THE STATE OF FLORIDA

FINANCIAL SERVICES COMMISSION

OFFICE OF INSURANCE REGULATION
MARKET INVESTIGATIONS

TARGET MARKET CONDUCT FINAL EXAMINATION REPORT

OF

UNITED PROPERTY & CASUALTY INSURANCE COMPANY

AS OF

November 18, 2011

NAIC COMPANY CODE: 10969
NAIC GROUP CODE: 0000

<u>**TABLE OF CONTENTS**</u>

EXECUTIVE SUMMARY

Over the scope period of the examination, the Company reported four hundred seventy (470) complaints for the period under review. A sample consisting of two hundred twenty (220) claims, subrogation, cancellations, and underwriting files were reviewed along with one hundred twenty-four (124) complaints. Rate filings, financial transactions and data validation supporting files were also reviewed over the course of the examination. Twenty-six (26) instances were seen that are considered by the Office to be in violation of Florida Statutes. The following represents general findings, however, specific details are found in each section of this report.

Statute/Rule	Description	Number of Violations
69O-167.001	Failure to comply with return of unearned premium requirements	2
69O-166.024	Failure to acknowledge communications and act promptly as to communications with respect to claims	1
624.318	Failure to maintain records	11
20.121(2)(h)2	Failure to respond to the Division of Consumer Services in a manner that addresses the issues raised in the complaint	12
626.9541(1)(j)	Failure to maintain complaint-handling procedures	Procedural

PURPOSE AND SCOPE OF EXAMINATION

The Office of Insurance Regulation (Office), Market Investigations, conducted a target market conduct examination of **UNITED PROPERTY AND CASUALTY INSURANCE COMPANY** (Company) pursuant to Section 624.3161, Florida Statutes. The examination was performed by Global Insurance Enterprises, Inc. The scope period of this examination was January 2009 through September 2011. The examination field work began September 19, 2011 and ended November 18, 2011.

The purpose of this examination was to review the Company's practices regarding, but not limited to, claims handling, complaint handling, rate filings, financial transactions and underwriting in an effort to determine compliance with the Florida Insurance Code. A data validation review of the claims and policy system was also performed. The Company's records were examined at the Company's home office located at 360 Central Avenue, Suite 900, St. Petersburg, Florida.

This Final Report is based upon information from the examiner's draft report, additional research conducted by the Office, and additional information provided by the Company. Procedures and conduct of the examination were in accordance with the Market Conduct Examiner's Handbook produced by the National Association of Insurance Commissioners.

COMPANY OPERATIONS/MANAGEMENT

Organization

The Company was incorporated under the laws of the State of Florida on February 25, 1999, commencing business on April 2, 1999. As of December 31, 2010, the Company was a wholly owned subsidiary of United Insurance Holdings, L.C. (UIH), a Florida insurance holding corporation, and wholly owned subsidiary of United Insurance Holdings Corporation (UIHC). The ultimate parent, UIHC, was incorporated as "FMG Acquisition Corporation" (FMG) under the laws of the State of Delaware on May 22, 2007 as a blank-check company, becoming a publicly-traded company in October of that same year. On September 30, 2008, a subsidiary of FMG merged into UIH and emerged as the surviving entity. Subsequently, FMG changed their name to the current title, UIHC.

The organizational chart reflected in the 2010 Annual Statement was as follows:

- United Insurance Holdings Corporation (UIHC)
    - United Insurance Holdings, L.C. (UIH)
        - United Insurance Management L.C. (UIM)
        - United Property & Casualty Insurance Company (the Company)
        - Skyways Claims Services, LLC.,

In April 2011, after a review by the rating organization Demotech, UIHC formed an off-shore reinsurer, UPC Re, located in the Cayman Islands. In order to achieve the desired rating from Demotech, the parent company formed a captive reinsurer to reduce the Company's retention from $15 million to $10 million for property catastrophe coverage for the contract year beginning June 1, 2011.

The corporate organizational chart provided to the examiners on September 19, 2011 reflected the company structure as of the Second Quarter filing on June 30, 2011. The chart reflected:

- United Insurance Holdings Corporation (UIHC) Owned 19.9% by Neil Savage; 19.8% by William Hood, III; 19.7% by Kern Davis; 14.9% by Synovus and 14.7% by Greg Branch.
    - United Insurance Holdings, L.C. (UIH)
    - UPC Re
            - United Property & Casualty Insurance Company (the Company)
            - United Insurance Management, L.C. (UIM)
            - Skyway Claims Services, LLC.

Effective August 10, 2011, UIH was merged into UIHC, with UIHC being the surviving entity. Management stated in interviews that the merger was a corporate reorganization for the purpose of simplifying the organizational structure. On September 28, 2011, Synovus Financial Corporation sold its remaining shares of UIHC. The organizational chart in the Third Quarter filing as of September 30, 2011 reflected:

- United Insurance Holdings Corporation (UIHC) Owned 23.4 % by Neil Savage; 23.4% by William Hood, III; 23.4% by Kern Davis; and 14.7 % by Greg Branch.
    - United Property & Casualty Insurance Company
    - United Insurance Management, L.C. (UIM)
    - Skyways Claims Services, LLC
    - UPC Re

<u>Method of Operations</u>

The Company is the fifteenth (15th) largest property and casualty insurer in the State of Florida. It wrote property and casualty insurance only in Florida through December 31, 2009. Through May 31, 2009, the Company wrote commercial lines in Florida, which included commercial automobile and commercial multi-peril. The commercial multi-peril line is in run-off status. As of September 31, 2011, premiums written in Florida represented 95.6% of the total direct written premium. Currently, the primary lines of business are homeowners, dwelling fire, and flood insurance, written in three (3) states. Total direct written premiums in Florida during the scope of this examination were as follows:

YEAR	***TOTAL DIRECT WRITTEN PREMIUM IN FLORIDA***
2009	**$156,767,805**
2010	**$154,488,185**
2011*	**$151,038,406**

*** January 1, 2011 through September 30, 2011**

The Company is currently authorized to transact insurance business in Florida, South Carolina, Massachusetts, and Rhode Island. Applications are pending in New Jersey and North Carolina.

Substantially all aspects of the Company's business are managed by an affiliate, UIM, under a managing general agency agreement. All direct business is written through UIM, except for flood insurance which is written under an agreement with the National Flood Insurance Program. UIM utilizes the services of a Third Party Administrator (TPA) to provide integrated policy underwriting, billing, collection and reporting services. For the period covered by this Market Conduct Examination, TPA services were provided by "Computer Sciences Corporation" (CSC) under a written agreement between CSC and UIM.

The opining actuary for year ending December 31, 2010, identified a variety of risk factors that exposed the Company's reserves to significant variability, as follows: sinkhole claims, Garage claims, Chinese drywall exposure, catastrophe losses and the magnitude of ceded reserves.

Findings are reflected as follows:

1. The Company is experiencing rapid growth. A 23% increase in premium volume was reported in the third quarter 2011.
2. The Company is not a named party to the agreements with TPA's. Under an exclusive managing general agency agreement between the Company and UIM, UIM manages substantially all aspects of the Company's business. Therefore, substantially all of the Company's policies are serviced by CSC. Additionally, it is noted that the managing general agency agreement is silent in regards to UIM's ability to contract with third parties for services to be provided.
3. The Company reported 38 sinkhole claims through its homeowners and dwelling fire policies for AY 2010. The Company reports sinkhole losses in 2010 have had "significantly less impact on its bottom line than competitors due primarily to underwriting guidelines and geographical areas of concentration".
4. The Garage line of business is in run-off mode.
5. After the hurricanes of 2004 and 2005, many homes were rebuilt using drywall imported from China. The drywall has been linked to a number of health risks being experienced by residents of these homes. The Company contends that these issues are construction defects and therefore not covered under homeowners or dwelling fire policies. The Company has a number of these claims which have been denied.
6. The Company's policyholders experienced significant losses in the series of hurricanes that struck Florida in 2004 and 2005. The company took a highly investigative approach to handling losses from these catastrophes, especially for Hurricane Wilma. Hurricane Wilma resulted in a much higher incidence of reopened and late reported claims.
7. At year-end 2010, the Company ceded off 49.1% of their statutory surplus in loss and loss adjustment expense reserves. The formation of an affiliated, unauthorized, off-shore reinsurer in 2011, while fully funded, raises concerns regarding collectability. As of December 31, 2010, 55.3% of the reinsurance recoverable was from reinsurers for which no A.M. Best rating was available, including 45.2% from the Florida Hurricane Catastrophe Fund.

Leadership Changes

Effective August 15, 2011, the Company's CFO, Joseph Peiso, announced his resignation. Shortly thereafter, the Company's President and CEO, Don Cronin, announced his intentions to retire by year-end 2011. In a press release dated November 14, 2011, the terms of Mr. Cronin's retirement were announced, with the effective date of retirement extended to May 1, 2012.

On August 31, 2011, the Company announced that it had entered into a management services agreement with "1347 Advisors, LLC.," for the purpose of providing the services of an interim CFO. Pursuant to the terms of the agreement, 1347 Advisors, LLC., a division of Kingsway Financial Services, will also be responsible for providing actuarial services. The parties to the agreement are UIM and 1347 Advisors, LLC. In accordance with the terms of the agreement, 1347 Advisors, LLC., is to be paid a monthly consulting fee of $60,000, payable in advance, plus out-of-pocket expenses, not to exceed $25,000 per quarter. The initial term of the agreement is from August 28, 2011 through February 28, 2012, with automatic three-month period extensions.

Hassan Baqar, the managing director of 1347 Advisors, LLC., was appointed to serve as the interim CFO for the Company. Mr. Baqar currently holds the position of Vice President of Kingsway and Vice President of several other related entities. Mr. Baqar also holds a key officer position with "Kingsway Capital," the merchant banking division of Kingsway.

One of the directors of United Property & Casualty Insurance Company, Mr. Larry Swets, Jr., is the current President, CEO, and Director of Kingsway America, Inc., a wholly owned subsidiary of Kingsway Financial Services, Inc. Mr. Swets was named Chairman of the committee formed to oversee the recruitment of the positions of President and CEO for the Company for a fee of $20,000 per month.

Per discussions with the Company representatives, the Board has not initiated a search for a replacement for Mr. Cronin. Mr. Cronin is expected to resign from his position as CEO on May 1, 2012. However, Mr. Cronin is expected to cease operating from the Company's home office in St. Petersburg, Florida by the end of November 2011. The Company is not planning to begin searching for a permanent replacement for the CFO position until after the CEO position has been filled. It appears that the outsourcing of the CFO will continue at least through May of 2012 and more likely, the better part of 2012. Per discussions with Mr. Cronin, it has been suggested by the Board of Directors that his position as CEO may also be outsourced in the same manner and under the same type of servicing agreement as with the current interim CFO.

Findings are reflected as follows:

1. Costs associated with the outsourcing of the services of a CFO and the recruitment for a new President and CEO exceed what would be considered "fair and reasonable" costs for the Company. However, the agreement for the outsourcing services is between 1347 Advisors, LLC., and the Company's affiliate, UIM. As indicated under the "Affiliated Transactions" caption of this report, the Company pays UIM a fee of 31.5% of earned premium under the terms of a managing general agency agreement. No additional costs will be incurred directly by the Company under this arrangement, other than for the costs of the actuarial services to be provided by 1347 Advisors, LLC. Pursuant to the terms of

the managing general agency agreement with UIM, all actuarial costs are direct expenses of the Company. Prior to the arrangement with 1347 Advisors, LLC., the Company utilized the independent actuarial firm, Milliman, Inc. for their actuarial services.

Director Larry Swets also has an affiliation in the following transaction: Effective March 30, 2011, United Property & Casualty Insurance Company purchased $2.25 million of promissory notes offered by Hamilton Risk Management Company (HRM), a Florida corporation engaged in the business of providing automobile insurance in Florida through its wholly-owned subsidiaries. The HRM notes bear interest at the rate of 2% per annum. All outstanding principal of and interest on the HRM notes are due on March 30, 2014. In consideration for its purchase of the HRM notes, the Company received a Class A limited partnership interest in "Acadia Acquisition Partners, L. P.," the parent company of Hamilton Risk Management. The Company's director, James R. Zuhike, is the acting Executive Chairman of Hamilton Risk Management on an interim basis for which he receives consulting fees. Larry Swets, Jr., one of the directors of United Property & Casualty Insurance Company is also one of two managers of the limited liability company that serves as general partner of Acadia Acquisition Partners. Mr. Swets will not receive compensation for acting as a manager of the general partner absent the written consent of its sole member, Kingsway America, Inc. Mr. Swets serves as President, CEO and a director of Kingsway America, Inc., a wholly owned subsidiary of Kingsway Financial Services, Inc. Kingsway America, Inc. owns a Class B limited partnership interest in Acadia Acquisition Partners and is the sole member of the general partner of Acadia Acquisition Partners. Using a discounted cash flow methodology, the Company bifurcated the $2.25 million transaction by recording an investment in the partnership of $302,050 and a note receivable with a carrying amount of $1,947,950. The Company plans to amortize the discount of the note using the effective interest method over the three-year life of the note. Subsequently following the conclusion of the examination, in April, 2012, Mr. Larry Swets, Mr. James Zuhlke, and Mr. Hassan Baqar relinquished their positions with United Insurance Holdings Corporation and terminated the management services agreement with "1347 Advisors".

AFFILIATED TRANSACTIONS

As of the current period, the affiliate UIM, a managing general agency (MGA) manages substantially all aspects of the Company's business under a managing general agency agreement. All employees working from the Company's home office are employees of UIM, with the exception of a few direct employees of an affiliate, Skyways Claims Services, LLC. For the period under examination, the Company incurred management fees of approximately $46.7 million, $29.8 million, and $33.6 million for the periods December 31, 2009, December 31, 2010, and through September 30, 2011, respectively.

Skyways Claims Services, LLC., an affiliate, provides claim adjusting services to the Company. The Company reported payables to Skyways in the amount of $8,000, $12,000, and $20,000 for the periods December 31, 2009, December 31, 2010, and through September 30, 2011, respectively.

The affiliated off-shore reinsurer, UPC Re, formed in April 2011, provides the first layer of the Property Excess of Loss Catastrophe coverage. For the current reinsurance agreement year beginning June 1, 2011, UPC Re is liable, in respect to each and every loss occurrence, for the ultimate net loss up to $5 million, over and above the Company's ultimate net loss retention of

$10 million. For the period, June 1, 2010 through June 1, 2011, the Company's retention had been $15 million. In accordance with the terms of the reinsurance agreement, the Company shall pay a deposit premium of $3.5 million, payable in three installments due July 1, 2011, October 1, 2011, and January 1, 2012. The deposit premium shall be adjusted based upon total insurance values (TIV) of the homeowners, dwelling fire, and condominium business written in the states of Florida and South Carolina, subject to a minimum premium of $2.8 million.

During the period covered by this Market Conduct examination, the Company's Investment Management agreement with Synovus Trust Company, N.A., (Synovus) had been recorded as a related party agreement. Synovus Financial Corporation, Synovus's parent, owned 14.6% of UIHC as of December 31, 2009, and 2010. Effective September 28, 2011, Synovus Financial Corporation sold their shares of UIHC. Therefore, the transactions under the Investment Management agreement are no longer treated as related party transactions.

Effective October 1, 2008, the Company became a party to a tax sharing agreement with UIHC (parent) and each of its subsidiaries whereby the income taxes are allocated to each subsidiary in proportion to the amount of taxable income that each subsidiary contributes to the consolidated taxable income. Each subsidiary, excluding UPC Re receives credit for any net operating losses.

Findings are reflected as follows:

1. UPC Re is an unauthorized reinsurer.
2. The tax sharing agreement had not been revised to reflect the current subsidiaries of UIHC. The agreement provided to the examination team included UIH which has been dissolved and did not include UPC Re.

Corrective Action: All related party agreements should be reviewed and revised when needed to reflect current subsidiaries.

CANCELLATION AND NONRENEWAL REVIEW

Description of Cancellation and Nonrenewal Procedures

In accordance with the Company's underwriting manual, cancellation and nonrenewal notices are sent to the insured, agent, and lienholder, where applicable. Return premiums are calculated as of the effective date of cancellation. Return premiums generated from cancellations are calculated on a pro-rata basis. The Company shall return the unearned portion of premium paid within fifteen (15) working days of the effective date of cancellation.

If the policy has been in effect over ninety (90) days, the insured shall be given ten (10) days notice of cancellation for nonpayment of premium. Each notice of cancellation or nonrenewal shall state the reason or reasons the policy is being canceled or nonrenewed.

Sample Review Findings:

The examiners reviewed twenty-three (23) cancelled and/or nonrenewed policies, and one hundred twenty-four (124) complaints.

Two (2) violations of Rule 69O-167.001, Florida Administrative Code were found due to failure to comply with timely return of unearned premium requirements.

Corrective Action: The Company should ensure that all refunds are made timely and all interest paid appropriately.

CLAIMS HANDLING REVIEW

Description of Claims Reviewed

The claims review consisted of liability, wind, theft, mold, water damage, sinkhole, and fire claims on personal lines residential property policies. Complaints relating to claims were also reviewed. Licensing and appointments of adjusters were also verified.

Claim Procedures Review:

The Company's claims procedures with respect to first notice reports, communication with claimants, and maintenance of records requirements were reviewed.

Sample Review Findings:

One hundred forty (140) claims, one hundred twenty-four (124) complaints, and licensed adjuster records were examined.

One (1) violation of Rule 69O-166.024, Florida Administrative Code was found due to failure to acknowledge communication regarding claims.

Corrective Action: The Company should ensure that communications regarding the acknowledgment of claims are made timely.

PAID CLAIMS REVIEW

Description of Claims Reviewed

The paid claims review consisted of liability, wind, theft, mold, water damage, sinkhole, and fire claims on personal lines residential property policies.

Sample Review Findings:

Thirty (30) paid claims and one hundred twenty-four (124) complaints were examined. Three (3) violations of Section 624.318, Florida Statutes, were found for failing to maintain files with related documentation.

Corrective Action: The Company should reinforce procedures to ensure that claims files contain all related documentation.

COMPLAINT HANDLING REVIEW

Total Population Findings

The Company has maintained a complete record of all complaints received from the Florida Department of Financial Services (DFS) since January 1, 2009, in accordance with Section 626.9541(1)(j), Florida Statutes, however, the examiners were unable to similarly determine compliance in regard to complaints received directly from consumers. As of September 19, 2011, the Company did not have uniform processes in place addressing complaints received from consumers.

The results of the review of the sample of DFS Complaints found seven (7) errors in violation of Section 20.121(2)(h)(2), Florida Statutes, for failure to timely respond to complaints received from DFS, three (3) errors for failure to address the issue raised in the complaint, and two (2) errors for failure to respond to the Department of Consumer Services. The examiners also found eight (8) violations for failure to maintain records as required by Section 624.318, Florida Statutes.

Corrective Action – The Company should refine its processes for addressing complaints received from consumers in compliance with Section 626.9541(1)(j), Florida Statutes, and should reinforce its internal procedures to ensure compliance with Sections 20.121(2)(h)2 and 624.318, Florida Statutes.

PRODUCER LICENSING

In the sample of one hundred twenty-four (124) complaints reviewed, one (1) complaint concerned the actions of the licensed agent. In accordance to Section 626.451(3), Florida Statutes, the Company is bound by the acts of the agent. No exceptions were noted.

FINANCIAL TRANSACTIONS

Included in the scope of this examination was a review of financial transactions for the Company. A nine (9) month review of the banking activities regarding the claims accounts utilized by the third party administrators for the period December 2010 through August 2011 was performed. No exceptions were noted in the activities reflected in the claims accounts.

DATA VALIDATION REVIEW

During this examination the examiners performed an analysis of the claims and policy data produced by the Company's systems. The data obtained was traced to the applicable regulatory filings. No material discrepancies were noted.

The Company utilizes the services of CSC, a third party administrator to provide integrated policy underwriting, billing, collection and reporting services. No material discrepancies were noted.

EXAMINATION FINAL REPORT SUBMISSION

The Office hereby issues this report as the Final Report, which is based upon information from the examiner's draft report, additional research conducted by the Office, and additional information provided by the Company.

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