

Pekin Insurance Company

**Report on Audits of Financial Statements -
Statutory Basis**

For the Years Ended December 31, 2008 and 2007

Pekin Insurance Company

Table of Contents

	Page(s)
Independent Auditor's Report on the Financial Statements	1
Financial Statements:	
Statutory Balance Sheets as of December 31, 2008 and 2007	2
Statutory Statements of Income and Changes in Stockholder's Equity for the years ended December 31, 2008 and 2007	3
Statutory Statements of Cash Flow for the years ended December 31, 2008 and 2007	4
Notes to Statutory Basis Financial Statements	5-16
Independent Auditor's Report on the Supplementary Information	17
Summary Investment Schedule	18
Investment Risks Interrogatories	19-21
Reinsurance Interrogatories	22-23

Independent Auditor's Report on the Financial Statements

Board of Directors
Pekin Insurance Company
Pekin, Illinois

We have audited the accompanying statutory balance sheets of Pekin Insurance Company (the "Company") as of December 31, 2008 and 2007, and the related statutory statements of income and changes in stockholder's equity and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the Company prepared these financial statements using accounting practices prescribed or permitted by the Illinois Department of Financial and Professional Regulation, Division of Insurance, which practices differ from U.S. generally accepted accounting principles. The effects on the statutory financial statements of the variances between the statutory basis of accounting and U.S. generally accepted accounting principles have not been determined, but are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the statutory financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the Company as of December 31, 2008 and 2007, or the results of its operations or its cash flow for the years then ended.

In our opinion, the statutory financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2008 and 2007, and the results of its operations and its cash flow for the years then ended, on the statutory basis of accounting described in Note 1.

Strohm Ballweg, LLP

Madison, Wisconsin
May 26, 2009

Pekin Insurance Company

Statutory Balance Sheets As of December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Admitted Assets:		
Bonds	\$ 169,559,198	\$ 166,987,882
Common stocks:		
Affiliates (cost: \$457,868 at 2008 and 2007)	9,271,987	9,497,788
Other than affiliates	6,066,046	10,470,045
Cash and short-term investments	2,084,177	951,260
Receivable for securities	200	-
	<u>186,981,608</u>	<u>187,906,975</u>
Cash and invested assets		
Federal income taxes:		
Net deferred tax asset	3,939,644	3,751,206
Current income taxes recoverable	1,384,834	-
Investment income due and accrued	2,199,062	2,246,951
	<u>2,199,062</u>	<u>2,246,951</u>
	<u>186,981,608</u>	<u>187,906,975</u>
Total admitted assets	<u>\$ 194,505,148</u>	<u>\$ 193,905,132</u>
Liabilities:		
Unpaid losses	\$ 59,290,679	\$ 52,478,317
Unpaid loss adjustment expenses	14,563,078	12,751,762
Unearned premiums	31,645,770	31,713,334
Commissions, expenses, fees and taxes	2,138,022	2,622,996
Current federal and foreign income taxes	-	658,120
Payable to parent	1,015,463	116,936
Other liabilities	836,854	1,061,059
	<u>109,489,866</u>	<u>101,402,524</u>
Total liabilities		
	<u>109,489,866</u>	<u>101,402,524</u>
Stockholder's Equity:		
Common capital stock, \$28.75 par value, 70,000 shares authorized, issued and outstanding	2,012,500	2,012,500
Unassigned surplus	83,002,782	90,490,108
	<u>85,015,282</u>	<u>92,502,608</u>
Total stockholder's equity		
	<u>85,015,282</u>	<u>92,502,608</u>
Total liabilities and stockholder's equity	<u>\$ 194,505,148</u>	<u>\$ 193,905,132</u>

The accompanying notes are an integral part of the statutory financial statements.

Pekin Insurance Company

Statutory Statements of Income and Changes in Stockholder's Equity For the Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Underwriting income:		
Premiums written	\$ 79,677,382	\$ 79,900,599
(Increase) decrease in unearned premiums	67,564	(828,617)
Premiums earned	<u>79,744,946</u>	<u>79,071,982</u>
Losses and expenses incurred:		
Losses	63,328,128	50,673,014
Loss adjustment expenses	8,343,398	6,557,236
Underwriting expenses	<u>20,701,208</u>	<u>21,690,090</u>
Total losses and expenses incurred	<u>92,372,734</u>	<u>78,920,340</u>
Underwriting gain (loss)	(12,627,788)	151,642
Net investment income	8,582,383	8,177,945
Realized capital gains (losses)	(2,392,408)	179,948
Other income	<u>412,676</u>	<u>258,148</u>
Net income (loss) before federal income tax	(6,025,137)	8,767,683
Federal income tax incurred	<u>(1,927,024)</u>	<u>2,076,558</u>
Net income (loss)	(4,098,113)	6,691,125
Other changes in stockholder's equity:		
Change in net unrealized capital gains (losses):		
Affiliates	(225,801)	102,920
Other than affiliates	(3,351,850)	(64,959)
Change in net deferred income taxes	188,438	150,489
Correction of error	<u>-</u>	<u>(410,183)</u>
Net change in stockholder's equity	(7,487,326)	6,469,392
Stockholder's equity, beginning of year	<u>92,502,608</u>	<u>86,033,216</u>
Stockholder's equity, end of year	<u><u>\$ 85,015,282</u></u>	<u><u>\$ 92,502,608</u></u>

The accompanying notes are an integral part of the statutory financial statements.

Pekin Insurance Company

Statutory Statements of Cash Flow For the Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash from operations:		
Net premiums collected	\$ 79,677,382	\$ 79,900,599
Net investment income received	9,369,580	8,783,387
Other income received	412,677	258,148
	<u>89,459,639</u>	<u>88,942,134</u>
Total cash received		
Benefits and loss related payments	56,515,766	46,161,606
Commissions, expenses paid and other deductions	27,718,263	28,278,101
Federal income taxes paid	115,930	1,900,000
	<u>84,349,959</u>	<u>76,339,707</u>
Total cash disbursed		
Net cash from operations	<u>5,109,680</u>	<u>12,602,427</u>
Cash from investments:		
Proceeds from investments sold, matured or repaid:		
Bonds	11,425,760	7,828,197
Stocks	172,307	536,288
	<u>11,598,067</u>	<u>8,364,485</u>
Total investment proceeds		
Cost of investments acquired:		
Bonds	15,965,579	17,378,476
Stocks	283,375	3,346,670
Miscellaneous applications	199	-
	<u>16,249,153</u>	<u>20,725,146</u>
Total investments acquired		
Net cash from investments	<u>(4,651,086)</u>	<u>(12,360,661)</u>
Cash from financing and miscellaneous sources:		
Other cash provided	<u>674,323</u>	<u>254,244</u>
Net change in cash and short-term investments	1,132,917	496,010
Cash and short-term investments at beginning of year	<u>951,260</u>	<u>455,250</u>
Cash and short-term investments at end of year	<u>\$ 2,084,177</u>	<u>\$ 951,260</u>

The accompanying notes are an integral part of the statutory financial statements.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

1. Nature of Operations and Summary of Significant Accounting Practices

Pekin Insurance Company (the “Company”) is a regional Midwest property and casualty insurance company domiciled in the State of Illinois. The Company sells insurance through independent agents. Insurance products primarily include private passenger and commercial automobile, homeowners, workers’ compensation, commercial multi-peril, general liability and business owners. Approximately 70% of the direct premium was written in the state of Illinois in 2008 and 2007.

The accompanying financial statements have been prepared principally for filing with regulatory agencies and, as such, are prepared in conformity with accounting practices prescribed or permitted by the Illinois Department of Financial and Professional Regulation, Division of Insurance (statutory accounting practices).

Prescribed statutory accounting practices include the National Association of Insurance Commissioners (NAIC) “*Accounting Practices and Procedures Manual*”, as well as state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed when such practices are approved by the insurance department of the insurer’s state of domicile. The Company does not use any permitted practices.

Accounting Estimates

The preparation of statutory financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Estimates that are particularly susceptible to significant change in the near-term relate to 1) the estimated unpaid losses and loss adjustment expenses, 2) the assumptions regarding the other than temporary impairment analysis of the investment portfolio, and 3) the discount rate used to determine the benefit obligations for the defined benefit pension plan and post-retirement benefit plan.

Summary of Significant Differences between Statutory Accounting and GAAP

A description of the significant accounting practices used by the Company and significant variances from accounting principles generally accepted in the United States of America (GAAP) are as follows:

A. Investments

Bonds and stocks are valued in accordance with rules prescribed by the NAIC. Investment grade bonds (i.e., NAIC designation 1 or 2) not backed by other loans are stated at amortized cost using a modified scientific method. Below investment grade bonds (i.e., NAIC designation 3 or higher) not backed by other loans are stated at lesser of fair value or amortized cost with any change in the carrying value of the bond being treated as an unrealized gain/loss and credited/charged directly to surplus. Common stocks of other than affiliates are carried at NAIC market value. Common stock of the insurance company affiliate is accounted for using the statutory equity method in which undistributed earnings are reported as unrealized gains and losses. Common stock of the wholly owned, non-insurance company affiliate is carried at audited GAAP equity. Under GAAP, the financial statements of wholly owned subsidiaries are consolidated with those of the parent.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

Mortgage-backed and asset-backed securities are stated at amortized cost using a prospective basis. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flow whose amounts differ from those estimated earlier. Changes in amortization and amortized cost will occur in future periods. Assumptions for mortgage-backed and asset-backed securities are updated twice a year. Agency pass-through and collateralized mortgage obligations use the three month generic prepayment speed assumption. Non-agency collateralized mortgage obligations and asset-backed securities are updated using projected principal payment windows.

Investment income is recorded when earned. Realized gains and losses on sales or maturity of investments are determined on the basis of specific identification. Aggregate unrealized capital gains and losses were credited or charged directly to unassigned surplus without current income tax effect. Statutory accounting requires that unrealized capital losses on investments that are determined to be other than temporary declines in value must be recognized as realized capital losses. The Company reviews its investment portfolio on a periodic basis to determine other than temporary declines in value. In evaluating whether a decline in value is other than temporary, management considers several factors including, but not limited to, 1) the Company's ability and intent to retain the security for a sufficient amount of time for it to recover, 2) the extent and duration of the decline in value, 3) the probability of collecting all cash flows according to contractual terms in effect at acquisition or restructuring, 4) relevant industry conditions and trends, and 5) the financial condition and current and future business prospects of the issuer. The amount of these declines deemed other than temporary was \$2,537,475 and \$0 for the years ended December 31, 2008 and 2007, respectively.

Under GAAP, equity securities that have readily determinable fair values and debt securities would be classified into three categories: held-to-maturity, trading, and available-for-sale. Held-to-maturity securities would be reported at amortized cost. Trading securities would be reported at fair value, with unrealized gains and losses reported as a separate component of income. Available-for-sale securities would be reported at fair value, with unrealized gains and losses, net of applicable taxes, reported as a separate component of unassigned surplus.

B. Unpaid Losses and Loss Adjustment Expenses

The liabilities for unpaid losses and loss adjustment expenses is based upon management's estimates of reported and unreported losses determined on the basis of claim evaluation and past statistical experience. The Company does not anticipate salvage and subrogation in the estimate of the liability for direct unpaid loss and loss adjustment expenses, which is required under GAAP. Reinsurance recoverables related to unpaid losses and loss adjustment expenses are netted with the respective liabilities; under GAAP, these reinsurance recoverables would be shown on a separate gross basis.

C. Policy Acquisition Costs

The costs of acquiring premium income are immediately charged against operations, whereas premium income is deferred over the periods covered by the policies. Under GAAP, costs, which vary directly with the production of new and renewal business, are capitalized and amortized as premium is earned.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

D. Pension Plan

Under GAAP, periodic net pension expense would be based on the cost of incremental benefits for employee service during the period, interest on projected benefit obligation, actual return on plan assets and amortization of actuarial gains and losses. The statutory basis of accounting adopts a similar actuarial approach to estimate pension costs; however, costs related to non-vested participants are excluded.

E. Income Taxes

Currently accrued federal income taxes are based on taxable income or loss. The Company records deferred tax assets and liabilities to reflect temporary differences between tax and financial reporting. Changes in net deferred tax assets/liabilities are recorded directly to surplus under statutory accounting. GAAP requires certain changes to be recorded through the income statement and also requires deferred tax assets and liabilities for state income taxes.

F. Premium Income Recognition

Premiums are earned over the terms of the related insurance policies and reinsurance contracts, on a daily pro rata basis. Unearned premium reserves are established to cover the unexpired portion of premiums written and are computed on a pro rata basis. The Company determined that a premium deficiency reserve was not necessary for the years ended December 31, 2008 and 2007. The Company does not anticipate investment income as a factor in the calculation of a potential premium deficiency reserve.

G. Cash and Short-Term Investments

For purposes of reporting cash flows, the Company follows statutory accounting practices and considers cash in checking accounts and certain money market funds and highly liquid debt instruments purchased with a remaining maturity of one year or less to be cash and short-term investments. The Company occasionally has on deposit in a financial institution a balance in excess of amounts insured by the Federal Deposit Insurance Corporation. The Company does not believe it is exposed to any significant credit risks on these accounts.

H. Other

Under statutory accounting practices, the Statements of Cash Flow reconcile cash and short-term investments with original maturities of one year or less. Under GAAP, the Statements of Cash Flow reconcile the corresponding captions of cash and cash equivalents with original maturity periods of three months or less.

Commissions on reinsurance ceded are credited to income at the time the premium is ceded; under GAAP, commissions on ceded premium would be deferred and recognized as income over the periods covered by the policies.

Statutory financial statements are presented in a form using language and groupings substantially the same as the annual statement of the Company filed with the NAIC and state regulatory authorities which differ from the presentation and disclosure of financial statements presented under GAAP.

Necessary reclassifications are made in prior period financial statements, whenever appropriate, to conform to the current presentation.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

2. Affiliated Entity Transactions

The Company and its parent, The Farmers Automobile Insurance Association (the Association), owned 69.47% and 65.84% of the Pekin Life Insurance Company (PLIC) at December 31, 2008 and 2007, respectively. Specifically, the Company owned 7.58% of PLIC at the end of December 31, 2008 and 2007.

The Company and the Association occupy the same building and, along with PLIC, utilize many common facilities, management, administrative and office personnel and services. Since 1966, the Company and the Association have had a reinsurance pooling agreement under which underwriting income and expense and other administrative expenses are prorated to the Association (80%) and to the Company (20%). Intercompany balances are paid periodically throughout the year based on estimates and settled within 45 days after year-end based on actual allocated expenses. The proration does not include provisions for federal income taxes or results of investment transactions.

3. Bonds and Common Stocks

The admitted value, unrealized gain and loss, and estimated market value of investments in bonds as of December 31, 2008, are as follows:

Obligation	2008			
	Admitted Value	Unrealized Gain	Unrealized Loss	Market Value
U.S. Government	\$ 5,344,630	\$ 210,635	\$ -	\$ 5,555,265
States, Territories and Possessions	9,845,673	290,317		10,135,990
Political Subdivisions of States and Territories	32,918,478	736,286	195,431	33,459,333
Special Revenue and Special Assessment	78,606,431	2,062,217	929,692	79,738,956
Public Utilities	1,725,908	105,405	-	1,831,313
Industrial and Miscellaneous	41,118,078	595,717	3,310,540	38,403,255
Total	<u>\$169,559,198</u>	<u>\$ 4,000,577</u>	<u>\$ 4,435,663</u>	<u>\$169,124,112</u>

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

The admitted value, unrealized gain and loss, and estimated market value of investments in bonds as of December 31, 2007 are as follows:

Obligation	2007			
	Admitted Value	Unrealized Gain	Unrealized Loss	Market Value
U.S. Government States, Territories and Possessions	\$ 4,109,055	\$ 110,064	\$ 11,045	\$ 4,208,074
Political Subdivisions of States and Territories	9,978,002	113,772	8,814	10,082,960
Special Revenue and Special Assessment	38,448,684	697,130	61,873	39,083,941
Public Utilities	77,040,832	1,279,726	158,598	78,161,960
Industrial and Miscellaneous	706,037	18,486	-	724,523
Total	<u>36,705,272</u>	<u>1,091,092</u>	<u>533,735</u>	<u>37,262,629</u>
	<u>\$166,987,882</u>	<u>\$ 3,310,270</u>	<u>\$ 774,065</u>	<u>\$169,524,087</u>

The admitted value and estimated market value of debt securities at December 31, 2008, by contractual maturity, are shown below. Market values for debt securities include estimated fair values determined by the Securities Valuation Office of the NAIC. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Admitted Value	Market Value
Due in one year or less	\$ 5,542,168	\$ 5,568,506
Due after one year through five years	11,960,547	11,919,424
Due after five years through ten years	64,018,067	65,173,149
Due after ten years	46,244,790	43,943,520
Total	127,765,572	126,604,599
Mortgage backed securities	41,793,626 *	42,519,513
Total	<u>\$ 169,559,198</u>	<u>\$ 169,124,112</u>

* The admitted value of mortgage backed securities include \$3,080,354 and \$1,833,675 of U.S. Government Guaranteed Securities for 2008 and 2007, respectively.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

Securities with unrealized losses based on estimated market values at December 31, 2008 are shown below:

<u>Description of Securities</u>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>
Political Subdivisions of States and Territories	\$ 4,166,850	\$ 71,788	\$ 3,825,580	\$ 123,643	\$ 7,992,430	\$ 195,431
Special Revenue and Special Assessment	9,449,522	240,551	7,003,245	689,141	16,452,767	929,692
Industrial and Miscellaneous	15,561,834	2,020,008	7,539,237	1,290,532	23,101,071	3,310,540
Subtotal Debt Securities	29,178,206	2,332,347	18,368,062	2,103,316	47,546,268	4,435,663
Common Stock - Unaffiliated	1,742,595	634,374	2,986,030	2,717,653	4,728,625	3,352,027
Total Securities With Unrealized Losses	<u>\$30,920,801</u>	<u>\$2,966,721</u>	<u>\$21,354,092</u>	<u>\$4,820,969</u>	<u>\$52,274,893</u>	<u>\$7,787,690</u>

Securities with unrealized losses based on estimated market values at December 31, 2007 are shown below:

<u>Description of Securities</u>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>	<u>Market Value</u>	<u>Unrealized Losses</u>
U.S. Government States, Territories and Possessions	\$ -	\$ -	\$ 1,372,955	\$ 11,045	\$ 1,372,955	\$ 11,045
Political Subdivisions of States and Territories	-	-	2,834,770	8,814	2,834,770	8,814
Special Revenue and Special Assessment	2,282,720	27,033	8,753,678	34,840	11,036,398	61,873
Industrial and Miscellaneous	2,665,410	48,255	10,245,925	110,343	12,911,335	158,598
Subtotal Debt Securities	7,216,180	420,322	3,406,053	113,413	10,622,233	533,735
Common Stock - Unaffiliated	12,164,310	495,610	26,613,381	278,455	38,777,691	774,065
Total Securities With Unrealized Losses	3,741,824	460,381	1,631,254	476,389	5,373,078	936,770
	<u>\$15,906,134</u>	<u>\$ 955,991</u>	<u>\$28,244,635</u>	<u>\$ 754,844</u>	<u>\$44,150,769</u>	<u>\$1,710,835</u>

Proceeds from sales of investments in debt securities, excluding calls and maturities, during 2008 and 2007 were \$6,353,560 and \$-0- respectively. There were gross gains of \$74,961 and \$-0- in 2008 and 2007 and gross losses of \$8,270 and \$-0- were realized on those sales, respectively.

Bonds carried at \$2,264,275 and \$2,275,380 at December 31, 2008 and 2007, respectively, were on deposit with the Illinois Department of Financial and Professional Regulation, Division of Insurance as required by law.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

The adjusted cost, unrealized gain and loss, and estimated market value of investments in stocks as of December 31, 2008 are as follows:

Common Stocks	2008			
	Adjusted Cost	Unrealized Gain	Unrealized Loss	Market Value
Other Than Affiliates	\$ 8,927,386	\$ 490,687	\$ 3,352,027	\$ 6,066,046
Affiliates	457,868	8,814,119	-	9,271,987
Total Stocks	<u>\$ 9,385,254</u>	<u>\$ 9,304,806</u>	<u>\$ 3,352,027</u>	<u>\$ 15,338,033</u>

The adjusted cost, unrealized gain and loss, and estimated market value of investments in stocks as of December 31, 2007 are as follows:

Common Stocks	2007			
	Adjusted Cost	Unrealized Gain	Unrealized Loss	Market Value
Other Than Affiliates	\$ 9,435,255	\$ 1,971,560	\$ 936,770	\$ 10,470,045
Affiliates	457,868	9,039,920	-	9,497,788
Total Stocks	<u>\$ 9,893,123</u>	<u>\$ 11,011,480</u>	<u>\$ 936,770</u>	<u>\$ 19,967,833</u>

The Company lends securities to agreed upon borrowers through an agreement with its custodian. The Company's policy is to require initial collateral from the borrower in an amount not less than 102% of the market value of the borrowed securities. All collateral so received is held either in the physical custody of the custodian or for the account of the custodian by their agent or a central bank. At December 31, 2008 and 2007, the amount of securities loaned was \$7,112,999 and \$4,833,293, respectively, and the related collateral was \$7,235,225 and \$4,954,875. Prior to December 31, 2008, a collateral deficiency developed due to adverse market conditions. This deficiency of approximately \$71,000 would only be assessed and expensed if the Company exited the securities lending program. At December 31, 2008, collateral assets valued at \$1,826,618 had maturity dates beyond one year.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

4. Liability for Loss and Loss Adjustment Expense Reserves

Activity in the liability for loss and loss adjustment expense reserves is summarized as follows:

	<u>2008</u>	<u>2007</u>
Balance at January 1	\$ 68,364,185	\$ 63,526,533
Less reinsurance recoverable	<u>(3,134,106)</u>	<u>(3,129,200)</u>
Net balance at January 1	<u>65,230,079</u>	<u>60,397,333</u>
Incurred related to:		
Current year	75,118,202	63,734,555
Prior years	<u>(3,446,676)</u>	<u>(6,504,305)</u>
Total incurred	<u>71,671,526</u>	<u>57,230,250</u>
Paid related to:		
Current year	40,654,124	31,955,087
Prior years	<u>22,393,724</u>	<u>20,442,417</u>
Total paid	<u>63,047,848</u>	<u>52,397,504</u>
Net balance at December 31	73,853,757	65,230,079
Plus reinsurance recoverable	<u>2,694,201</u>	<u>3,134,106</u>
Balance at December 31	<u>\$ 76,547,958</u>	<u>\$ 68,364,185</u>

As a result of actual claim payments varying from previous estimates of insured events and subsequent reserve changes, the provision for loss and loss adjustment expenses decreased by \$3,446,676 and \$6,504,305 in 2008 and 2007, respectively. The decrease in incurred loss and loss adjustment expense in 2008 is primarily attributable to favorable development of automobile liability, general liability and homeowners estimated loss and loss adjustment expense reserves. The decrease in incurred loss and loss adjustment expenses in 2007 is primarily attributable to favorable development of worker's compensation, automobile liability, and general liability estimated loss and loss adjustment expense reserves.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

5. Reinsurance

The Company is party to an intercompany pooling agreement with the Association. All direct business written by the Company is ceded 100% to the intercompany pool. No direct business is ceded to third parties by the Company. Under this agreement, underwriting income and expenses and other administrative expenses are prorated to the Association (80%) and to the Company (20%).

	Assumed Reinsurance		Ceded Reinsurance		Net	
	Premium Reserve	Commission Equity	Premium Reserve	Commission Equity	Premium Reserve	Commission Equity
<u>At December 31, 2008</u>						
Intercompany pooling agreement	\$31,645,770	\$4,605,542	\$89,393,223	\$14,476,608	\$(57,747,453)	\$(9,871,066)
<u>At December 31, 2007</u>						
Intercompany pooling agreement	\$31,713,334	\$4,640,194	\$91,197,676	\$14,665,185	\$(59,484,342)	\$(10,024,991)

The direct unearned premium reserve was \$89,393,223 and \$91,197,676 at December 31, 2008 and 2007, respectively.

6. Pension Plan, Post-Retirement Benefits, and Deferred Compensation

Retirement Benefits

The Company and its parent, The Farmers Automobile Insurance Association and its affiliate, Pekin Life Insurance Company, participate in a trusted non-contributory defined benefit pension plan. The Company has no legal obligation for benefits under this plan. This plan covers full-time employees who have completed one year of service and have reached the age of 21. As described in Note 2, the Company and its parent maintain a reinsurance pooling agreement under which certain income and expenses are prorated to the Association (80%) and to the Company (20%). The Company's allocated pension cost based on the reinsurance pooling agreement amounted to \$452,562 in 2008 and \$1,002,682 in 2007.

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

401(k) Savings Plan

The Company and its affiliates participate in a voluntary 401(k) savings plan for eligible participants. The participation requirements are the same as the defined benefit plan mentioned above. The Company may elect, at its sole discretion, to contribute a matching contribution to the savings plan. The Company has elected to match 25 percent of the employee's contributions up to a maximum match of \$400 in 2008 and 2007. Employer contributions of \$27,146 and \$26,346 respectively, were made to this plan in 2008 and 2007. At December 31, 2008 and 2007, the fair value of plan assets was \$13,327,814 and \$18,737,544 respectively.

Post-Retirement Benefits

In addition to providing pension benefits, the Company and its affiliates provide certain health care and life insurance benefits (post-retirement benefits) for retired employees. Substantially all employees may become eligible for these benefits if they reach retirement age while working for the Company.

Net post-retirement benefit cost for the years ended December 31, 2008 and 2007, was \$777,155 and \$243,389, respectively, and includes the expected cost of such benefits for newly-eligible or vested employees, interest cost, and gains and losses arising from differences between actuarial assumptions and actual experience, and amortization of the transition obligation.

Deferred Compensation

The Company maintains a deferred compensation plan for its directors. This plan allows for voluntary deferral of all or any part of compensation to which a director might otherwise be entitled to as directors' fees, in accordance with the plan provisions. During 2008 and 2007, respectively, \$8,000 and \$32,000 of directors' fees were deferred. The liability for directors' deferred compensation was \$162,679 and \$366,175 at December 31, 2008 and 2007, respectively.

Medicare Act

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act introduced a prescription drug benefit under Medicare in 2006, as well as a federal subsidy to qualifying sponsors of retiree healthcare benefit plans. The net post-retirement benefit cost included in these financial statements reflects an expected Medicare reimbursement of \$119,350 and \$77,316, respectively, in 2008 and 2007. Additionally, the Company's accumulated post-retirement benefit obligation at December 31, 2008 and 2007, has been reduced by \$599,599 and \$591,446, respectively, as a result of the federal subsidy.

7. Income Taxes

The components of the net deferred tax asset at December 31 are as follows:

	<u>2008</u>	<u>2007</u>
Deferred tax assets (gross)	\$ 12,161,883	\$ 8,309,382
Deferred tax liabilities	(1,723,624)	(2,549,138)
Deferred tax assets nonadmitted	(6,498,615)	(2,009,038)
Net deferred tax asset	<u>\$ 3,939,644</u>	<u>\$ 3,751,206</u>
Increase (decrease) in deferred tax assets nonadmitted	<u>\$ 4,489,577</u>	<u>\$ (364,027)</u>

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are as follows:

	<u>December 31, 2008</u>	<u>December 31, 2007</u>	<u>Change</u>
Deferred tax assets:			
Reserves	\$ 1,980,138	\$ 1,776,577	\$ 203,561
Unearned premium	2,215,204	2,219,933	(4,729)
Capital losses - common stocks:			
Other than temporary	3,801,359	2,886,001	915,358
Accrued salvage and subrogation	1,091,647	1,014,367	77,280
Accrual of discount on bonds	1,959,314	-	1,959,314
Other items	1,114,221	412,504	701,717
Gross deferred tax assets	<u>12,161,883</u>	<u>8,309,382</u>	<u>3,852,501</u>
Nonadmitted deferred tax assets	<u>(6,498,615)</u>	<u>(2,009,038)</u>	<u>(4,489,577)</u>
Admitted deferred tax assets	<u>5,663,268</u>	<u>6,300,344</u>	<u>(637,076)</u>
Deferred tax liabilities:			
Unrealized gain - Pekin Life Insurance Company	1,721,274	1,825,315	(104,041)
Unrealized capital gains - common stocks	-	362,177	(362,177)
Other items	<u>2,350</u>	<u>361,646</u>	<u>(359,296)</u>
Total deferred tax liabilities	<u>1,723,624</u>	<u>2,549,138</u>	<u>(825,514)</u>
Net admitted deferred tax asset	<u>\$ 3,939,644</u>	<u>\$ 3,751,206</u>	<u>\$ 188,438</u>

Current law governing the taxation of property and casualty insurance companies requires substantial adjustments to statutory net income in arriving at taxable income. The effective tax rate differs from the federal income tax rate of 34 percent in 2008 and 35 percent in 2007 due to the following differences between statutory and tax valuations of assets and liabilities:

	<u>2008</u>	<u>2007</u>
Federal income tax	\$ (2,048,547)	\$ 3,068,687
Tax exempt interest	(1,082,793)	(1,097,460)
Capital gains	813,419	(62,982)
Dividends received deduction	(110,135)	(99,060)
Conditional reserve	131,660	159,910
Release of tax contingency	(85,493)	(36,971)
Unearned premium	(4,594)	58,003
Loss reserve discounting	200,124	95,200
Salvage and subrogation	81,600	84,000
Pension benefits	36,824	(147,612)
All others	140,911	54,843
Federal income tax expense (benefit)	<u>\$ (1,927,024)</u>	<u>\$ 2,076,558</u>

Pekin Insurance Company

Notes to Financial Statements – Statutory Basis

Federal income tax incurred of (\$1,927,024) includes a benefit of \$1,841,531 and \$85,493 from 2008 and 2007, respectively. At December 31, 2008, the Company had a net operating loss of \$5,803,504 which it plans to carry-back to tax year 2006. There are capital losses of \$695,904 available to be carried forward to offset future capital gains.

Federal income tax returns of the Company have been examined by the Internal Revenue Service for all years through 2001. In the opinion of management, the liability for federal income taxes is sufficient to cover computed taxes for the current and prior years that are currently payable. As of December 31, 2008, the Company has accrued \$851,660 for potential tax contingencies as an income tax liability on the statutory balance sheet and \$141,750 is recognized as income taxes incurred on the statutory statement of income. State income tax benefit of \$322,454 in 2008 and state income tax expense in 2007 of \$469,381 is included in underwriting expenses.

8. Structured Settlements

The Company has purchased annuities of which the claimant is payee, but for which the Company is contingently liable. The aggregate amount of annuities from all life insurers was \$1,159,023 and \$1,103,832 at December 31, 2008 and 2007, respectively.

9. Correction of Error

At December 31, 2007, the Company accrued a liability of \$401,850 for the directors' nonqualified pension obligation. This liability had not been reflected in prior years' financial statements. At December 31, 2006, the liability that should have been provided for was \$410,183. The 2008 and 2007 Statements of Income reflect the appropriate change in directors' nonqualified pension liability (as if the December 31, 2006, liability had been provided). The 2007 Statement of Changes in Stockholder's Equity includes a charge of \$410,183, which represents the correction of the prior year end error.

SUPPLEMENTAL FINANCIAL INFORMATION

Independent Auditor's Report on the Supplementary Information

Board of Directors
Pekin Insurance Company
Pekin, Illinois

Our audits were made for the purpose of forming an opinion on the statutory financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the statutory financial statements. This information is presented in a format consistent with the Annual Statement filed by the Company with the regulatory authorities. Such information has been subjected to the auditing procedures applied in the audits of the statutory financial statements and, in our opinion, is fairly stated in all material respects in relation to the statutory financial statements taken as a whole.

Strohm Ballweg, LLP

Madison, Wisconsin
May 26, 2009

Pekin Insurance Company

Summary Investment Schedule December 31, 2008

	Gross Investment Holdings		Admitted Assets as Reported in the Annual Statement	
	Amount	Percentage	Amount	Percentage
1. Bonds:				
1.1 U.S. treasury securities	\$ 2,264,275	1.2	\$ 2,264,275	1.2
1.2 U.S. government agency obligations:				
1.21 Issued by U.S. government agencies				
1.22 Issued by U.S. government sponsored agencies				
1.3 Foreign government				
1.4 Securities issued by states, territories, and possessions and political subdivisions in the U.S.:				
1.41 States, territories and possessions general obligations	9,845,672	5.3	9,845,672	5.3
1.42 Political subdivisions of states, territories and possessions and political subdivisions general obligations	32,918,477	17.6	32,918,477	17.6
1.43 Revenue and assessment obligations	46,217,225	24.7	46,217,225	24.7
1.44 Industrial development and similar obligations				
1.5 Mortgage-backed securities (includes residential and commercial MBS):				
1.51 Pass-through securities:				
1.511 Issued or guaranteed by GNMA	3,080,354	1.6	3,080,354	1.6
1.512 Issued or guaranteed by FNMA and FHLMC	27,459,969	14.7	27,459,969	14.7
1.513 All Other				
1.52 CMO's and REMIC's				
1.521 Issued by GNMA, FNMA, FHLMC or VA	4,929,235	2.6	4,929,235	2.6
1.522 Issued by non-US Government issuers and collateralized by mortgage-backed securities issued or guaranteed by agencies shown in Line 1.521				
1.523 All Other	6,324,066	3.4	6,324,066	3.4
2. Other debt and other fixed income securities (excluding short-term)				
2.1 Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	34,301,111	18.3	34,301,111	18.3
2.2 Unaffiliated foreign securities	2,218,814	1.2	2,218,814	1.2
2.3 Affiliated securities				
3. Equity interests:				
3.1 Investments in mutual funds	2,030,712	1.1	2,030,712	1.1
3.2 Preferred stocks:				
3.21 Affiliated				
3.22 Unaffiliated				
3.3 Publicly traded equity securities (excluding preferred stocks):				
3.31 Affiliated				
3.32 Unaffiliated	4,035,334	2.2	4,035,334	2.2
3.4 Other equity securities:				
3.41 Affiliated	9,271,987	5.0	9,271,987	5.0
4. Mortgage loans: None				
5. Real estate investments: None				
6. Contract loans: None				
7. Receivables for securities	200	0.0	200	0.0
8. Cash, cash equivalents and short-term investments	2,084,177	1.1	2,084,177	1.1
9. Other invested assets				
10. Total invested assets	<u>\$ 186,981,608</u>	<u>100.0</u>	<u>\$ 186,981,608</u>	<u>100.0</u>

See Independent Auditor's Report on the Supplementary Information.

Pekin Insurance Company

Investment Risks Interrogatories December 31, 2008

1. Reporting entity's total admitted assets as reported on Page 2 of this annual statement. \$ 194,505,148
2. Ten largest exposures to a single issuer/borrower/investment.

1	2	3	4
<u>Issuer</u>	<u>Description of Exposure</u>	<u>Amount</u>	<u>Percentage of Total Admitted Assets</u>
2.01 Fannie Mae	Bond	\$ 21,833,806	11.2 %
2.02 Freddie Mac	Bond	10,555,400	5.4 %
2.03 Pekin Life Insurance Company	Affiliated Common Stock	8,880,815	4.6 %
2.04 Loudoun County VA	Bond	2,601,511	1.3 %
2.05 Massachusetts St Health & Edl	Bond	2,186,541	1.1 %
2.06 Contra Costa County Calif Pensio	Bond	2,063,047	1.1 %
2.07 Ohio St Tpk Common Tpk Rev	Bond	2,008,074	1.0 %
2.08 Kansas St Dept Transn Hwy Rev	Bond	1,983,596	1.0 %
2.09 Cintas Corp No. 2	Bond	1,978,797	1.0 %
2.10 Virginia St Pub Sch Auth	Bond	1,864,732	1.0 %

3. Amounts and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

<u>Bonds</u>		<u>1</u>	<u>2</u>	<u>Preferred Stocks</u>		<u>3</u>	<u>4</u>
3.01	NAIC-1	\$ 159,265,902	81.9 %	3.07	P/RP-1	\$	%
3.02	NAIC-2	\$ 10,896,738	5.6 %	3.08	P/RP-2	\$	%
3.03	NAIC-3	\$ -	0 %	3.09	P/RP-3	\$	%
3.04	NAIC-4	\$ -	0 %	3.10	P/RP-4	\$	%
3.05	NAIC-5	\$ 997,167	.5 %	3.11	P/RP-5	\$	%
3.06	NAIC-6	\$ 398,120	.2 %	3.12	P/RP-6	\$	%

4. Assets held in foreign investments:

4.01	Are assets held in foreign investments less than 2.5% of the reporting entity's total admi	Yes [X]	No []
4.02	Total admitted assets held in foreign investments	\$ 2,641,463	
4.03	Foreign-currency-denominated investments	\$	
4.04	Insurance liabilities denominated in that same foreign currency	\$	

If response to 4.01 above is yes, responses are not required for interrogatories 5 - 10.

5. Aggregate foreign investment exposure by NAIC sovereign rating:

6. Two largest foreign investment exposures in a single country, categorized by the country's NAIC sovereign rating:

	<u>1</u>	<u>2</u>
7. Aggregate unhedged foreign currency exposure	\$	%

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign rating:

9. Two largest unhedged foreign currency exposures to a single country, categorized by the country's NAIC sovereign rating:

10. Ten largest non-sovereign (i.e. non-governmental) foreign issues:

See Independent Auditor's Report on the Supplementary Information.

Pekin Insurance Company

Investment Risks Interrogatories December 31, 2008

11. Amounts and percentages of the reporting entity's total admitted assets held in Canadian investments and unhedged Canadian currency exposure:

11.01 Are assets held in Canadian investments less than 2.5% of the reporting entity's total admitted assets?
If response to 11.01 is yes, detail is not required for the remainder of Interrogatory 11. Yes [X] No []

12. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments with contractual sales restrictions:

12.01 Are assets held in investments with contractual sales restrictions less than 2.5% of the reporting entity's total admitted assets?
If response to 12.01 is yes, responses are not required for the remainder of Interrogatory 12. Yes [X] No []

13. Amounts and percentages of admitted assets held in the ten largest equity interests:

13.01 Are assets held in equity interests less than 2.5% of the reporting entity's total admitted assets?

1		2	3
Name of Issuer		Amount	Percentage of Total Admitted Assets
13.02	Pekin Life Insurance Company	\$ 8,880,815	4.7 %
13.03	Oracle Corp	531,882	0.3 %
13.04	PAC, Inc	391,172	0.2 %
13.05	Time Warner Inc	301,800	0.2 %
13.06	CVS Caremark Corp	287,400	0.1 %
13.07	Cisco Systems Inc	260,800	0.1 %
13.08	JPMorgan Chase & Co	236,475	0.1 %
13.09	State Street Corp	235,980	0.1 %
13.10	Shire PLC-ADR	223,900	0.1 %
13.11	General Electric Co	178,200	0.1 %

14. Amounts and percentages of the reporting entity's total admitted assets held in nonaffiliated, privately placed equities:

14.01 Are assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity's total admitted assets?
If response to 14.01 above is yes, responses are not required for the remainder of Interrogatory 14. Yes [X] No []

15. Amounts and percentages of the reporting entity's total admitted assets held in general partnership interests:

15.01 Are assets held in general partnership interests less than 2.5% of the reporting entity's total admitted assets?
If response to 15.01 above is yes, responses are not required for the remainder of Interrogatory 15. Yes [X] No []

16. Amounts and percentages of the reporting entity's total admitted assets held in mortgage loans:

16.01 Are mortgage loans reported in Schedule B less than 2.5% of the reporting entity's total admitted assets?
If response to 16.01 above is yes, responses are not required for the remainder of Interrogatory 16 and Interrogatory 17. Yes [X] No []

17. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date:

18. Amounts and percentages of the reporting entity's total admitted assets held in each of the five largest investments in real estate:

18.01 Are assets held in real estate reported less than 2.5% of the reporting entity's total admitted assets?
If response to 18.01 above is yes, responses are not required for the remainder of Interrogatory 18. Yes [X] No []

See Independent Auditor's Report on the Supplementary Information.

Pekin Insurance Company

Investment Risks Interrogatories December 31, 2008

19. Report aggregate amounts and percentages of the reporting entity's total admitted assets held in investments held in mezzanine real estate loans:

19.01 Are assets held in investments held in mezzanine real estate loans less than 2.5% of the reporting entity's total admitted assets?

If response to 19.01 is yes, responses are not required for the remainder of Interrogatory 19. Yes [X] No []

20. Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

	At Year-End		(Unaudited)	At End of	(Unaudited)	(Unaudited)
	<u>1</u>	<u>2</u>	1st Qtr	Each Quarter	2nd Qtr	3rd Qtr
			<u>3</u>	<u>4</u>	<u>5</u>	
20.01 Securities lending agreements (do not include assets held as collateral for such transactions)	\$ 7,112,999	3.7 %	\$ 7,850,184	\$ 4,938,938	\$ 5,645,079	
20.02 Repurchase agreements	\$	%	\$	\$	\$	
20.03 Reverse repurchase agreements	\$	%	\$	\$	\$	
20.04 Dollar repurchase agreements	\$	%	\$	\$	\$	
20.05 Dollar reverse repurchase agreements	\$	%	\$	\$	\$	

21. Amounts and percentages of the reporting entity's total admitted assets for warrants not attached to other financial instruments, options, caps, and floors:

22. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for collars, swaps, and forwards:

23. Amounts and percentages of the reporting entity's total admitted assets of potential exposure for futures contracts:

See Independent Auditor's Report on the Supplementary Information.

Pekin Insurance Company

Reinsurance Interrogatories December 31, 2008

- 7.1 Has this reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss ratio cap, an aggregate limit or any similar provisions)? Yes [] No [X]
- 9.1 Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:
- a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
 - b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
 - c. Aggregate stop loss reinsurance coverage;
 - d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;
 - e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
 - f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity. Yes [] No [X]
- 9.2 Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member where:
- a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
 - b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in a separate reinsurance contract. Yes [] No [X]
- 9.3 If yes to 9.1 or 9.2, please provide the following information in the Reinsurance Summary Supplemental Filing for General Interrogatory 9:
- a. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income;
 - b. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting the criteria in 9.1 or 9.2; and
 - c. A brief discussion of management's principle objectives in entering into the reinsurance contract including the economic purpose to be achieved.

N/A

See Independent Auditor's Report on the Supplementary Information.

Pekin Insurance Company

Reinsurance Interrogatories December 31, 2008

9.4 Except for transactions meeting the requirements of paragraph 31 of SSAP No. 62, Property and Casualty Reinsurance, has the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or
- b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP? Yes [] No [X]

See Independent Auditor's Report on the Supplementary Information.