>	
Losses incurred	884,152
Loss expenses incurred	2,028
Aggregate write-insurance for underwriting deductions	<u>863,840</u>
Net underwriting gain or (loss)	<u>7,726,027</u>
<b>Investment Income</b>	
Net investment income earned	818,425
Net realized capital gains	<u>9,354</u>
Net investment gain	<u>827,779</u>
<b>Other income</b>	
Miscellaneous income	<u>10,772</u>
Net income before dividends to policyholders and before federal income taxes	8,564,578
Less: Federal income taxes incurred	<u>2,955,136</u>
Net income	<u>\$ 5,609,442</u>

**AMERICAN FEDERATED INSURANCE COMPANY  
RECONCILIATION OF CAPITAL AND SURPLUS  
FOR EXAMINATION PERIOD ENDED DECEMBER 31, 2007**

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Surplus as regards policyholders, beginning of the year	\$10,556,953	\$ 6,241,220	\$7,665,568
Net income	2,714,714	4,594,968	5,609,442
Change in net unrealized capital gains or (losses)	(74,010)	(173,697)	(67,097)
Change in net deferred income tax	203,440	145,421	136,409
Capital changes: Paid-in	-0-	600,000	-0-
Dividends to stockholders	(7,159,877)	(3,492,344)	(5,966,522)
Aggregate write-ins for gains and losses in surplus		(250,000)	-0-
Surplus as regards policyholders, end of the year	<u>\$ 6,241,220</u>	<u>\$7,665,568</u>	<u>\$7,377,800</u>

**AMERICAN FEDERATED INSURANCE COMPANY**  
**RECONCILIATION OF EXAMINATION ADJUSTMENTS TO SURPLUS**  
**DECEMBER 31, 2007**

As a result of this examination, there have been no adjustments affecting Surplus as regards policyholders reported by the Company in the December 31, 2007 annual statement. The Surplus as regards policyholders reported by the Company of \$7,377,800 is accepted as reasonably stated for purposes of the balance sheet per the examination.

## **MARKET CONDUCT ACTIVITIES**

A full market conduct examination in accordance with the NAIC *Market Conduct Handbook* was not performed; however, particular areas of the Company's market conduct were examined in connection with the financial examination. The particular areas reviewed are as follows:

### **Policy Forms and Underwriting**

The Company had appropriate licensure to issue its products, and the applicable policy forms were approved by the MID. In addition, a review of premium charges and refunds indicated that the Company was in compliance with approved policies and applicable laws.

### **Territory and Plan of Operation**

The Company was licensed to transact business in the States of Alabama, Louisiana, Mississippi and Missouri and wrote credit related property and casualty insurance to customers of affiliated lending companies.

### **Advertising and Sales Material**

During the examination period, the Company did not do any direct advertising or provide any sales material to policyholders.

### **Treatment of Policyholders**

The Company maintained a complaint log during the examination period, and all complaints appeared to have been resolved amicably and no policyholder abuse or undesirable patterns were noted.

### **Privacy**

The Company had a privacy policy in place for the protection of its policyholders, and this policy appeared to be in compliance with applicable law and standards.

## **COMMITMENTS AND CONTINGENCIES**

The Company was a named defendant in a class action suit brought by two Tower Loan borrowers, Claudia Smith and Wilbert Walker, in the United States District Court for the Southern District of Mississippi, Southern Division. American Federated Insurance Company, American Federated Life Insurance Company, Tower Loan, and other affiliates of First Tower Corp., are named defendants in similar actions brought by hundreds of borrowers in other courts. The class action and the actions in other courts, which assert many of the same claims brought in the class action, challenge virtually every material aspect of the loan/insurance practices of the Tower Loan companies and allege violations of state and federal laws. The insurance companies and the loan companies have denied the allegations in all of these cases.

In 2001, the parties to the class action entered into a proposed classwide settlement. Objectors to the class action settlement exhausted their rights to appeal when, on January 18, 2005, the United States Supreme Court denied the objectors' petition for writ of certiorari. Under the supervision of

the District Court, implementation of the class action settlement agreement commenced in March 2005. Distributions to Class Members appearing to have been accomplished, the District Court entered an order on September 20, 2006 directing the disbursement to a number of charitable organizations of approximately sixty-seven percent (67%) of the funds remaining in the Settlement Fund. The only matter remaining before entry of an order discharging the Settlement Administrator is judicial direction regarding disbursement (presumably to charitable organizations) of the approximately \$168,500.00 remaining in the Settlement Fund as of August 31, 2008.

### **SUBSEQUENT EVENTS**

During the year 2008, prior to the completion of fieldwork, the Company paid cash dividends in the amount of \$4,871,670. These payments were made to the Company's parent in lieu of commissions and were approved by the MID.

## ACKNOWLEDGMENT

The examiners representing the Mississippi Insurance Department and participating in this examination were:

Actuary:	Matthew P. Merlino, FCAS, MAAA, FCA
Examiner-in-charge:	Mitch Rayborn, CFE, CIE, FLMI
Administrative Examiner:	Dale Miller, CFE, CPA

The courteous cooperation of the officers and employees responsible for assisting in the examination is hereby acknowledged and appreciated.

Respectfully submitted,

  
\_\_\_\_\_  
Mitch Rayborn, CFE, CIE, FLMI  
Examiner-in-charge