REPORT OF EXAMINATION
OF THE
FINANCIAL INDEMNITY COMPANY
AS OF
DECEMBER 31, 2009

Participating State
and Zone:

California

Filed June 16, 2011

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Los Angeles, California
May 6, 2011

Honorable Joseph Torti, III
Chairman of the NAIC Financial
Condition Subcommittee
Superintendent of Business Regulation
Division of Insurance
Cranston, Rhode Island

Honorable Linda S. Hall
Secretary, Zone IV-Western
Director of Insurance
Alaska Division of Insurance
Anchorage, Alaska

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

FINANCIAL INDEMNITY COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 8360 LBJ Freeway, Suite 400, Dallas, Texas 75243. The Company's statutory home office is located at 21650 Oxnard Street, Suite 1800, Woodland Hills, California 91367.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2009, as deemed necessary under the circumstances.

The examination was a multi-state coordinated examination and was conducted concurrently with the examinations of its California affiliates: Valley Insurance Company and Response Indemnity Company of California and other insurance entities in the holding company group which included participation from the following States: Alabama, Connecticut, Indiana, Illinois, Missouri, Oklahoma, and Wisconsin.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees', and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

SUBSEQUENT EVENTS

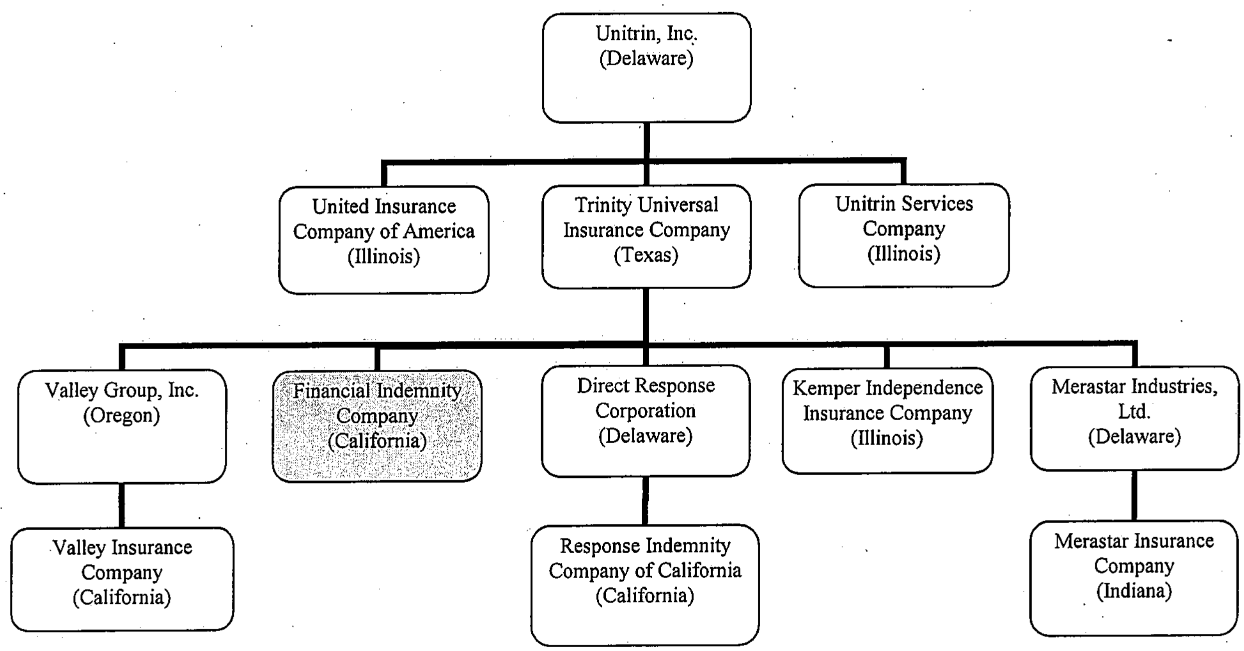
On February 10, 2011, the California Department of Insurance (CDI) received an application from the Company to re-domesticate from California to Illinois. As of the date of this examination report, the transaction has not yet been approved by the CDI.

COMPANY HISTORY

The Company was incorporated in 1945 under the laws of the State of California, and commenced transacting insurance business in 1946. During the four-year period under review, the Company paid dividends of cash and securities totaling $18,000,000 to its parent, Trinity Universal Insurance Company. The dividend transactions did not meet or exceed the thresholds requiring California Department of Insurance (CDI) approval; however, for all the transactions, the Company submitted notice to the CDI before the payments of the dividend.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Trinity Universal Insurance Company (Trinity), a stock insurance company domiciled in Texas. Trinity is a wholly-owned subsidiary of the ultimate parent, Unitrin, Inc., a Delaware Corporation. The following abridged organizational chart depicts the Company's relationship within the holding company system (all ownership is 100%):



Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2009 follows:

Directors

Name and Residence	Principal Business Affiliation
John W. Mullen* Mc Kinney, Texas	President Unitrin Specialty and Financial Indemnity Company

Name and Residence	Principal Business Affiliation
John M. Boschelli Geneva, Illinois	Vice President and Chief Investment Officer Unitrin, Inc.
James A. Schulte Jacksonville, Florida	P & C Group Executive Unitrin Services Group
Richard Roeske Naperville, Illinois	Vice President and Chief Accounting Officer Financial Indemnity Company
Francis J. Sodaro Park Ridge, Illinois	Vice President Planning and Analysis Unitrin, Inc.

Principal Officers

Name	Title
John W. Mullen*	President
Ronald J. Ballard	Vice President – Finance and Treasurer
Lisa K. Bage	Senior Vice President and Secretary
Edward D. Cimini, Jr.	Senior Vice President and Actuary
David B. Piper	Senior Vice President – Underwriting Services

* Resigned and replaced by Timothy D. Bruns, effective October 28, 2010.

Management Agreements

General Service Agreement: On July 1, 2004, the Company entered into a general service agreement with its affiliate, Unitrin Services Company (USC). Under the terms of the agreement, the Company receives the following services from USC: trade execution and investment accounting, tax return preparation, tax accounting and advice, maintenance of benefit plans, benefit plan regulatory reporting and support, risk management, automobile fleet management, internal audit including field audit, cash management and bank relations, financial planning and analysis of results of operations, capital project review and evaluation, real estate management, corporate secretarial functions, and legal support and advice. The expenses shall be allocated pro-rata based on revenues of the Company as a percentage of the revenues of all affiliates of USC to which USC renders services under the general service agreement. For legal support service and filed audit services, the allocation will be based on the actual number of hours spent. No element of profit or markup shall be added to such compensation. For 2006, 2007, 2008, and 2009, the Company paid $3.99 million, $4.28 million, $3.98 million, and $3.66 million, respectively, in fees to USC for its services. The California Department of Insurance (CDI) approved this agreement on July 16, 2004.

General Services Agreement: Effective January 1, 2009, the Company entered into a general service agreement with Merastar Insurance Company (Merastar), an affiliate. Under the terms of this agreement, Merastar shall administer the new and renewal property and casualty lines insurance business of the Company, as well as provide the Company with services such as: marketing, underwriting, claim adjusting, reinsurance reporting, facilities, supplies, staffing, and accounting. Direct expenses shall be charged on an actually incurred basis. Shared or indirect expenses shall be apportioned to the Company based on cost studies and usage metrics of services provided. For 2009, the Company paid Merastar $61.37 million, gross of reinsurance. The CDI approved this agreement on December 1, 2008.

Computer Service Agreement: On July 1, 2004, the Company entered into a computer service agreement with USC. This agreement was approved by the CDI on June 17, 2004. Under the terms of the agreement, USC provides the Company with the following: computer data processing services and components using mainframe, midrange and minicomputer and other central processors and controllers, data storage devices, cartridge and tape drivers, MVS, UNIX and other operating system software, database management software, groupware, middleware and network software, routers and other network and telecommunications equipment and lines located at its data center facilities and internet and intranet access software and systems, computing services, and consulting services. Amendment Numbers One and Two were approved by the CDI on October 23, 2007 to renew the agreement for three more years and to indicate that the Company retains ultimate control and responsibility of the functions it has delegated. The Company is charged for its proportionate share of the cost of maintaining and operating the systems based on the Company's actual usage. For 2006, 2007, 2008, and 2009, the Company paid $1.82 million, $1.89 million, $2.51 million, and $2.19 million, respectively, in fees to USC under the terms of this agreement. This agreement has been further extended for another three years, effective July 1, 2010, and was approved by CDI on June 30, 2010.

Information Technology Services Agreement: The Company entered into an information technology services agreement with Unitrin Direct Property & Casualty Company (UDPC), an affiliate, effective January 1, 2009. Under the terms of this agreement, UDPC provides information technology services, such as IT applications and consulting services with respect to technology shared among the Unitrin, Inc. property and casualty affiliates. Direct expenses shall be charged on an actually incurred basis. Shared or indirect expenses shall be apportioned to the Company based on cost studies and usage metrics of services provided. The Company paid $1.37 million expenses in 2009. The agreement was approved by the CDI on December 1, 2008.

Administrative Services Agreement: The Company entered into an administrative services agreement (ASA), effective April 30, 2009, with Trinity Universal Insurance Company (Trinity), its second tier parent, for the provision of insurance banking facilities and premium collection and disbursement services related to the Amended 90% Quota Share Reinsurance Agreement (QSRA). This 90% QSRA, effective April 1, 2005, was entered between the Company and Trinity at the request of the CDI. No separate compensation shall be paid as the parties agree that compensation due Trinity pursuant to the QSRA shall adequately compensate Trinity for the services. The ASA was approved by the CDI on June 1, 2009. Subsequently this ASA was amended and restated, effective January 1, 2010, to continue to provide the same services to a Second Amended and Restated 100% Quota Share Agreement, effective July 1, 2009. This ASA amendment was approved by the CDI on December 10, 2010.

Federal Income Tax Agreement: On November 6, 1995, the Company entered into a Federal Income Tax Agreement with it ultimate parent, Unitrin, Inc. (Unitrin). The agreement established the method of settlement of federal income tax payments and refunds between Unitrin and its subsidiaries. Under the terms of the agreement, the Company pays to, or receives from, Unitrin the amount of tax it would owe, or be refunded from, the Internal Revenue Service as if the Company was filing a separate federal income tax return. The tax agreement has been amended various times to add and delete other entities. Each of these amendments were made after January 1, 1997, and are subject to the prior approval requirements of California Insurance Code Section 1215.5(b)(4). The amendments were not filed as recommended in the previous examination report and it is recommended that the Company submit any future amendments to the CDI for approval. The Company paid the following amounts during the examination period:

Year	Amount
2006	$ 392,817
2007	1,988,000
2008	(111,581)
2009	(573,345)

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company was licensed to write various property and casualty coverage in the following twenty one states:

Alabama	Indiana	Oregon
Arizona	Louisiana	Tennessee
California	Missouri	Texas
Colorado	Montana	Utah
Delaware	Nevada	Washington
Idaho	New Mexico	Wisconsin
Illinois	Ohio	Wyoming

The Company's business is written through approximately 2,200 brokers and agents. The principal line of business written is nonstandard automobile liability and physical damage coverage on private and commercial vehicles. In 2009, direct premiums written were $315.3 million. For the year ended December 31, 2009 the five largest premium volume states were as follows:

State	Direct Premiums Written	Percentage of Total
California	$230,231,424	73.02%
Louisiana	$ 24,795,007	7.86%
Washington	$ 10,681,199	3.39%
Utah	$ 8,547,399	2.71%
Nevada	$ 7,294,689	2.31%

REINSURANCE

Assumed

The Company assumes a small book of business through its participation in a mandatory pool with the California Commercial Automobile Insurance Procedure. The Company is also a participant in a 50% quota share assumption after excess of loss reinsurance of certain general liability pools that are in run off.

Ceded

On January 1, 1997, the Company entered into a 90% Quota Share Reinsurance Agreement (90% QSRA) with its second tier parent, Trinity Universal Insurance Company (Trinity). Under the terms of this agreement, the Company cedes 90% of its net liability (net of all other reinsurance) on all inforce policies written or assumed by the Company at the date of the agreement and on all of its policies written or renewed after the effective date of the agreement. Effective April 1, 2005, an Amended 90% QSRA was entered into by the Company and Trinity with the same terms as above. This agreement was approved by the California Department of Insurance (CDI) on February 23, 2005.

Effective July 1, 2009, the Company and Trinity entered into an Amended and Restated 100% Quota Share Reinsurance Agreement (100% QSRA), which replaced the Amended 90% QSRA. The CDI issued a non-objection notice to the execution of this agreement on October 27, 2009. Under the terms of this reinsurance agreement, the Company cedes 100% ultimate net loss with respect to its existing and new business to Trinity. The 100% QSRA also provides for administration of the business by Trinity unless Trinity assigns all or part of its administrative responsibilities to one or more of its affiliates. On December 10, 2010, the CDI approved the Second Amended and Restated 100% QSRA, the CDI required related Amended and Restated Administrative Services Agreement, and the Amended and Restated Trust Agreement. The Company reported total reinsurance recoverables of $363,597 or 1.1% of the reported surplus as of the examination date.

ACCOUNTS AND RECORDS

Taxes, Licenses and Fees

California Insurance Code (CIC) Section 1872.8(a) states, in part, that each insurer doing business in the State of California must pay an annual Vehicle Fraud Assessment Fee for each vehicle insured under an insurance policy it issues in California. The fee provides funding for the increased investigation and prosecution of fraudulent automobile insurance claims and automobile theft in the State of California.

The Company did not report the correct vehicle counts as defined in the California Code of Regulations Section 2698.61(r) for the years 2007, 2008, and 2009. It is recommended that the Company implement the appropriate procedures to ensure the correct filings in order to comply with CIC Section 1872.8.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 36,348,235	$	$ 36,348,235	(1)
Cash and short-term investments	657,376		657,376	
Investment income due and accrued	411,849		411,849	
Premiums and agents' balances in course of collection	70,680,321		70,680,321	
Amounts recoverable from reinsurers	363,596		363,596	
Current federal and foreign income tax recoverable	1,310,035		1,310,035	
Guaranty funds receivable or on deposit	135		135	
Receivable from parent, subsidiaries and affiliates	1,366,163		1,366,163	
Total assets	$ 111,137,710	$	$ 111 137,710	

Liabilities, Surplus and Other Funds			
Losses		$ 0	(2)
Loss adjustment expenses		0	
Commissions payable, contingent commissions and other similar charges		3,345,908	
Other expenses		234,180	
Taxes, licenses and fees		859,607	
Net deferred tax liability		5,843	
Advance premiums		1,459,644	
Dividends declared and unpaid: Stockholders		3,000,000	
Ceded reinsurance premiums payable		70,479,883	
Funds held by company under reinsurance treaties		463,351	
Provision for reinsurance		316,200	(3)
Total liabilities		80,164,616	
Common capital stock	$ 2,600,000		
Gross paid in and contributed surplus	5,334,000		
Unassigned funds (surplus)	23,039,094		
Surplus as regards policyholders		30,973,094	
Total liabilities, surplus and other funds		$ 111,137,710	

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Statement of Income

Underwriting Income		
Premiums earned		$ 16,327,599
Deductions:		
Losses incurred	$ 10,246,823	
Loss adjustment expenses incurred	2,225,506	
Other underwriting expenses incurred	4,265,957	
Total underwriting deductions		16,738,286
Net underwriting loss		(410,687)
Investment Income		
Net investment income earned	$ 2,317,874	
Net realized capital gain	533,469	
Net investment gain		2,851,343
Other Income		
Net loss from agents' or premium balances charged off	$ (258,221)	
Finance and service charges not included in premiums	1,200,572	
Total other income		942,351
Net income before federal and foreign income taxes		3,383,007
Federal and foreign income taxes incurred		(878,180)
Net income		$ 4,261,187

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008		$ 30,804,503
Net income	$ 4,261,187	
Change in net unrealized capital losses	(1,670)	
Change in net deferred income tax	(1,280,951)	
Change in provision for reinsurance	190,025	
Dividends to stockholders	(3,000,000)	
Change in surplus as regards policyholders		168,591
Surplus as regards policyholders, December 31, 2009		$ 30,973,094

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2009

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2005, per Examination			$ 35,766,430
Net income	$ 14,427,834	$	
Change in net unrealized capital losses		17,041	
Change in net deferred income tax		1,725,956	
Change in nonadmitted assets	362,659		
Change in provision for reinsurance	159,168		
Dividends to stockholders		18,000,000	
Totals	$ 14,949,661	$ 19,742,997	
Net decrease in surplus as regards policyholders			(4,793,336)
Surplus as regards policyholders, December 31, 2009, per Examination			$ 30,973,094

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The Illinois Insurance Department, the lead state for this multi-state coordinated examination, performed a review of the Unitrin Group's custodial agreements. They noted that a number of the custodial agreements did not contain all of the required provisions in accordance with the National Association of Insurance Commissioners Financial Condition Examiners Handbook. The examination finding pertained to various entities within the Group, including the California Companies. It is recommended that the Company draft a new custodial agreement to remedy the deficiencies and submit them to the California Department of Insurance (CDI) in accordance with the California Insurance Code (CIC) Section 1104.9.

(2) Losses and Loss Adjustment Expenses

Based on the analysis by a Casualty Actuary from the CDI, the Company's December 31, 2009 reserves for losses and loss adjustment expenses were determined to be reasonably stated. The Company reported no net loss and loss adjustment expense reserve due to the 100% cession in 2009.

(3) Provision for Reinsurance

The provision for reinsurance was incorrectly calculated. The amount was not deemed material and no examination adjustment was made. It is recommended that the Company implement procedures to ensure compliance with the CIC Section 923.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Management Agreements – Federal Income Tax Agreement (Page 6): Amendments to the Federal Income Tax Agreement were made after January 1, 1997 and were subject to the prior approval requirements of the California Insurance Code (CIC) Section 1215.5(b)(4). The amendments were not filed as recommended in the previous examination report and it is recommended that the Company submit any future amendments to the California Department of Insurance (CDI) for approval.

Accounts and Records – Taxes, Licenses and Fees (Page 9): The Company did not report the correct vehicle counts as defined in the California Code of Regulations Section 2698.61(r) for the years 2007, 2008, and 2009. It is recommended that the Company implement the appropriate procedures to ensure the correct filings in order to comply with CIC Section 1872.8.

Comment on Financial Statement Items – Bonds (Page 14): It is recommended that the Company draft a new custodial agreement to remedy the deficiencies and submit it to the CDI in accordance with the CIC Section 1104.9.

Comment on Financial Statement Items – Provision for Reinsurance (Page 14): It is recommended that the Company implement procedures to ensure compliance with the CIC Section 923.

Previous Report of Examination

Management and Control (Page 6): It was recommended that the Company submit the amendments to the CDI for approval. The Company did not comply.

Corporate Records (Page 6): It was recommended that the Company implement procedures to ensure future compliance with CIC Section 735. The Company has complied with this recommendation.

Accounts and Records (Page 9): It was recommended that the Company and its parent comply with CIC Sections 1100 and 1104.1. The Company has complied with this recommendation.

Accounts and Records (Page 10): It was recommended that the Company follow up on the corrective actions relating to the Texas Department of Insurance's Examination Report of the Company's parent to insure that they are implemented properly and in a timely manner. The Company has complied with this recommendation.

<u>ACKNOWLEDGMENT</u>

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

______/s/______________
Victoria Wang, CFE
Examiner-In-Charge
Department of Insurance
State of California