REPORT ON EXAMINATION

OF

TOWER HILL PREFERRED INSURANCE COMPANY

GAINESVILLE, FLORIDA

AS OF

DECEMBER 31, 2009

BY THE

OFFICE OF INSURANCE REGULATION

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TALLAHASSEE, FLORIDA

March 4, 2011

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, Rule 69O-138.005 Florida Administrative Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2009, of the financial condition and corporate affairs of:

TOWER HILL PREFERRED INSURANCE COMPANY
7201 N.W. 11TH PLACE
GAINESVILLE, FLORIDA 32605

Hereinafter referred to as, the "Company". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2005, through December 31, 2009. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2004. This examination commenced with planning at the Office on December 13, 2010, to December 17, 2010. The fieldwork commenced on December 20, 2010, and concluded as of March 4, 2011.

This financial examination was a statutory financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

SUMMARY OF SIGNIFICANT FINDINGS

Current Exam Findings

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during this examination.

Reinsurance

1. Pursuant to Rule 69O-144.005(6), Florida Administrative Code, letters of credit from reinsurers must contain certain clauses and language. The letters of credit from the following reinsurers did not contain all the required clauses or language:

   - Glencoe Insurance Ltd.
   - Renaissance Reinsurance, Ltd.

The specific missing clauses and language were communicated to the Company with the exception memorandum.

Subsequent event: On June 17, 2011, the Company notified OIR that these two letters of credit were no longer in effect.

Prior Exam Findings

The following is a summary of significant adverse findings contained in the Office's prior examination report as of December 31, 2004, along with resulting action taken by the Company in connection therewith.

Custodial Agreement

The Custodial Agreement was not in compliance with Rule 69O-143.042 (2) (a)(d)(g)(h)(i)(k)(l)(m), Florida Administrative Code. **Resolution:** The Company submitted an amended custodial agreement that was reviewed and approved by the Office.

SUBSEQUENT EVENT

During the first quarter of 2010, the Company, owned by Tomoka Re Holdings, Inc., entered into a discussion with Hillcrest Insurance Company (Hillcrest), owned by Hillcrest Holdings, LLC, regarding the merger of Hillcrest into the Company. A Memorandum of Understanding was signed by the companies and a request for approval of the merger and ancillary documents were submitted to the Office and approved on May 27, 2010 in a related Consent Order. The merger was effective June 1, 2010. Per accounting regulations, the merger was accounted for as a statutory merger transaction and the assets and liabilities of Hillcrest have been recorded in the Company's accounts at historical basis.

HISTORY

General

The Company is a domestic property and casualty, stock company that is licensed to write insurance only in Florida. It was incorporated on November 26, 1986, and commenced writing business on January 1, 1987, as Regency Insurance Company, domiciled in North Carolina. A Certificate of Domestication and Articles of Incorporation were approved effective January 13, 2004, upon transfer of domicile from the State of North Carolina to the State of Florida. A name change from Regency Insurance Company to Tower Hill Preferred Insurance Company was filed and approved on March 19, 2004.

The Company was authorized to transact the following insurance coverage in Florida on December 31, 2009:

Fire
Homeowners' Multiple Peril
Mobile Home Multiple Peril
Inland Marine
Allied Lines

The Company had not written insurance coverage during the examination period in the line of business of Mobile Home Multi Peril in violation of Section 624.430 (1), Florida Statutes.

Dividends to Stockholders

In accordance with Section 628.371, Florida Statutes, the Company declared and paid dividends to its stockholder in 2009 and 2008 in the amounts of $1,500,000 and $5,200,000, respectively.

Capital Stock and Capital Contributions

As of December 31, 2009, the Company's capitalization was as follows:

Number of authorized common capital shares	100,000
Number of shares issued and outstanding	100,000
Total common capital stock	$100,000
Par value per share	$1.00

Control of the Company was maintained by its parent, Tomoka Re Holdings, Inc, which owned 100% of the stock issued by the Company, which in turn was equally owned by William J. Shively (100% voting control) and Patricia A Shively (non-voting shares).

Subsequent Event: Upon the merger of the Company with Hillcrest, Tomoka Re Holdings, Inc. ownership was 55% by William J. Shively (retained 55% voting) and Patricia A Shively (non-voting) and 45% by Hillcrest Holdings, LLC.

Surplus Debentures

The Company did not have any surplus debentures as of December 31, 2009.

Subsequent Event: As a result of the merger with Hillcrest, the Company acquired the surplus note previously issued by Hillcrest. On February 28, 2007, a surplus note in the amount of $2,000,000 was issued to Hillcrest Holdings, LLC (the former parent company of Hillcrest) in exchange for cash. The outstanding surplus note balance at December 31, 2010 was $1,400,000.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales Through Reinsurance

There were no acquisitions, mergers, disposals, dissolutions, or purchase or sales through reinsurance during the period of examination.

CORPORATE RECORDS

The recorded minutes of the shareholder, Board of Directors (Board), and certain internal committees were reviewed for the period under examination.

Conflict of Interest

The Company adopted a policy statement requiring annual disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

MANAGEMENT AND CONTROL

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2009, were:

Directors

Name and Location	Principal Occupation
William J. Shively Lexington, Kentucky	Chief Executive Officer Tower Hill Insurance Group, LLC
Donald C. Matz Jr. Gainesville, Florida	President Tower Hill Insurance Group, LLC
Joel P. Curran Gainesville, Florida	Chief Underwriting Officer Tower Hill Insurance Group, LLC
Keyton Benson, Sr. Gainesville, Florida	Chief Marketing Officer Tower Hill Insurance Group, LLC

Timothy J. Meenan Tallahassee, Florida	Partner Blank & Meenan, P.A.
Timothy A. Bienek Flower Mound, Texas	Chief Operating Officer Tiger Risk Partners

<u>Subsequent Events:</u> On June 1, 2010, Timothy A. Bienek was removed as a Director. On June 22, 2010, The Board appointed Ernie and Kathy Petrone of Winter Park, Florida, as Directors.

The Board, in accordance with the Company's bylaws, appointed the following senior officers:

Senior Officers

Name	**Title**
William J. Shively	Chief Executive Officer
Donald C. Matz, Jr.	President, Chief Operating Officer
Joel P. Curran	Vice President, Secretary
Keyton Benson, Sr.	Vice President, Treasurer

The Company's Board appointed an internal committee in accordance with Section 607.0825, Florida Statutes. Following was the principal internal board committee and its members as of December 31, 2009:

Audit Committee

Timothy A.Bienek[1]
Timothy J. Meenan
Joel P. Curran

[1] Chairman

Affiliated Companies

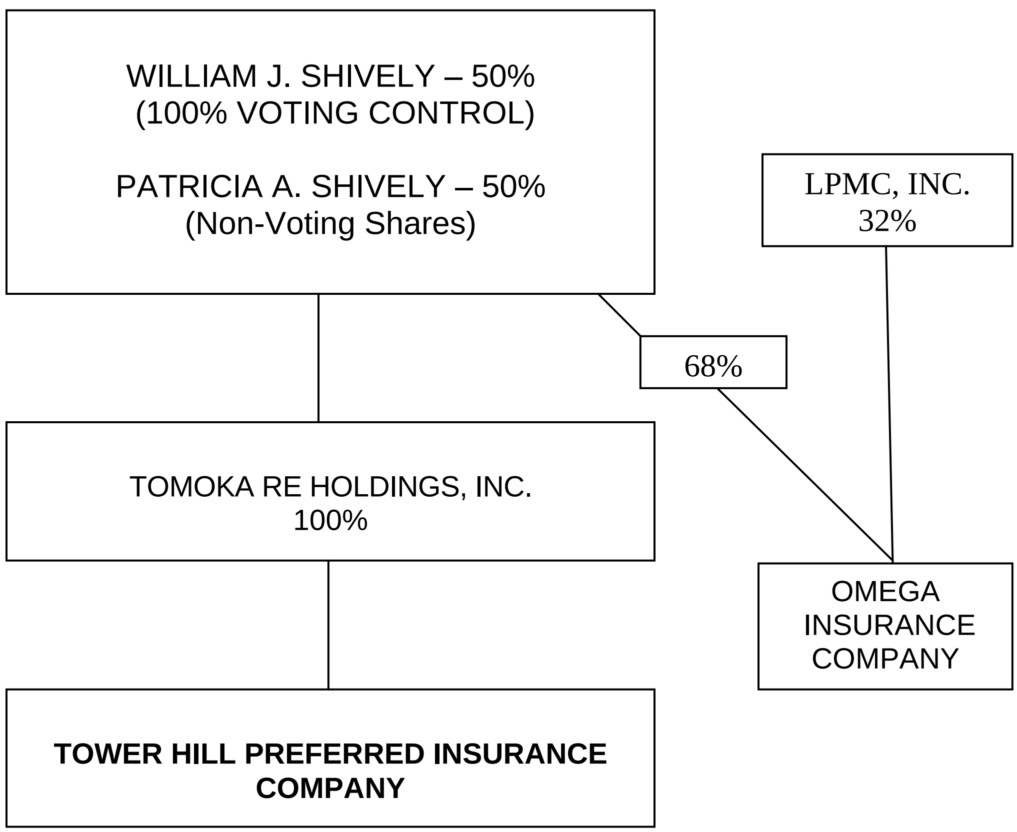
The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on June 10, 2010, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2009, reflecting the holding company system, is shown below. Schedule Y of the Company's 2009 annual statement provided a list of all related companies of the holding company group.

TOWER HILL PREFERRED INSURANCE COMPANY

Organizational Chart

DECEMBER 31, 2009



The following agreements were in effect between the Company and its affiliates:

Tax Allocation Agreement

The Company, along with its parent, Tomoka Re Holdings, Inc. (Tomoka Re), filed a consolidated federal income tax return. On December 31, 2009, the method of allocation between the Company and its parent was on a separate-entity basis. Income tax provisions were allocated to the respective companies based on their contribution to consolidated taxable income.

Management Agreement

The Company entered into a Management Agreement with its parent, Tomoka Re, on January 13, 2004, to provide certain management services including, executive management, reinsurance assistance, legal counsel, financial management and other such services. The agreement continues in force for a term of five years and will automatically renew for successive five-year periods, unless otherwise terminated within the guidelines of the agreement. The management fee paid by the Company each month was equal to 2.0% of written premium on new and renewed business. Fees incurred under this agreement during 2009 amounted to $1,412,412.

General Agency Agreement

The Company entered into a General Agency (GA) Agreement with its affiliate, Tower Hill Insurance Group, LLC, on September 5, 2006. Services provided by the GA included, but were not limited to, marketing, underwriting, policy issue, premium billing and policy service. The agreement continues in force for a term of five years and will automatically renew for successive five-year periods, unless otherwise terminated within the guidelines of the agreement. Fees were based on 22.5% of direct written and included the $25 policy fee. Fees incurred under this agreement during 2009 amounted to $56,454,379.

Claims Service Agreement

The Company entered into a Claims Service Agreement with its affiliate, Tower Hill Claims Service, Inc., on September 5, 2006. Pursuant to the agreement, Tower Hill Claims Service Inc. was authorized to process, investigate, evaluate, adjust and negotiate settlements of all claims. The agreement continues in force for a term of five years and will automatically renew for successive five-year periods, unless otherwise terminated within the guidelines of the agreement. Claims administration fees were calculated according to a fee schedule based on size of claim. Fees incurred under this agreement during 2009 amounted to $1,144,071.

Reinsurance Pooling Agreement

The Company entered into a Reinsurance Pooling Agreement with its affiliate, Omega Insurance Company on June 1, 2009, with the expectation of reducing administrative and management expenses and providing a broader distribution of risk by lines of business and territory. Pursuant to terms of the agreement, the quota-share percentage participation was 65% to the Company and 35% to Omega Insurance Company. Effective with the agreement, there was an initial portfolio transfer of net underwriting liabilities in order to reflect the quota-share percentage for each participant as provided for in accordance with the agreement. All underwriting business of the companies was subject to the pooling agreement.

Subsequent Event: The Reinsurance Pooling Agreement was terminated as of June 1, 2010.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to $3,100,000 with a deductible of $50,000 that reached the suggested minimum as recommended by the NAIC. The Company also maintained professional liability coverage, with an aggregate limit of $1,000,000 with a deductible of $250,000; directors and officers (D&O) coverage, with an aggregate limit of $3,000,000 with a deductible of $25,000; as well as worker's compensation, general liability and umbrella coverage.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company did not have any pension stock ownership or employee insurance plans.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance only in the State of Florida.

Treatment of Policyholders

The Company established procedures for handling written complaints in accordance with Section 626.9541(1) (j), Florida Statutes. The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) (i) 3a, Florida Statutes.

COMPANY GROWTH

In response to recent years' losses resulting from the active hurricane seasons of 2004 and 2005, the Company reduced policy counts to temper its overall exposure to weather-related events, while implementing various rate actions. In addition, various capital initiatives in recent years by the parent company have been implemented.

The Company's surplus increased 5.7% over the period of examination. Assets have remained primarily invested in interest-bearing investments with an overall maturity of less than 5 years, 99% of which are rated Class 1, Highest Quality, by the NAIC. The net loss from operations reported for 2009 was due to the combination of reduced direct writings, the higher cost of catastrophe reinsurance protection and the one-time ceded commission expense from the non-renewal of a quota share contract.

Profitability of Company

The following table shows the profitability trend (in dollars) of the Company for the period of examination, as reported in the filed annual statements.

	2009	**2008**	**2007**	**2006**	**2005**
Premiums Earned	20,247,653	19,092,786	34,680,394	32,866,745	17,403,807
Net Underwriting Gain/(Loss)	(11,670,305)	1,643,624	11,115,132	(4,990,863)	(4,887,749)
Net Income	(11,219,504)	2,432,150	10,763,195	(2,761,599)	(4,141,675)
Total Assets	77,904,168	46,935,500	67,936,364	86,068,060	71,327,394
Total Liabilities	57,142,498	22,708,669	40,053,017	69,723,290	52,180,902
Surplus As Regards Policyholders	20,761,670	24,226,831	27,883,347	16,344,770	19,146,492

LOSS EXPERIENCE

There was not any significant change in the Company's loss experience.

REINSURANCE

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting, and settlement information deadlines.

Assumed

All assumptions were related to the Reinsurance Pooling Agreement with the Company's affiliate, Omega Insurance Company, as noted above. Pursuant to terms of the agreement, the quota-share percentage participation was 65% to the Company and 35% to Omega Insurance Company.

Ceded

In addition to the cessions related to the Reinsurance Pooling Agreement, the Company ceded risk on a per risk excess of loss and per occurrence catastrophe basis to the Florida Hurricane Catastrophe Fund (FHCF) and various affiliated and non-affiliated reinsurers. For the year ended December 31, 2009, the commercial excess of loss treaties generally provided coverage on ultimate net losses of $191,300,000 in excess of $1 million per occurrence, not to exceed $329,000,000 for all occurrences. The FHCF provided coverage for 90% of the losses from qualifying catastrophic events in excess of $46,400,000, up to a maximum of $106,600,000.

The reinsurance contracts were reviewed by the Company's appointed actuary and were utilized in determining the ultimate loss opinion.

Subsequent Event: The Company entered into a new quota-share reinsurance agreement effective on June 1, 2010. Under the new quota share, the Company cedes 32.50% of new, renewal and in-force business while retaining 67.50%.

ACCOUNTS AND RECORDS

The Company maintained its principal operational offices in Gainesville, Florida, where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements annually for the years 2005, 2006, 2007, 2008, and 2009 in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with US Bank entered into on July 17, 2006. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

Asset Management Agreement

The Company maintained an asset management agreement with Conning Asset Management Company (Conning) entered into on February 15, 2002. Pursuant to the agreement, Conning provided investment advisory and portfolio management services in accordance with the investment guidelines of the Company.

Independent Auditor Agreement

The Company contracted with KPMG, LLP, to perform the annual audit of its financial statements as required by Rule 69O-137.002 (7) (c), Florida Administrative Code.

INFORMATION TECHNOLOGY REPORT

INS Services, Inc. performed an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology Report provided to the Company.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes:

STATE	Description	Par Value	Market Value
FL	Cash	$ 8,924	$ 8,924
FL	Fed Home Loan Bank 5.5%, 09/16/13	350,000	377,405
TOTAL SPECIAL DEPOSITS		$358,924	$386,329

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2009, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

Tower Hill Preferred Insurance Company
Assets

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Bonds	$21,504,676		$21,504,676
Cash and S/T investments	33,625,570		33,625,570
Receivables for securities	3,026		3,026
Investment income due and accrued	192,472		192,472
Agents' Balances: Uncollected premium	11,220,056		11,220,056
Reinsurance recoverable	6,286,826		6,286,826
Current federal and foreign income tax recoverable and interest thereon		2,219,300	2,219,300
Net deferred tax asset	4,308,300	(2,219,300)	2,089,000
Guaranty funds receivable or on deposit	786,256		786,256
Aggregate write-in for other than invested assets	(23,014)		(23,014)
Totals	$77,904,168	$0	$77,904,168

Tower Hill Preferred Insurance Company
Liabilities, Surplus and Other Funds

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Losses	$7,601,923		$7,601,923
Reinsurance payable	1,644,966		1,644,966
Loss adjustment expenses	677,389		677,389
Other expenses	80,365		80,365
Taxes, licenses and fees	134,277		134,277
Unearned premium	19,522,731		19,522,731
Ceded reinsurance premiums payable	26,759,594		26,759,594
Amounts withheld	582,283		582,283
Provision for reinsurance	22,000		22,000
Payable to parent, subsidiaries and affiliates	116,970		116,970
Total Liabilities	$57,142,498	$0	$57,142,498
Aggregate write-ins for special surplus funds	$1,996,700	($1,996,700)	$0
Common capital stock	100,000		100,000
Gross paid in and contributed surplus	27,968,328		27,968,328
Unassigned funds (surplus)	(9,303,358)	1,996,700	(7,306,658)
Surplus as regards policyholders	$20,761,670	$1,996,700	$20,761,670
Total liabilities, surplus and other funds	$77,904,168	$1,996,700	$77,904,168

Tower Hill Preferred Insurance Company
Statement of Income

DECEMBER 31, 2009

Underwriting Income	
Premiums earned	$20,247,653
Deductions:	
Losses incurred	$13,812,096
Loss expenses incurred	2,014,680
Other underwriting expenses incurred	16,091,182
Total underwriting deductions	$31,917,958
Net underwriting gain or (loss)	($11,670,305)
Investment Income	
Net investment income earned	$374,551
Net realized capital gains or (losses)	259,269
Net investment gain or (loss)	$633,820
Other Income	
Aggregate write-ins for miscellaneous income	$1,717
Total other income	$1,717
Net income before dividends to policyholders and before federal & foreign income taxes	($11,034,768)
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	($11,034,768)
Federal & foreign income taxes	184,736
Net Income	($11,219,504)
Capital and Surplus Account	
Surplus as regards policyholders, December 31 prior year	$24,226,831
Net Income	($11,219,504)
Change in net deferred income tax	2,119,496
Change in non-admitted assets	(250,853)
Change in provision for reinsurance	(11,000)
Change in excess statutory over statement reserves	0
Surplus adjustments: Paid in	5,400,000
Dividends to stockholders	(1,500,000)
Aggregate write-ins for gains & losses in surplus	0
Examination Adjustment	1,996,700
Change in surplus as regards policyholders for the year	($3,465,161)
Surplus as regards policyholders, December 31 current year	$20,761,670

A comparative analysis of changes in surplus is shown below.

TOWER HILL PREFERRED INSURANCE COMPANY
Comparative Analysis of Changes In Surplus

DECEMBER 31, 2009

The following is a reconciliation of Surplus as regards policyholders between that reported by the Company and as determined by the examination.

	PER COMPANY	PER EXAM	INCREASE (DECREASE) IN SURPLUS	
Surplus as Regards Policyholders December 31, 2009, per Annual Statement				$20,761,670
ASSETS:				
Current federal and foreign income tax recoverable	$0	$2,219,300	$2,219,300	
Net deferred tax asset	4,308,300	2,089,000	(2,219,300)	
LIABILITIES:				
No Adjustment				
SURPLUS:				
Aggregate write-ins for other than special surplus funds	$1,996,700	$0	($1,996,700)	
Unassigned Surplus	(9,303,358)	(7,306,658)	1,996,700	
Net Change in Surplus:				0
Surplus as Regards Policyholders December 31, 2009, Per Examination				$20,761,670

COMMENTS ON FINANCIAL STATEMENTS

Assets

Current Federal and Foreign Income Tax Recoverable $2,219,300
Net Deferred Tax Asset $2,089,000

In 2009, the Company generated a net operating loss (NOL) for federal income tax reporting. In recording this NOL, the Company recorded it as a deferred tax asset and did not record the income tax benefit through the statement of operations. The recording of the deferred tax asset had the effect of crediting surplus for the benefit; however, no benefit to net income was recorded. The adjustments identified above reduce the reported net deferred tax asset and record a current federal and foreign income tax recoverable. There was no effect on surplus as a result of these adjustments.

Subsequent event: During the first quarter of 2010, the Company posted the adjustments identified above.

Liabilities

Losses and Loss Adjustment Expenses $8,279,312

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2009, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

The Office engaged an independent actuarial firm, INS Consultants, Inc., to review the reserves for loss and loss adjustment expenses carried in the Company's balance sheet as of December 31, 2009, and was in concurrence with this opinion.

Capital and Surplus

Aggregate Write-Ins For Special Surplus Funds	$0
Unassigned funds (surplus)	$(7,306,658)

In 2009, the Company generated a net operating loss (NOL) for federal income tax reporting. In recording this NOL, the Company recorded it as a deferred tax asset and did not record the income tax benefit through the statement of operations. The recording of the deferred tax asset had the effect of crediting surplus for the benefit; however, no benefit to net income was recorded. The adjustments identified above record the effect had the Company properly posted the income tax benefit of the NOL through the statement of operations. There was no effect on surplus as a result of these adjustments.

Subsequent event: During the first quarter of 2010, the Company posted the adjustments identified above.

The amount reported by the Company of $20,761,670 exceeded the minimum of $5,714,250 required by Section 624.408, Florida Statutes.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Tower Hill Preferred Insurance Company** as of December 31, 2009, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was $20,761,670, which exceeded the minimum of $5,714,250 required by Section 624.408, Florida Statutes.

In addition to the undersigned, John V. Normile, CFE, Examiner-In-Charge; J. Matthew Perkins, CFE; Bill W. Holmes, CFE; and Don Gaskill, CFE, Participating Examiners; and Patricia Casey Davis, CPA, CFE, Manager of INS Regulatory Insurance Services, Inc. participated in this examination. James Boswell, Systems Specialist; Michael W. Morrow, ACAS, MAAA, consulting actuary and Robert Gardner, FCAS, MAAA, consulting actuaries of INS Consultants, Inc.; Claude Granese, CPA, Director of Finance and Quality Control of INS Services, Inc.; and Fidel S. Gonzalez, Financial Examiner/Analyst Supervisor of the Office also participated in the examination.

Respectfully submitted,

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Kethessa Carpenter CPA
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation