

REPORT ON EXAMINATION

of the

**TENNESSEE FARMERS ASSURANCE COMPANY
147 BEAR CREEK PIKE
COLUMBIA, TENNESSEE**

as of

DECEMBER 31, 2005

DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

NASHVILLE, TENNESSEE

TABLE OF CONTENTS

<u>Item</u>	<u>Page</u>
Salutation	one
Introduction	1
Scope of Examination	1
Comments – Previous Examinations	2
Company History (includes exhibit of growth and financial history).....	4
Charter and Bylaws.....	5
Management and Control.....	7
Corporate Records.....	10
Fidelity Bond and Other Insurance.....	10
Territory (includes inforce by state).....	11
Plan of Operation	11
Reinsurance	12
Retirement Plan and Other Employee Benefits.....	13
Loss Experience.....	13
Accounts and Records.....	13
Statutory Deposits.....	14
Agreements with Parent, Subsidiaries and Affiliates	14
Pecuniary Interest Tenn. Code Ann. § 56-3-103.....	16
Commission Equity	16
Dividends or Distributions	16
Litigation.....	17
Subsequent Events	17
Financial Statement	20
Analysis of Changes in Financial Statement and Comments Resulting from Examination	25
Comments and Recommendations.....	26
Conclusion	27
Affidavit	28
Organizational Chart	29

Columbia, Tennessee
June 13, 2008

Honorable Leslie A. Newman
Commissioner
State of Tennessee
Department of Commerce and Insurance
Nashville, Tennessee 37243

Dear Commissioner:

Pursuant to your instructions and in accordance with Tennessee Insurance Laws, regulations, and resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial examination was made of the condition and affairs of the

TENNESSEE FARMERS ASSURANCE COMPANY
147 BEAR CREEK PIKE
COLUMBIA, TENNESSEE 38401

hereinafter and generally referred to as the Company, and a report thereon is submitted as follows:

INTRODUCTION

This examination was called by the Commissioner of Commerce and Insurance of the State of Tennessee on August 7, 2006. On-site examination work commenced on September 25, 2006. With the Company having authority to write business only in the State of Tennessee, the examination was not classified as an Association Examination under NAIC Guidelines. The examination was performed by duly authorized representatives of the Department of Commerce and Insurance, State of Tennessee ("TDCI") and was conducted simultaneously with three (3) other insurance companies in the Tennessee Farmers Insurance Group, all based in Columbia, Tennessee as follows:

Tennessee Farmers Mutual Insurance Company
Tennessee Farmers Life Insurance Company
Tennessee Farmers Life Reinsurance Company

SCOPE OF EXAMINATION

This examination report covers the period from January 1, 2001 to the close of business on December 31, 2005, and includes any material transactions and/or events occurring subsequent to the examination date and noted during the

course of the examination.

The examination of the financial condition was conducted in accordance with guidelines and procedures contained in the NAIC Financial Condition Examiners Handbook. During the course of examination, assets were verified and valued and liabilities were determined and estimated as of December 31, 2005. The financial condition of the Company and its amount of solvency were thereby established. Test checks were made of income and disbursement items for selected periods, and a general review was made of the Company's operations, practices, and compliance with applicable statutes and regulations. All asset and liability items contained in the financial statement of this report were examined and verified with relative emphasis according to their amount and potential impact on capital and surplus.

In addition, the following topics were reviewed:

- Comments – Previous Examinations
- Company History
- Charter and Bylaws
- Management and Control
- Corporate Records
- Fidelity Bonds and Other Insurance
- Territory (includes inforce/premium by state)
- Plan of Operation
- Reinsurance
- Retirement Plan and Other Employee Benefits
- Loss Experience
- Accounts and Records
- Statutory Deposits
- Agreements with Parent, Subsidiaries and Affiliates
- Pecuniary Interest Tenn. Code Ann. § 56-3-103
- Commission Equity
- Dividends or Distributions
- Litigation
- Subsequent Events
- Financial Statement

COMMENTS –PREVIOUS EXAMINATIONS

The previous financial examination was conducted as of December 31, 2000, by authorized representatives of the TDCI. The previous examination resulted in a decrease of \$5,342,756 in surplus due to the value of the Company's sole mortgage loan and the accrued interest related to said loan being classified as non-admitted assets. The mortgagor had become delinquent on both regularly scheduled principal and interest payments.

No regulatory requirements resulted from the previous examination. Several comments were made in the previous examination report to which the Company made a formal reply. These comments and replies are outlined as follows:

- **Registered Agent:** The report cited the comment from the examination as of December 31, 1995 stating that the Registered Agent for the Company had changed and that this was not reflected via a charter amendment. The Company advised that the change of registered agent is made in the annual filing with the Secretary of State, State of Tennessee and does not warrant a change in the charter. The TDCI has made no regulatory requirement in this matter and no charter amendment has been deemed necessary.
- **Corporate Records – Board Approval for Actuaries and Independent Auditors:** The report cited the fact that formal board approval was absent for the actuary and independent auditor for the years under examination. The Company agreed with finding; however, their reply stated that formal approval was present for subsequent years. Said approval was also verified during the current examination.
- **Litigation and Contingent Liabilities:** The report referenced the Franchise and Excise Tax Audit by the Department of Revenue, State of Tennessee with an amount of \$10,929,479 assessed including interest. The Company subsequently paid the amount in question under protest and prepared to file legal suit to recover. The legal proceedings were terminated during 2006 and are discussed under the caption, "Litigation."

The United States Internal Revenue Service conducted an audit through year, 1997. Some adjustments resulted and these adjustments were carried forward to tax years, 1998 through 2000. These adjustments are of an immaterial overall amount. The Company agreed with the statement.

- **Mortgage Loans:** Value was reduced by \$5,217,217 per examination due to default in the Company's sole mortgage. The Company replied that said assets would be non-admitted by a direct charge to surplus on future financial filings.
- **Cash:** The Company listed some money market investment accounts as cash rather than short-term investments in the 2000 Annual Statement. The Company replied that they were in agreement with said interpretation of NAIC Accounting Practices and Procedures and made the proper classification on future financial filings.
- **Interest, Dividends and Real Estate Income Due & Accrued:** Accrued interest was reduced by \$125,539 per examination. This reduction was

associated with interest in default on the Company's sole mortgage loan. The Company agreed and indicated that said interest would be non-admitted on future financial filings.

Findings reviewed during the present examination indicated that the Company has addressed all comments made during previous financial examinations.

During 2004, the TDCI performed a Target Financial Examination of the Company. The Report on Examination was made as of December 31, 2003 and was signed on December 22, 2004. The recommendations from the examination report are as follows:

- It is recommended that the Company file and report transactions within its holding company system in a holding company registration statement in accordance with Tenn. Code Ann. § 56-11-205.
- It is recommended that the Parent Company's investment subsidiary, TFIC, Inc. should submit financial statements to the TDCI in accordance with SAP and NAIC Annual Statement instructions.
- It is recommended that the Company adopt a corporate investment policy for the Investment Committee with Board of Director level supervision and periodic review and approval.
- It is recommended that the Company revise its conflict of interest policy and procedures such that investments by the Company that create a conflict of interest in violation of Tenn. Code Ann. § 56-3-103 are identified and prevented.

Findings reviewed during the present examination indicated that the Company has complied with the above recommendations. As to the last recommendation, on April 25, 2005, Tenn. Code Ann. § 56-3-103 was amended and the Company's practices are in compliance with the statute as amended.

COMPANY HISTORY

The Company was incorporated under the provisions of the Tennessee General Corporation Act on April 3, 1991. The Company operates as a stock property and casualty insurance company and was issued a Certificate of Authority by the TDCI dated May 2, 1991. Business commenced on August 1, 1991.

Subsequent to the Company's incorporation, TFHC, Inc. a wholly owned subsidiary of three (3) affiliates of the Company, purchased 24,400,000 shares of one dollar (\$1) par value common stock. Through additional purchases and declared stock dividends, TFHC, Inc. as of December 31, 2005 owned

35,363,247.822 shares of the Company's common stock.

A special stock offering was made to employees, agents and directors during August of 1992. A total of 478,300 shares were purchased through this offering on a five (5) year payment plan.

As of December 31, 2005, there are 38,947,090 shares of common stock issued and outstanding. The additional shares from the purchases already mentioned are issued to policyholders, agents, officers and directors of Tennessee Farmers Mutual Insurance Company and its affiliates.

Since August, 1992 and until December 31, 2005, the only changes in the Company's outstanding common stock and paid in and contributed surplus resulted from small repurchases of common stock and new stock certificates issued to Tennessee Farmers Mutual Insurance Company in order to contribute to its 401K retirement plans. Also, a few new shares were issued to new agents and directors. The Company has also declared stock dividends at various times over the years.

At December 31, 2005, the Company was licensed in one state, Tennessee.

The following exhibit depicts certain aspects of the growth and financial history of the Company since the previous examination, according to annual statements filed with the TDCI.

<u>Date</u>	<u>Earned Premiums</u>	<u>Incurred Losses & LAE</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Total Surplus</u>
12/31/2001	\$287,514,969	\$219,357,592	\$481,358,190	\$233,995,852	\$247,362,338
12/31/2002	316,398,650	258,173,657	536,497,520	258,531,161	277,966,359
12/31/2003	339,570,899	300,579,552	567,019,526	280,683,388	286,336,138
12/31/2004	358,028,953	253,163,830	653,981,310	301,210,009	352,771,301
12/31/2005	385,545,717	266,012,047	742,524,432	311,527,446	430,996,986

CHARTER AND BYLAWS

Charter:

The Charter was filed and recorded with the Secretary of State, State of Tennessee on April 3, 1991 and was filed and recorded with the Maury County Register of Deeds on April 9, 1991. The Charter had been approved by the TDCI on April 3, 1991.

The Charter provided for the operation of a "for profit" corporation and authorized a maximum number of 100,000,000 shares of capital common stock with a par value of one dollar (\$1) per share. These shares have unlimited voting rights and have the right to receive the net assets of the Company upon dissolution.

The principal purposes of the Company are:

1. "To issue contracts of insurance and/or to reinsure or accept reinsurance of all forms of property and casualty insurance, including, but not limited to, all forms of fire insurance, liability insurance, disability insurance, automobile insurance, use and occupancy insurance; and all other insurance against loss or damage by any hazard for any risk not otherwise provided for in this section which is not prohibited by statute or common law from being the subject of insurance, excepting life insurance."
2. "To engage in any lawful act or activity for which corporations for profit may be organized under the laws of the State of Tennessee; and the corporation shall have all powers necessary to conduct such business and engage in such activities, including, but not limited to, the powers enumerated in the Tennessee Business Corporation Act or any amendment thereto."

The principal office of the Company was established as follows:

Highway 412, Bear Creek Pike
Columbia, Tennessee 38401
Maury County, Tennessee

Bylaws:

The Restated Bylaws of the Company in effect at December 31, 2005 were enacted effective April 9, 1992 in order to comply with the Tennessee Corporation Act of 1986 and alleviate any technical deficiencies that may have surfaced since the Company was incorporated.

The Bylaws provide for an annual meeting of shareholders at which a Board of Directors is elected. Officers are elected by the Board annually at the first Board meeting after the annual meeting of shareholders.

The Board is charged with managing the business and affairs of the Company. Each director must be a member in good standing of the Tennessee Farm Bureau Federation. The Board shall be composed of not less than five (5) members nor more than 25 in number. Said number shall be set by the Board.

The current Bylaws are such as generally found in corporations of this type and contain no unusual provisions. They provide for regulation of the business and

for the conduct of the affairs of the Company, directors and its members. Said Bylaws have not been amended during the period of examination.

MANAGEMENT AND CONTROL

Board of Directors:

Management of the Company is vested in a Board of Directors elected annually. In accordance with the Bylaws, the Board shall consist of not less than five nor more than 25 members. The composition of the board has been identical for all four companies comprising the Tennessee Farmers Group. The following persons had been duly elected and were serving as members of the Company's Board of Directors at December 31, 2005:

<u>Name, Address and County</u>	<u>Principal Occupation</u>
Flavius Barker Columbia, TN (Sequatchie)	President & Chairman of the Board/Farmer
Lacy Upchurch Crossville, TN (Cumberland)	Vice President/Farmer
Jeff Aiken Telford, TN (Washington)	Farmer
Malcolm Burchfiel Newbern, TN (Dyer)	Farmer
Linda Davis Rutherford, TN (Gibson)	Farmer/Homemaker
Joan Fussell Erin, TN (Houston)	Farmer/Homemaker
Charles Hancock Bumpus Mills, TN (Stewart)	Farmer
Dan Hancock Smithville, TN (DeKalb)	Farmer
David Mitchell Blaine, TN (Grainger)	Farmer
William Danny Rochelle Nunnelly, TN (Hickman)	Farmer

Bobby Willis Hillsboro, TN (Coffee)	Farmer
Willard Brown Cookeville, TN (Putnam)	Farmer
Martin Davis Shelbyville, TN (Bedford)	Farmer
Robert Earhart Bristol, TN (Sullivan)	County Executive
Allen Peddy Henderson, TN (Chester)	Farmer
Jack Sanders Charleston, TN (Bradley)	Farmer

The Board of Directors is charged with managing the business and affairs of the Company. Each director must be a member in good standing of the Tennessee Farm Bureau Federation, which in turn requires membership in good standing of a county Farm Bureau. Though not required by the Charter or Bylaws of the Company, historically 11 members of the Board have also served on the Federation Board of Directors.

Officers:

The Bylaws of the Company provide that the Board of Directors shall elect annually a president, a first vice president, a chief executive officer, a secretary, a treasurer, and such additional officers as the chief executive officer may propose and the Board of Directors approve. The following officers were duly elected and were serving in the positions indicated for the Company at December 31, 2005:

Flavius Barker	President & Chairman of the Board
Lacy Upchurch	First Vice President
Matthew M. Scoggins, Jr.	Chief Executive Officer
Wayne Harris	Chief Financial Officer
Edward Lancaster	General Counsel, Secretary
John Law	Chief Operating Officer, P&C Operations

Neal Townsend

Chief Marketing Officer

The Board of Directors has given authority to the Chief Executive Officer (CEO) to appoint such other officers as needed to operate the Company. The following officers were appointed by the CEO and serving in positions indicated for the Company at December 31, 2005:

Wayne Merrill

Vice President, Accounting

Vickie Knight

Vice President, Property Underwriting

Sam McDaniel

Vice President, Automobile
Underwriting

Steve Burt

Vice President, Information Services

Wayne Erwin

Vice President, Claims

The President functions as the Chairman of the Board of Directors and presides over all meetings of the stockholders and the Board of Directors. The President also serves as a conduit to the executive personnel concerning policy established by the Board of Directors. Subject to the control of the Board of Directors, the Chief Executive Officer shall have general management and control of the affairs and business of the Company, and shall perform all other duties and exercise all other powers commonly incident to his office, or which are required by law.

The Company's Investment Committee at December 31, 2005 is as follows:

<u>Name</u>	<u>Title</u>
Flavius Barker	President
Matthew M. Scoggins, Jr.	Chief Executive Officer
Hulet Chaney	Chief Executive Officer Emeritus
Wayne Harris	Chief Financial Officer
Dennis Stephen	Chief Operating Officer – Life Operations

Non Voting Members

Randy Maxwell	Investment Portfolio Manager
David Williamson	Investment Portfolio Manager
Edward Lancaster	Secretary

The administrative and executive functions of the Company are performed by the home office staff of Tennessee Farmers Mutual Insurance Company under recitals of a Management Services Agreement. The Company is a direct writer of non standard automobile insurance which is marketed through captive agents. Offices are typically located in county farm bureau offices throughout Tennessee.

These offices are staffed by licensed agents who operate as independent contractors. Underwriting activities are also performed under recitals of the referenced Management Services Agreement.

Certain services are purchased from outside contractors if needed and are not available from in house personnel. Such services include actuarial analysis and independent audit.

Actuarial Services: Patrick J. Crowe, FCAS, MAAA
7371 Wolf Spring Trace
Louisville, Kentucky

Auditing Services: PricewaterhouseCoopers, LLC
500 West Main
Louisville, Kentucky

A holding company organizational chart is included at the last page of this examination report.

CORPORATE RECORDS

Minutes of meetings of the Company's stockholders, Board of Directors including Executive Session and Investment Committee were reviewed for the period under examination. In general, such minutes appear to be in proper order and accurately report the proceedings of each respective meeting.

FIDELITY BOND AND OTHER INSURANCE

The Company has elected to not obtain fidelity coverage with the exception of its retirement plan. Minimum fidelity bond coverage of \$1,250,000 to \$1,500,000 is suggested by guidelines published in the NAIC Financial Condition Examiners Handbook.

The following is a schedule of insurance maintained by the Company at December 31, 2005.

<u>Type of Coverage</u>	<u>Coverage Limits</u>
1. Commercial General Liability	
Each occurrence	\$2,000,000
General aggregate	\$2,000,000
Products-Completed operations aggregate limit	\$2,000,000
Personal & advertising limit	\$2,000,000

Damage to premises rented	\$50,000
Medical expense limit (any one person)	\$5,000

Coverage is underwritten by Tennessee Farmers Mutual Insurance Company which is licensed in Tennessee as a "Tennessee Domiciled Property and Casualty Insurer."

2. Directors and Officers

Aggregate	\$10,000,000
Deductible each claim	\$100,000

Coverage is underwritten by Great American Insurance Company which is licensed in Tennessee as a "Foreign Property and Casualty Insurer."

TERRITORY

As of December 31, 2005, and as of the date of this examination report, the Company was licensed to transact business in the State of Tennessee. The Certificate of Authority for that jurisdiction was reviewed. During 2005, the Company wrote direct premium in one (1) state:

<u>State</u>	<u>Amount</u>
Tennessee	<u>\$15,278,710</u>
Total	\$15,278,710

PLAN OF OPERATION

The majority of the Company's business is from the assumption of premiums written by its parent, Tennessee Farmers Mutual Insurance Company. Under the terms of the participation reinsurance agreement, the Company will share 50% of the premiums written and retained by Tennessee Farmers Mutual and 50% of the losses, loss adjustment expenses, underwriting expenses and policyholder dividends. The business written by Tennessee Farmers Mutual is sold to members of the Tennessee Farm Bureau Federation and includes various property and casualty lines of business.

During 1999, the Company began writing non standard automobile policies which constitute their direct premium. The Company then cedes 50% of the subject premium and 50% of the losses, loss adjustment expenses, and underwriting expenses to Tennessee Farmers Mutual Insurance Company.

The Company continues to operate as a direct writer using the same captive

agents utilized by Tennessee Farmers Mutual Insurance Company. These agents are considered independent contractors.

The largest net amount insured by the Company in any one risk is \$400,000.

During the period under review and through the date of this report, all policy preparation was performed in the home office and was subject to the underwriting rules adopted by the Company and promulgated in accordance with approved rates. Further overview is contained under the caption "Agreements with Parent, Subsidiaries and Affiliates" as all personnel performing home office operations are supplied under recitals of a Management Services Agreement with Tennessee Farmers Mutual Insurance Company.

The adjustment of claims is handled by Tennessee Farmers Mutual Insurance Company under recitals of a Management Services Agreement which is discussed under the caption "Agreements with Parent, Subsidiaries and Affiliates" in this report.

REINSURANCE

The Company routinely assumes and cedes reinsurance with other insurance companies. The Company's significant reinsurance agreements are summarized below.

Assumed Reinsurance with Affiliates

Tennessee Farmers Mutual Insurance Company

The company assumes, thru a quota share agreement, 50% of all lines of business issued by Tennessee Farmers Mutual Insurance Company effective August 1, 1991. This agreement covers liabilities that existed on and after August 1, 1991.

Ceded Reinsurance with Affiliates

Tennessee Farmers Life Reassurance Company

The company cedes, thru two quota share agreements, 100% of the automobile accidental death medical pay policies issued by the Company to Tennessee Farmers Life Reassurance Company effective January 1, 1995. This agreement covers liabilities which existed on and after January 1, 1995.

Tennessee Farmers Mutual Insurance Company

The company cedes, thru a quota share agreement, 50% of all lines of business

issued by the Company to Tennessee Farmers Mutual Insurance Company effective January 1, 1999. This agreement covers liabilities that existed on and after January 1, 1999.

Other Considerations:

All of the Company's significant reinsurance agreements were found to contain such language as recommended by the NAIC and as required for reinsurance credit pursuant to Tenn. Code Ann. § 56-2-207(a)(2). All agreements also appear to effectuate proper transfer of risk in accordance with SSAP No. 62 and NAIC guidelines.

RETIREMENT PLAN AND OTHER EMPLOYEE BENEFITS

At December 31, 2005 and during the period covered by this examination, the Company had no employees. The administrative and executive functions of the Company are performed by the home office staff of Tennessee Farmers Mutual Insurance Company under recitals of a Management Services Agreement. A discussion of employee benefits as afforded employees of Tennessee Farmers Mutual Insurance Company is included in the "Report on Examination of the Tennessee Farmers Mutual Insurance Company as of December 31, 2005."

LOSS EXPERIENCE

<u>Year</u>	<u>Losses Incurred</u>	<u>LAE Incurred</u>	<u>Premiums Earned</u>	<u>Loss Ratio</u>
2001	\$ 198,899,520	\$ 20,458,072	\$ 287,514,969	76.3%
2002	237,084,419	21,089,238	316,398,650	81.6%
2003	278,778,917	21,800,635	339,570,899	88.5%
2004	230,941,946	22,221,884	358,028,953	70.7%
2005	243,129,915	22,882,132	<u>385,545,717</u>	69.0%
Total	\$1,188,834,717	\$108,451,961	\$1,687,059,188	76.9%

ACCOUNTS AND RECORDS

During the course of examination, such tests and audit procedures were made as were considered necessary, including substantial verification of postings, extensions and footings and reconciliation of subsidiary ledgers to control accounts where necessary. General ledger trial balances were reconciled with copies of annual statements for the years 2001, 2002, 2003, 2004 and 2005.

Accounting records conform to generally accepted insurance accounting practices and appear to properly reflect the operations during the period under examination and the status of the Company at the date of examination.

The Company's Risk Based Capital Report was reviewed. The Company was in compliance with Title 56, Chapter 46, of the Tennessee Code Annotated (Risk Based Capital for Insurers).

An annual audit of the Company is performed by an independent accounting firm, PricewaterhouseCoopers, LLP

Books and records of the Company are kept at the home office location:

147 Bear Creek Pike
Columbia, Tennessee 38401

STATUTORY DEPOSITS

In compliance with statutory requirements, the Company maintained the following deposits at December 31, 2005.

<u>Where Deposited and Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
Tennessee			
Tenn. St 5%, due 5/01/2014	\$2,500,000	\$2,559,314	\$2,627,750
Total general deposits held for the benefit of all policyholders and creditors of the Company	<u>2,500,000</u>	<u>2,559,314</u>	<u>2,627,750</u>
Total	<u>\$2,500,000</u>	<u>\$2,559,314</u>	<u>\$2,627,750</u>

The above deposit was confirmed with the custodian at the Division of Insurance.

AGREEMENTS WITH PARENT, SUBSIDIARIES AND AFFILIATES

The Company meets the definition of a holding company pursuant to Tenn. Code Ann. § 56-11-201.

The insurance companies in the Tennessee Farmers Group had previously been exempt from the registration requirements under Tenn. Code Ann. § 56-11-205 based on an order from Commissioner Elaine McReynolds dated February 12, 1987 which granted the exemption pursuant to Tenn. Code Ann. § 56-11-205(j).

During 2004, the TDCI performed a Target Financial Examination of the four (4) companies (Tennessee Farmers Mutual Insurance Company, Tennessee Farmers Assurance Company, Tennessee Farmers Life Insurance Company, and Tennessee Farmers Life Reassurance Company) in the Holding Company. The Report on Examination was made as of December 31, 2003 and was signed on December 22, 2004. The TDCI and the four Companies subsequently agreed that, henceforth, all companies would be subject to the regulation requirements under Title 56, Chapter 11, Tennessee Code Annotated, "Insurance Holding Company System Act of 1986".

The Company started filing Form B "Insurance Company System Annual Registration Statement" and Form C "Summary of Registration Statement" with the TDCI for the year, 2004. This information was filed on April 29, 2005 in compliance with Tenn. Code Ann § 56-11-205.

A Form D "Prior Notice of a Transaction" filing for the two agreements referenced under this caption was also filed with the TDCI on April 29, 2005.

Management Services Agreement:

The Company entered into a Management Services Agreement with its parent, Tennessee Farmers Mutual Insurance Company effective April 25, 1991. Under this agreement, the parent performs all management, administrative and other services that are reasonably necessary for the operation of the Company. These services include, but are not limited to: employee, legal, claims, managerial and accounting.

The agreement provides for the parent to be paid for services and supplies an amount determined in accordance with Treasury Regulation Section 1.482-2(b) (3) et seq. as codified in United States Internal Revenue Code Title 26. The agreement calls for settlement to be remitted on a quarterly basis.

The agreement had an ending date of December 31, 1991 with the option to renew on calendar year basis thereafter.

Agreement To Allocate Consolidated Federal Income Tax Liability:

The Company is party to a consolidated tax return filed in the name of Tennessee Farmers Mutual Insurance Company, its parent. This return additionally includes the Company, Tennessee Farmers Insurance Agency, Inc. and TFIC, Inc. The Agreement to Allocate Consolidate Federal income Tax Liability was entered into effective December 31, 2004.

The previous agreement had been effective as of December 31, 2000.

During 2005, Tennessee Farmers Mutual Insurance Company was paid

\$63,561,332 by the Company. Federal Income Tax allocation for the Company was \$16,699,330.

PECUNIARY INTEREST TENN. CODE ANN. § 56-3-103

The Company established a conflict of interest policy for its directors and officers to attest to compliance with Tenn. Code Ann. § 56-3-103, prohibiting officers and directors from having pecuniary interest in investment or disposition of Company funds. The officers and directors file annual conflict of interest statements.

COMMISSION EQUITY

The Company correctly reports commission equity of \$511,442 in the notes to financial statement in compliance with NAIC Annual Statement Instructions. This amount is related to the Quota Share Reinsurance Agreement (50%) with its parent company.

This amount is immaterial based on the surplus position of the company and its parent company. No contingent liability is proposed due to the financial strength of the parties and the unlikelihood that the reinsurance agreement would be commuted.

DIVIDENDS OR DISTRIBUTIONS

During the period of examination the Company paid the following amounts in policyholder dividends and dividends or distributions to stockholders.

Policyholder Dividends

Year	Amount
2001	\$12,352,175
2002	7,780,797
2003	9,057,438
2004	14,740,244
2005	<u>9,608,363</u>
Total Paid During Period of Examination	\$53,539,017

The policyholder dividends represented above are dividends paid on participating policies issued by Tennessee Farmers Mutual Insurance Company which are ceded to the Company under a Quota Share Reinsurance Agreement.

Stockholder Dividends

Paid by Stock Dividend:

<u>Year</u>	<u>Amount</u>
2001	\$1,552,042
2002	1,630,790
2003	1,713,473
2004	1,080,077
2005	<u>1,854,701</u>
Total Paid During Period of Examination	\$7,831,083

The above amounts represent the cash value of the dividends which was paid in the form of shares of common stock issued by the Company.

LITIGATION

As of December 31, 2005, the Company has committed no reserves to cover any contingent liability. Various lawsuits against the Company have arisen in the normal course of business relating to insurance claims' settlements. Contingent liabilities arising from litigation are not considered material in relation to the financial position of the company.

The Department of Revenue, State of Tennessee assessed additional Franchise and Excise Taxes for the period 1/1/95 – 12/31/98 in the amount of \$10,929,479 including accrued interest. A second examination for the period covering years, 1999 -2002 assessed \$7,352,092 including accrued interest. The Company paid the assessed amounts including interest for both of the audits under protest and contested these findings in court.

On January 26, 2005, the Company filed suit to recover the disputed assessment arising from the years 1999 – 2002. The trial court had previously granted the Company's motion for summary judgment on the assessment for the period 1/1/95 – 12/31/98 and the State of Tennessee appealed to the Court of Appeals.

The Company made the determination to terminate both legal proceedings during 2006 after review of the evidence that was still available and the cost effectiveness of further litigation.

SUBSEQUENT EVENTS

Settlement of the Franchise and Excise Tax issue per audit of the Department of Revenue, State of Tennessee was discussed previously under the caption, "LITIGATION."

The Company and its two (2) custodians, The Northern Trust Company and First Farmers and Merchants Bank completed amendments to their custodian agreements during the course of the examination to insure that the documents complied with the technical language pursuant to Tenn. Comp. R. & Regs. ch. 0780-1-46-.03(2)(a), which became effective on July 12, 2005. The rule states:

"The custodial agreement required by this rule shall contain the following:

1. A provision stating that the standard of responsibility on the part of the custodian shall not be less than that of the responsibility of a bailee for hire or a fiduciary under statutory or case law of Tennessee;
2. A provision stating that the securities held by the custodian are subject to instructions of the insurance company;
3. A provision stating that the securities may be withdrawn immediately upon demand of the insurance company; and
4. A provision stating that the agreement is between the custodian and the insurance company, and not the parent or affiliate of the insurance company."

The original documents had protective language; however, that language was written in a more generic form than the specific four (4) provisions of the above rule. These amendments were transacted at the request of the Company.

The Northern Trust Company Amendment was effective on March 1, 2007 exhibiting language compliant with Tenn. Comp. R. & Regs. ch. 0780-1-46-.03 (2)(a). Signature date for the Company was March 22, 2007 and signature date for Northern Trust was April 19, 2007.

The First Farmers and Merchants Bank Amendment was effective on March 1, 2007 exhibiting language compliant with Tenn. Comp. R. & Regs. ch. 0780-1-46-.03(2)(a). Signature date for the Company and First Farmers was June 6, 2007.

As of December 31, 2005, Northern Trust held \$8,566,041 in common stock and \$10,632 in short-term investments. First Farmers and Merchants Bank held \$648,913,779 in bonds, \$23,627,889 in common stocks and \$11,540,950 in cash equivalent funds.

The Company determined in August, 2007 that a change would be made in their auditors from PricewaterhouseCoopers, LLP to Blackman Kallick Bartelstein, LLP. This change was related to customer service issues and did not involve any disputed audit findings. This was confirmed and attested by letter from PricewaterhouseCoopers, LLP dated September 24, 2007 in compliance with Tenn. Comp. R. & Regs. ch. 0780-1-65-.06. Official notice of the change was

given to the TDCI via letter from the Company dated August 31, 2007.

FINANCIAL STATEMENT

There follows a statement of assets, liabilities and statement of income at December 31, 2005, together with a reconciliation of capital and surplus for the period under review, as established by this examination:

ASSETS

	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$651,473,093			\$651,473,093
Preferred Stocks	15,929,983		250,000	15,679,983
Common Stocks	38,302,422		563,401	37,739,021
Cash and short-term investments	11,739,194			11,739,194
Receivables for securities	259,419			259,419
Investment income due and accrued	8,566,572			8,566,572
Premiums and agents, balances In course of collection	5,533,426			5,533,426
Net deferred tax asset	11,335,977			11,335,977
Receivable from parent, subsidiaries and Affiliates	197,747			197,747
Other non-admitted assets	0			0
Aggregate write-ins for other than invested Assets	<u>258,772</u>	_____	<u>258,772</u>	<u>0</u>
 Totals	 <u>\$743,596,605</u>	 <u>\$0</u>	 <u>\$1,072,173</u>	 <u>\$742,524,432</u>

LIABILITIES, SURPLUS, AND OTHER FUNDS

Losses	\$109,265,232
Reinsurance payable on paid loss and loss adjustment expenses	0
Loss adjustment expenses	22,961,595
Commissions payable, contingent commissions and other similar charges	208,141
Other expenses (excluding taxes, licenses and fees)	5,138,626
Taxes, licenses and fees (excluding federal and foreign income tax)	774,353
Federal and foreign income taxes	0
Unearned premiums	142,893,498
Advance premiums	45,971
Dividends declared and unpaid: policyholders	9,874,067
Ceded reinsurance premiums payable (net of ceding commissions)	0
Amounts withheld or retained by company for account of others	29,438
Payable to parent, subsidiaries and affiliates	18,667,253
Payable for securities	256,432
Aggregate write-ins for liabilities (related to deferred benefits at retirement)	<u>1,412,840</u>
Total Liabilities	311,527,446
Common capital stock	38,947,090
Gross paid in and contributed surplus	28,254,010
Unassigned funds (surplus)	<u>363,795,886</u>
Surplus as regards policyholders	430,996,986
Total liabilities and surplus	<u>\$742,524,432</u>

STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned		\$385,545,717
Deductions: Losses incurred	\$243,129,915	
Loss expenses incurred	22,882,132	
Other underwriting expenses incurred	<u>52,262,575</u>	
Total underwriting deductions		<u>318,274,622</u>
Net underwriting gain		67,271,095

INVESTMENT INCOME

Net investment income earned	27,100,628	
Net realized capital gains (losses)	<u>2,377,934</u>	
Net investment gain		29,478,562

OTHER INCOME

Finance and service charges not included in premiums		311,396
Aggregate write-ins for miscellaneous income		<u>5,587,204</u>
Total other income		5,898,600
Net income before dividends to policyholders and before federal income taxes		102,648,257
Dividends to policyholders		9,608,363
Federal income taxes incurred		<u>16,628,364</u>
Net income		<u>\$76,411,530</u>

CAPITAL AND SURPLUS

Surplus as regards policyholders, December 31 prior year		\$352,771,301
Net income	\$76,411,530	
Change in net unrealized capital gains (losses)	4,225,155	
Change in net deferred income tax	(1,803,695)	
Change in non-admitted assets	(688,312)	
Cumulative effect of changes in accounting principles	0	
Capital changes: Paid in	24,190	
Capital changes: Transferred from surplus (Stock Dividend)	1,854,701	
Surplus adjustments: Paid in	233,325	
Surplus adjustments: Transferred to capital (Stock Dividend)	(1,854,701)	
Aggregate write-in for gains and losses in surplus	(176,508)	
Change in surplus as regards policyholders for the year		78,225,685
Surplus as regards policyholders, December 31 current year		<u>\$430,996,986</u>

**RECONCILIATION OF CAPITAL AND SURPLUS
FOR THE PERIOD UNDER EXAMINATION**

Surplus as regards policyholders December 31	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Previous Year	\$227,780,283	\$247,362,338	\$277,966,359	\$286,336,138	\$352,771,301
Net Income	25,620,628	26,402,398	5,793,666	59,692,998	76,411,530
Change in net unrealized capital gains or (losses)	(2,503,883)	(2,805,263)	1,318,598	5,852,868	4,225,155
Change in net deferred income tax	99,754	(1,143,968)	1,389,227	(499,406)	(1,803,695)
Change in non-admitted Assets	8,071	(24,396)	13,434	1,460,519	(688,312)
Change in provision for Reinsurance	0	0	0	0	0
Cumulative effect of changes in accounting principles	(3,643,738)	7,831,948	0	0	0
Capital changes: Paid in	15,761	23,825	22,322	8,901	24,190
Capital changes: Transferred From surplus (Stock Dividend)	1,552,042	1,630,790	1,713,473	1,080,077	1,854,701
Surplus adjustments: Paid in	122,385	188,129	187,058	82,202	233,325
Surplus adjustments: Transferred to capital (Stock Dividend)	(1,552,042)	(1,630,790)	(1,713,473)	(1,080,077)	(1,854,701)
Aggregate write-ins for gains and losses in surplus	<u>(136,923)</u>	<u>131,348</u>	<u>(354,526)</u>	<u>(162,919)</u>	<u>(176,508)</u>
Surplus as regards policyholders, December 31 current year	<u>\$247,362,338</u>	<u>\$277,966,359</u>	<u>\$286,336,138</u>	<u>\$352,771,301</u>	<u>\$430,996,986</u>

**ANALYSIS OF CHANGES IN FINANCIAL STATEMENT AND COMMENTS
RESULTING FROM EXAMINATION**

Differences in various items were noted during the course of examination; however, none were considered to produce a material effect on surplus funds, as regards policyholders, either singly or in aggregate.

**SUMMARY SCHEDULE FOR "ANALYSIS OF CHANGES
IN FINANCIAL STATEMENT AND COMMENTS RESULTING FROM
EXAMINATION" AS THEY AFFECT SURPLUS**

No schedule or comment is applicable. All noted differences were within the tolerable error and planning materiality established for examination purposes.

COMMENTS AND RECOMMENDATIONS

Comments:

- The Company amended its two (2) custodial agreements with The Northern Trust Company and First Farmers and Merchants Bank during the course of the examination to clarify some technical language pursuant to Tennessee Regulations. These agreements were discussed previously in the report under the caption "Subsequent Events."

Recommendations:

- None

4 (r) 12

CONCLUSION

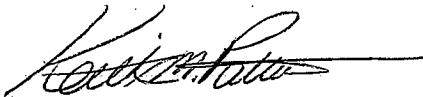
Insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of Tennessee Farmers Assurance Company of Columbia, Tennessee.

In such manner, it was determined that, as of December 31, 2005, the Company had admitted assets of \$742,524,432 and liabilities, exclusive of unassigned funds, of \$311,527,446. Thus, there existed for the additional protection of the policyholders, the amount of \$430,996,986 in the form of capital, gross paid in and contributed surplus and unassigned funds (surplus).

The courteous cooperation of the officers and employees of the Company extended during the course of the examination is hereby acknowledged.

In addition to the undersigned, Gregory S. Wilson, FCAS, MAAA of the actuarial firm, Lewis & Ellis, Inc, Richardson, Texas and Norman Chandler, CPA, CPCU, AIAF, ARC, ACP of the firm, TaylorChander, LLC, Montgomery, Alabama participated in the work of this examination. Insurance Examiners; David N. Bobo, Stephanie D. Brooks, Gregory Bronson and Mitchell Walker, Jr. also participated in this examination.

Respectfully submitted,



Keith M. Patterson
Insurance Examiner
State of Tennessee
Southeastern Zone, N.A.I.C.

AFFIDAVIT

The undersigned deposes and says that he has duly executed the attached examination report of Tennessee Farmers Assurance Company dated June 13, 2008, and made as of December 31, 2005, on behalf of the Department of Commerce and Insurance, State of Tennessee. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.



Keith M. Patterson
Insurance Examiner
State of Tennessee
Southeastern Zone, N.A.I.C.

Subscribed and sworn to before me

this 13th day of

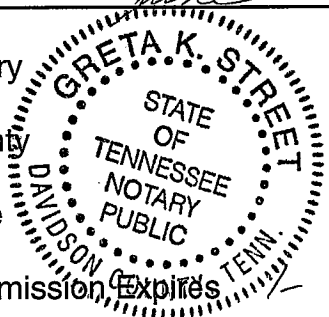
June, 2008

Notary

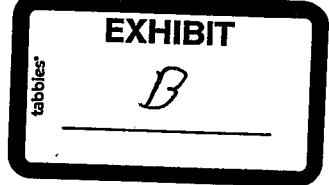
County

State

Commission Expires



9-2012



Tennessee Farmers
Insurance Companies
Corporate Headquarters
Post Office Box 998 • Columbia, TN 38402-0998
931.388.7872 • www.tennesseefarmers.com

June 19, 2008

RECEIVED

JUN 20 2008

Dept. Of Commerce & Insurance
Company Examinations

Phil Blustein
Chief Examiner
TN Department of Commerce and Insurance
Nashville, TN 37243

RE: Financial Condition Examination made as of December 31, 2005 for
Tennessee Farmers Mutual Insurance Company
Tennessee Farmers Assurance Company

Dear Phil:

We are satisfied with the Final Reports for the companies referenced above and hereby waive our right of rebuttal. Thank you.

Yours,

Wayne Harris
CFO

C: Matthew M. Scoggins, Jr.
Ed Lancaster