ORGANIZATIONAL EXAMINATION

of the

FIRST ACCEPTANCE INSURANCE COMPANY OF TENNESSEE, INC.
3813 GREEN HILLS VILLAGE DRIVE
NASHVILLE, TENNESSEE 37215

RECEIVED
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Dept. Of Commerce & Insurance
Company Examinations

as of

December 4, 2006

DEPARTMENT OF COMMERCE AND INSURANCE

STATE OF TENNESSEE

NASHVILLE, TENNESSEE

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Nashville, Tennessee
December 14, 2006

Honorable Paula A. Flowers
Commissioner
State of Tennessee
Department of Commerce and Insurance
Nashville, Tennessee 37243

Dear Commissioner:

Pursuant to your instructions and in accordance with Tenn. Code Ann. § 56-2-103, a financial examination was made of the condition and affairs of the

FIRST ACCEPTANCE INSURANCE COMPANY OF TENNESSEE, INC.
3813 GREEN HILLS VILLAGE DRIVE
NASHVILLE, TENNESSEE 37215

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, State of Tennessee and commenced on December 12, 2006. The examination was the "Organizational Examination" and was conducted by a duly authorized representative of the Department of Commerce and Insurance, State of Tennessee.

SCOPE OF EXAMINATION

Upon payment by the Company of the application fee of six hundred seventy-five dollars ($675) prescribed in Tenn. Code Ann. § 56-4-101, this examination was conducted as of December 4, 2006, to determine if the Company has complied with the statutory and regulatory requirements to be issued a Certificate of Authority to establish and operate a property and casualty insurance company according to the provisions of Tenn. Code Ann. § 56-2-101 *et. seq.*

COMPANY HISTORY AND ORGANIZATION

The Company was incorporated on June 30, 2006, under the Tennessee Business Corporation Act as a for-profit corporation authorized to transact business in the State of Tennessee. The Charter and Bylaws are discussed in detail in this report under the

caption "CHARTER AND BYLAWS".

The Board of Directors held the Organizational Meeting on July 6, 2006 and undertook the following actions:

- Approve the Articles of Incorporation;
- Approve the Bylaws;
- Election of officers as follows:

Stephen J. Harrison	Chairman and President
Thomas M. Harrison, Jr.	Executive Vice President, Secretary
Michael J. Bodayle	Chief Financial Officer and Treasurer

- Approve form of stock certificate representing shares of Common Stock of the Corporation;
- Approve form of Minute Book;
- Authorize the President to open an account in the name of the Corporation with SunTrust Bank, Nashville;
- Authorize the proper officer to execute and deliver the customary form of corporate banking resolutions, signature cards, etc.;
- Authorize the issue of one thousand (1,000) shares of Common Stock for a consideration of two dollars ($2.00) per share;
- Appoint the Commissioner and Deputy Commissioner of the Department of Commerce and Insurance, State of Tennessee to acknowledge service of all legal process;
- Proper officers are directed to make legally required regulatory filings to obtain a Certificate of Authority to transact business as an insurance company in the State of Tennessee;
- Proper officers are authorized and empowered to pay all fees and expenses incident to or arising from the organization of the Company, and reimburse any person who has made reasonable disbursements therefore;
- Proper officers are authorized to take all such further action, and to execute and deliver all such further instruments and documents in the name and on behalf of

the Company and to pay all such fees and expenses, which shall in their judgment be necessary, proper or advisable.

The plan of operation for the Company is discussed under separate heading in the report.

Funding of the Company was completed on December 4, 2006, with the issue of four hundred ninety-nine thousand (499,000) shares of Common Stock to the parent corporation, First Acceptance Insurance Company, Inc.

CHARTER AND BYLAWS

Charter:

The Amended and Restated Charter of the Company was filed and recorded with the Secretary of State, State of Tennessee on October 12, 2006, after having been approved by the Department of Commerce and Insurance, State of Tennessee on October 10, 2006. Said Charter establishes and sets forth the following:

1. "The name of the corporation is First Acceptance Insurance Company of Tennessee, Inc.

2. The corporation is for profit.

3. The purpose of the corporation is to engage in the business of insurance as a principal, including but not limited to property or casualty insurance, and to engage in any other, lawful business under the laws of the State of Tennessee.

4. The street address of the corporation's principal office is:

   3813 Green Hills Village Drive
   Nashville, Tennessee 37215
   County of Davidson.

   (a) The name of the corporation's registered agent is:

   Thomas M. Harrison, Jr.

   (b) The street address of the corporation's registered office in Tennessee is:

3813 Green Hills Village Drive
Nashville, Tennessee 37215
County of Davidson.

5. The name and address of the incorporator is:

Lee Watson
3813 Green Hills Village Drive
Nashville, Tennessee 37215.

6. The number of shares of stock the corporation is authorized to issue is ten million (10,000,000) shares of common stock, two dollars ($2.00) par value.

7. The shareholders of the corporation shall not have preemptive rights.

8. To the fullest extent permitted by the Tennessee Business Corporation Act as in effect on the date hereof and as hereafter amended from time to time, a director of the corporation shall not be liable to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director. If the Tennessee Business Corporation Act or any successor statute is amended after adoption of this provision to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the corporation shall be eliminated or limited to the fullest extent permitted by the Tennessee Business Corporation Act, as so amended from time to time. Any repeal or modification of this Paragraph 8 by the shareholders of the corporation shall not adversely affect any right or protection of a director of the corporation existing at the time of such repeal or modification or with respect to events occurring prior to such time; provided, however that nothing herein shall diminish liability of a director of the corporation under Title 56, Tennessee Code Annotated."

Bylaws:

The Bylaws of the Company in effect at December 4, 2006, were adopted by the Board of Directors on July 6, 2006, and have not been amended or changed during the period covered by this examination. Said bylaws are such as those generally found in corporations of this type and contain no unusual provisions.

An annual meeting of the shareholders of the Company shall be held between January 1 and May 30 of each year at such time and place, either within or without this State, as may be designated from time to time by the Board of Directors.

Special meetings of the shareholders for any purpose or purposes may be called by the President or Secretary at the request in writing of a majority of the Board of Directors, or at the request in writing of shareholders owning not less than ten percent (10%) of all the shares entitled to vote at the meetings.

The holders of a majority of the shares issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum.

The business and affairs of the Company and all corporate powers shall be managed by the Board of Directors, subject to any limitation imposed by statute, the Articles of Incorporation or the Bylaws as to action which requires authorization or approval by the shareholders.

The number of Directors which shall constitute the whole Board shall be not less one (1) or more than nine (9) as determined by the shareholders.

The Directors shall be elected at the annual meeting of the shareholders.

Special meetings of the Board of Directors shall be called by the President.

A majority of Directors shall constitute a quorum at the meeting of the Board of Directors.

The officers for the Company shall be elected by the Board of Directors and shall consist of a President, a Secretary, a Treasurer and such other officers as the Board of Directors shall from time to time deem necessary. Two (2) or more offices may be held by the same person. None of the officers need be Directors except the President.

The fiscal year of the Company shall be fixed by resolution of the Board of Directors.

MANAGEMENT AND CONTROL

Management:

As of December 4, 2006, the "Board of Directors" of the Company was composed of the following:

Stephen Joe Harrison
Thomas Marshall Harrison, Jr.
Michael John Bodayle

As of December 4, 2006, the Officers of the Company were the same as those elected at the initial board meeting on June 30, 2006, and referenced in the "HISTORY" caption

of this report.

Control:

The Company is one hundred percent (100%) owned by First Acceptance Insurance Company, Inc. which is a one hundred percent (100%) owned subsidiary of USAuto Holdings, Inc. which is a one hundred percent (100%) owned subsidiary of First Acceptance Corporation, a publicly-traded company. The ultimate controlling parties of First Acceptance Corporation are Gerald J. Ford (thirty-two and nine tenths percent, 32.9% ownership), Stephen Joe Harrison (fourteen and eight tenths percent, 14.8% ownership) and Thomas Marshall Harrison, Jr. (fourteen and eight tenths percent, 14.8% ownership).

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

PROPOSED PLAN OF OPERATION

The Company's plan of operation is to offer Non-Standard Automobile Insurance in the State of Tennessee. The Company's parent, First Acceptance Insurance Company (Texas domicile) has been licensed and writing this same type of coverage in the State of Tennessee since 1995. Prior to November of this year, the parent company was a Tennessee domiciled insurance company.

The Company intends to enter into a Loss Portfolio Transfer via a reinsurance agreement with its parent, First Acceptance Insurance Company, Inc. in order to assume all active polices written by First Acceptance Insurance Company, Inc. in the State of Tennessee. The amount of liability ceded by the parent company and assumed by the Company would be approximately seven million five hundred thousand dollars ($7,500,000). The agreement calls for the parent to pay to the Company one hundred percent (100%) of premiums on the Tennessee business after December 31, 2006, (equal to the amount of unearned premiums as of such date). Ceding commission on this transaction would be seven and five tenths percent (7.5%).

The above referenced transaction was filed with the Department of Commerce and Insurance, State of Tennessee on December 6, 2006, as a Form D filing pursuant to Tenn. Code Ann. § 56-11-206.

Ninety-five percent (95%) plus of the business written will be basic limit coverage.

The Company will contract its underwriting and administration functions through its parent and claims handling services will be performed by First Acceptance Services,

Inc. an affiliated company. There is an intercompany agreement effective January 1, 1999, which covers all wholly owned subsidiary corporations of USAuto Holdings, Inc. USAuto Holdings, Inc. has been performing these same type services for the Company's parent and affiliates since that time.

Solicitation of business will be primarily through existing Acceptance Insurance retail locations which will be leased by the Company. In Shelby County, Tennessee, the Company will utilize an independent agency.

Advertising will mainly be concentrated in radio and television spots with support by Yellow Page advertisements. Business is marketed under the trade name of Acceptance Insurance.

The Company estimates written premium in excess of twenty million dollars ($20,000,000) in year one.

STATUTORY DEPOSIT

In compliance with statutory requirements, the Company maintained the following deposit at December 4, 2006:

Where Deposited and Description	Par Value	Statement Value	Market Value
Tennessee			
U. S. Treasury Note 4.625%, due 10/31/2011	$425,000	$425,778	$425,780
Total general deposits held for the benefit of all policyholders and creditors of the Company	$425,000	$425,778	$425,780
Total	$425,000	$425,778	$425,780

The above deposit was delivered to the Commissioner of Commerce and Insurance, State of Tennessee on December 8, 2006. The securities are held pursuant to a Depository Agreement with SunTrust Bank, Nashville (201 Fourth Avenue, South, Nashville, Tennessee 37219) signed by SunTrust on December 4, 2006, and signed by the Company on November 16, 2006.

SUBSEQUENT EVENTS

None

FINANCIAL STATEMENT

There follows a statement of assets and liabilities at December 4, 2006, established by this examination:

ASSETS

	Ledger Assets 12/4/2006	Assets Not Admitted	Net Admitted Assets 12/4/2006
Bonds	$ 425,778		$ 425,778
Cash and short-term investments	7,072,645		7,072,645
Investment income due and accrued	1,970		1,970
Totals	$7,500,393		$7,500,393

LIABILITIES, SURPLUS, AND OTHER FUNDS

			12/4/2006
Current federal income taxes			$ 137
Total Liabilities			137
Common capital stock			1,000,000
Gross paid in and contributed surplus			6,500,000
Unassigned funds			256
Surplus as regards policyholders			$7,500,256
Totals			$7,500,393

STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned		$0
Deductions: Losses incurred	$0	
Loss expenses incurred	0	
Other underwriting expenses incurred	0	
Total underwriting deductions		0
Net underwriting gain		$0

INVESTMENT INCOME

Net investment income earned	$393	
Net realized capital gains (losses)	0	
Net investment gain		$393

OTHER INCOME

Aggregate write-ins for miscellaneous income		$ 0
Net income before dividends to policyholders and before federal income taxes		$393
Dividends to policyholders		0
Federal income taxes incurred		137
Net income		$256

CAPITAL AND SURPLUS

Surplus as regards policyholders, December 31 prior year		$ 0
Net income	$ 256	
Net unrealized capital gains (losses)	0	
Change in net deferred income tax	0	
Change in non-admitted assets	0	
Cumulative effect of changes in accounting principles	0	
Capital changes: Paid in	1,000,000	
Surplus adjustments: Paid in	6,500,000	
Aggregate write-in for gains and losses in surplus	0	
Change in surplus as regards policyholders for the year		7,500,256
Surplus as regards policyholders, December 31 current year		$7,500,256

COMMENTS

- The Company signed an Investment Management Agreement with Hyperion Brookfield Asset Management, Inc. on November 1, 2006.

- First Acceptance Corporation has an Investment Policy in place which covers all its subsidiaries. The most recent edition is dated, May 16, 2005.

- The Company was made a party to the Tax Allocation Agreement with First Acceptance Corporation effective July 6, 2006. The Department of Commerce and Insurance, State of Tennessee had previously approved this agreement on June 10, 2004, on behalf of First Acceptance Insurance Company, Inc.

RECOMMENDATIONS

- The Company is party to a Custodial Agreement signed November 16, 2006, with SunTrust Bank in order to hold short-term investments in a STI Classic FDS Prime Quality Money Market Fund. This fund is part of the STI family of investment funds. The agreement had a clause indicating: "These assets shall be held, administered, and invested by the Custodian in accordance with the Provisions of this Agreement and applicable law"; however, the Company asked for an amendment to make certain the agreement contained language which mirrored and complied with the language required pursuant to Tenn. Comp. R. and Regs. 0780-1-46.

- The Company is a member of an Insurance Holding Company System as defined by Tenn. Code Ann. § 56-11-201. The controlling persons are required to file Form B filings along with biographical data and financial statements as had been previously required when First Acceptance Insurance Company, Inc., parent of the Company was a Tennessee domiciled insurance company.

  The Company is hereby notified that the controlling persons are required to file a Holding Company Registration within fifteen (15) days after the Company is licensed and every year thereafter by April 30 of each year for the previous calendar year. Tenn. Comp. R. & Regs. 0780-1-67 exhibits the reporting forms and instructions.

  The Company is also aware that agreements within an Insurance Holding Company System are required to be submitted to the Department of Commerce and Insurance, State of Tennessee at least thirty (30) days prior to the effective date.

CONCLUSION

I have verified the foregoing financial statement as included in this examination report. In conjunction, I have inspected the following documents and records of the Company: Charter of Incorporation, Bylaws, minutes of the Board of Directors' meetings, biographical sketches of all directors and officers and the plan of operation.

It appears that the Company has fulfilled all necessary requirements to receive a Certificate of Authority to establish and operate a property and casualty insurance company in the State of Tennessee. Therefore, I recommend that First Acceptance Insurance Company of Tennessee, Inc. be issued a Certificate of Authority pursuant to Title 56, Chapter 2, Tennessee Code Annotated to establish and operate such property and casualty insurance company in Tennessee.

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 Organizational Examination Report of First Acceptance Insurance Company of Tennessee, Inc. dated December 14, 2006, and made as of December 4, 2006, 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 20th day of

December, 2006

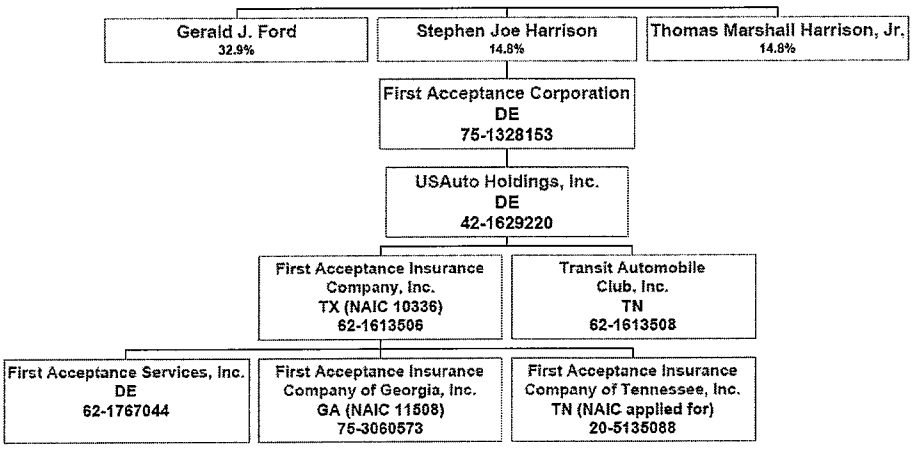
Notary Helen W. Dorsey

County Davidson

State Tennessee

Commission Expires 05/22/2010

HELEN W. DORSEY
STATE OF TENNESSEE NOTARY PUBLIC
DAVIDSON COUNTY, TENN.

My Commission Expires MAY 22, 2010

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