


REPORT OF EXAMINATION
OF THE
MERCURY INSURANCE COMPANY
AS OF
DECEMBER 31, 2021

A handwritten signature in blue ink, appearing to be 'D. DeLuca', is positioned above the filing date.

Filed on May 30th, 2023

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Los Angeles, California
April 28, 2023

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

MERCURY INSURANCE COMPANY

(hereinafter also referred to as the Company). Its primary location of its books and records is located at 4484 Wilshire Boulevard, Los Angeles, California, 90010. The Company's statutory home office and main administrative office is located at 555 West Imperial Highway, Brea, California 92821.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was made as of December 31, 2017. This examination covers the period from January 1, 2018, through December 31, 2021.

The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook (Handbook). The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. The examination also included identifying and evaluating significant risks that could cause the Company's surplus to be materially misstated, both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This includes assessing significant estimates made by

management, and evaluating management’s compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company’s financial statements.

This examination report includes findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report, but separately communicated to other regulators and/or the Company.

The examination was a coordinated examination of the Mercury Insurance Group with California as the lead state, and conducted concurrently with the Florida, Georgia, Illinois, Oklahoma, and Texas Departments of Insurance. The insurance entities reviewed as part of this examination are identified below by state of domicile:

<u>Company</u>	<u>State</u>
California Automobile Insurance Company	California
California General Underwriters Insurance Company, Inc.	California
Mercury Casualty Company	California
Mercury Insurance Company	California
Orion Indemnity Company (fka Workmen’s Auto Insurance Company)	California
Mercury Indemnity Company of America	Florida
Mercury Insurance Company of Florida	Florida
Mercury Indemnity Company of Georgia	Georgia
Mercury Insurance Company of Georgia	Georgia
Mercury Insurance Company of Illinois	Illinois
American Mercury Insurance Company	Oklahoma
Mercury County Mutual Insurance Company	Texas
American Mercury Lloyds Insurance Company	Texas

COMPANY HISTORY

The Company was incorporated in the state of California on November 20, 1972, as Mercury Insurance Company of California. The “of California”, was deleted from the name on December 27, 1973. The Company is a wholly-owned subsidiary of Mercury Casualty Company (MCC). MCC in turn, is a wholly-owned subsidiary of Mercury General Corporation (MGC), a publicly traded insurance holding company.

Capitalization

The Company has 200,000 shares of \$100 par value common stock authorized and 100,000 shares issued and outstanding.

Dividends

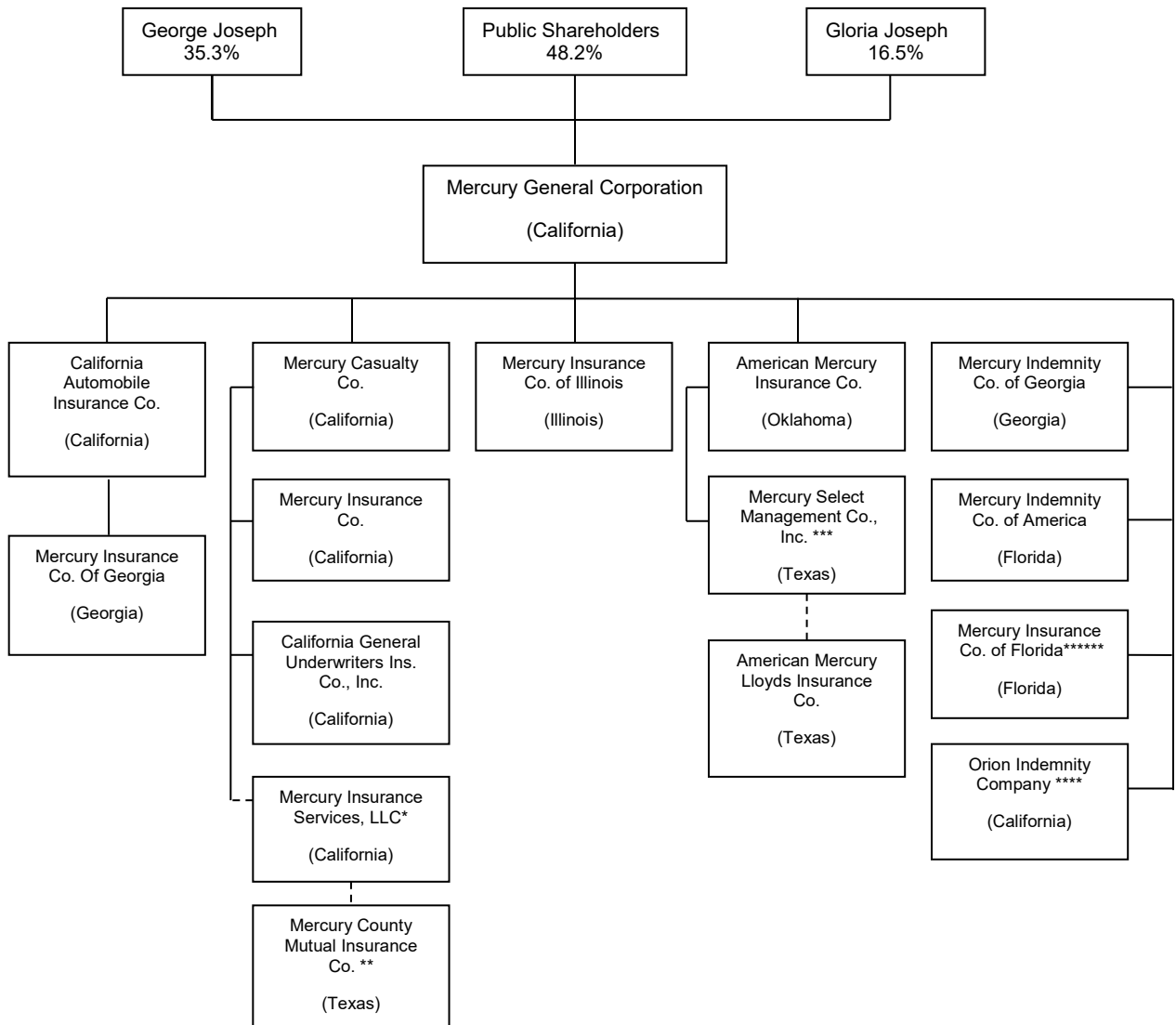
The Company paid the following cash dividends to its parent, MCC, during the examination period:

<u>Year</u>	<u>Ordinary Dividends</u>
2021	\$ 176,000,000
2020	88,000,000
2019	30,000,000
2018	30,000,000
Total	<u>\$ 324,000,000</u>

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Mr. George Joseph is the ultimate controlling person. Mercury General Corporation (MGC) is a publicly traded insurance holding company. As of December 31, 2021, the controlling stockholders, George Joseph and Gloria Joseph, own 35.3% and 16.5%, respectively, of MGC's stock with the remaining 48.2% held by public shareholders, none of whom own 10% or more interest.

The following organizational chart depicts the Company's relationship within the holding company system. All ownership is 100% unless otherwise indicated.



* Mercury Insurance Services, LLC, is controlled by its sole and managing member, Mercury Casualty Company, through a management agreement.

** Mercury County Mutual Insurance Company is managed and controlled by Mercury Insurance Services, LLC, through a management agreement.

*** Mercury Select Management Company, Inc. is Attorney-in-fact for American Mercury Lloyds Insurance Company, a Texas Lloyds Plan Insurer.

****Orion Indemnity Company, a California insurer, was formerly named Workmen's Auto Insurance Company.

*****Mercury National Insurance Company, an Illinois domiciled insurance company and 100% owned subsidiary of MICIL, was dissolved.

*****Mercury Insurance Company of Florida was dissolved effective November 30, 2022.

The seven members of the Company's board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving on December 31, 2021:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
George G. Braunegg Los Angeles, California	Advisor and Investor Terafina Inc
Ramona L. Cappello Los Angeles, California	Principal The Cappello Group
James G. Ellis San Marino, California	Retired
George Joseph Los Angeles, California	Chairman of the Board Mercury General Corporation
Joshua E. Little St. George, Utah	Shareholder Durham Jones & Pinegar, P.C.
Martha E. Marcon Glendale, California	Retired
Gabriel Tirador Tustin, California	President and Chief Executive Officer Mercury General Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Gabriel Tirador	President and Chief Executive Officer
Theodore R. Stalick	Senior Vice President, Chief Financial Officer, and Treasurer
Judith A. Walters	Secretary
Christopher W. Graves	Vice President and Chief Investment Officer

Management Agreements

Tax Allocation Agreement: Since January 1, 1983, the Company and various affiliates have been parties to a Tax Allocation Agreement with the ultimate parent, MGC. Under the terms of this agreement, the tax liability of the Company and its affiliates are computed as if each entity filed a separate stand-alone return, with current credit for net losses incurred by the insurance subsidiaries to the extent it can be used in the current consolidated return. In 2015, the agreement was amended to: 1) add affiliate Workmen's Auto Insurance Company (now Orion Indemnity Company (Orion)), 2) delete dissolved entities, and 3) include several technical provisions required by the California Department of Insurance (CDI), which did not alter or affect existing practices. The amendment was approved by the CDI on June 5, 2015. Taxes paid or (recovered) by the Company totaled \$(15,546,831), \$19,983,991, \$49,112,412, and \$31,589,610 for the years 2018, 2019, 2020, and 2021, respectively.

Management Agreement: Since January 1, 2001, the Company has been a party to a Management Agreement with Mercury Insurance Services, LLC (MIS), a subsidiary of Mercury Casualty Company (MCC). Approval of the agreement was granted by the CDI on December 27, 2001. Under the terms of this agreement, MIS performs underwriting and loss adjustment services for the MGC group of companies. The management fee is based on actual incurred expenses. The underwriting portion of the management fee is allocated between the Company and its affiliates based upon their proportionate share of direct premiums written. The fee for allocated loss adjustment expenses is based on actual payments by MIS for claims on policies issued by the Company. The unallocated loss adjustment expenses portion of the management fee is allocated between the Company and its affiliates based upon their proportionate share of net losses incurred. In 2013, the agreement was amended: 1) authorizing MIS to pay certain expense items that were previously reserved to the insurers, including agent commissions and audit fees and 2) adding a 60-day due date for the payment of management fees, in order to comply with Statement of Statutory Accounting Principles No. 96. The amendment was approved by the CDI on September 25, 2013. In 2015, the agreement was amended again to allow MIS to pursue salvage and subrogation claims on behalf of the insurers, with MIS

remitting the recoveries to the insurers. This amendment was approved by the CDI on June 11, 2015. The Company incurred management fees of \$593,654,784, \$642,736,739, \$653,272,942, and \$652,577,930 during the years 2018, 2019, 2020, and 2021, respectively.

Service Agreement: Effective January 11, 2005, the Company entered into a Service Agreement with MCC and California Automobile Insurance Company (CAIC). Under the terms of this agreement, MCC collects premiums on behalf of the Company and CAIC. Approval of the agreement was granted by the CDI on January 11, 2005. Effective December 1, 2019, the agreement was amended to add California General Underwriters Insurance Company, Inc. (CGU) as a party. The amendment was approved by the CDI on December 20, 2019. There are no fees or costs paid by any affiliates under this agreement.

Multiple-Cedents Reinsurance Allocation Agreement: Effective July 1, 2013, the Company, American Mercury Insurance Company (AMIC), CAIC, CGU, and MCC entered into a Multiple-Cedents Reinsurance Allocation Agreement, providing for the allocation of premiums and recoveries in connection with external reinsurance treaties covering all the parties at a single rate, as required by Statement of Statutory Accounting Principles No. 62R. The agreement approval was granted by the Oklahoma Department of Insurance (ODI) and the CDI, on March 28, 2014 and June 26, 2014, respectively.

Effective July 1, 2018, the agreement was amended to add affiliate Orion Indemnity Company (Orion) as a party. The amendment also renewed the agreement for three years until June 30, 2022. The amendment was approved by the ODI on June 11, 2019 and by the CDI on September 4, 2019. A total of \$33,100 in premiums were transferred between affiliates under this agreement in 2021. The California insurers recovered \$2,076,512 under multi-cedent reinsurance in 2021, and reimbursed reinsurers \$5,318,712 in subrogation recoveries. Those amounts were paid to or by CAIC, respectively, and allocated as follows pursuant to this agreement:

<u>Insurer</u>	<u>Recoveries</u>	<u>Subrogation Paid</u>
California Automobile Insurance Company	\$1,938,859	\$(5,144,019)
Mercury Casualty Company	112,311	(104,052)
Mercury Insurance Company	25,335	(70,422)
Orion Indemnity Company	7	(218)

The Multiple-Cedents Reinsurance Allocation Agreement was renewed effective July 1, 2022, and will automatically renew for consecutive one-year terms until June 30, 2025.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to write various property and casualty coverages solely in California.

The Company's writings are limited to preferred private passenger automobile liability and physical damage. During 2021, the Company wrote \$1.9 billion of direct premiums in California. The Company's business is distributed and marketed through a network of appointed independent agents. Branch offices are maintained in various locations throughout California.

REINSURANCE

Assumed

The Company did not assume reinsurance during the period covered by this examination.

Ceded

The Company is party to a Catastrophe Reinsurance Treaty (2021 Treaty) with affiliated companies that are under the ownership, control or management of Mercury General Corporation. The 2021 Treaty covers a wide range of perils that is effective from July 1, 2021 through June 30, 2022. The 2021 Treaty provides \$792 million of coverage on a per occurrence basis after covered catastrophe losses exceed the \$40 million combined company retention limit. The 2021 Treaty specifically excludes coverage for

any Florida business and for California earthquake losses on fixed property policies, such as homeowners, but does cover losses from fires following an earthquake. In addition, the 2021 Treaty provides for one full reinstatement of coverage limits and excludes losses from wildfires on certain coverage layers of the 2021 Treaty.

Coverage on individual catastrophes provided for the 12 months ended June 30, 2022 under the 2021 Treaty is presented below in various layers.

	<u>Catastrophe Loss and LAE</u>		<u>Percentage of Coverage</u>
	<u>In Excess of</u>	<u>Up to</u>	
	(Amounts in Millions)		
Layer of Coverage (1)	\$ 40	\$ 100	70
Layer of Coverage (2)	100	400	100
Layer of Coverage (2)(3)(4)	400	792	100

(1) The 2021 Treaty covers 70% placement for the layer of \$40 million to \$100 million.

(2) Layer of Coverage represents multiple actual treaty layers that are grouped for presentation purposes.

(3) 13.4% of this layer covers only California wildfires and fires following an earthquake in California and is not subject to reinstatement.

(4) 14% of this layer includes a territorial restriction covering California, Arizona, and Nevada only.

ACCOUNTS AND RECORDS

Annual Statement Findings

Pursuant to the National Association of Insurance Commissioners (NAIC) Annual Statements Instructions, Note to Financial Statements, 14D, Claims Related Extra Contractual Obligation and Bad Faith Losses Stemming from Lawsuits, the Company shall disclose the dollar amount paid (for the extra contractual and bad faith portion of the total claim amount) for claims related extra contractual obligations and bad faith losses stemming from lawsuits, in the current reporting period on a direct basis. The Company's 2021 Annual Statement Note to Financial Statements 14D was not prepared in accordance to the NAIC's Annual Statement Instructions and did not disclose the potential risk and/or uncertainties related to lawsuits in the manner or format required by the NAIC. The Company should compile its bad faith/extra contractual litigation settlements arising from claims and disclose it annually in the Notes to Financial Statements 14D in accordance with the NAIC Annual Statement Instructions. It is recommended the Company implement procedures to ensure compliance with the National Association of Insurance Commissioners Annual Statement Instructions for Note 14D to the Financial Statements, Claims related extra contractual obligations and bad faith losses stemming from lawsuits. The Company has subsequently updated its reporting procedures to ensure Note 14D is in compliance with the NAIC Annual Statement Instructions.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2021. The accompanying comments to the amounts reported in the annual statements should be considered an integral part of the financial statements. No adjustments were made to the statutory financial statements filed by the Company.

Statement of Financial Condition as of December 31, 2021

Underwriting and Investment Exhibit for the Year Ended December 31, 2021

Reconciliation of Surplus as Regards Policyholders from December 31, 2017 through December 31, 2021

Statement of Financial Condition
as of December 31, 2021

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 1,608,184,457	\$	\$ 1,608,184,457	
Preferred stocks	37,083,150		37,083,150	
Common stocks	214,121,819		214,121,819	
Cash and short-term investments	64,384,761		64,384,761	
Other invested assets	17,956,309		17,956,309	
Receivable for securities	1,703,719		1,703,719	
Investment income due and accrued	19,805,166		19,805,166	
Premiums and agents' balances in course of collection	61,600,748	272,930	61,327,818	
Premiums, agents' balances and installments booked but deferred and not yet due (including \$0 earned but unbilled premiums.	297,043,400		297,043,400	
Amounts recoverable from reinsurers	(896,226)		(896,226)	
Net deferred tax asset	23,418,263		23,418,263	
Receivables from parent, subsidiaries and affiliates	61,833,939		61,833,939	
Total assets	<u>\$ 2,406,239,505</u>	<u>\$ 272,930</u>	<u>\$ 2,405,966,575</u>	

Liabilities, Surplus and Other Funds

	<u>Current Year</u>	<u>Notes</u>
Losses	\$ 734,691,136	(1)
Loss adjustment expenses	224,027,745	(1)
Commissions payable, contingent commissions and other similar charges	6,126,000	
Other expenses	595,139	
Taxes, licenses and fees	10,481,418	
Current federal and foreign income taxes	5,004,395	
Unearned premiums	581,526,610	
Advance premiums	17,292,172	
Payable to parent, subsidiaries and affiliates	671	
Payable for securities	<u>10,619,052</u>	
Total liabilities	1,590,364,338	
Common capital stock	10,000,000	
Gross paid-in and contributed surplus	82,503,673	
Unassigned funds (surplus)	<u>723,098,564</u>	
Surplus as regards policyholders	<u>815,602,237</u>	
Total liabilities, Surplus, and other funds	<u>\$ 2,405,966,575</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2021

State of Income

<u>Underwriting Income</u>	<u>Current Year</u>
Premiums earned	\$ 1,893,876,184
Deductions:	
Losses incurred	\$ 1,066,562,983
Loss adjustment expenses incurred	242,315,835
Other underwriting expenses incurred	466,746,438
Total underwriting deductions	1,775,625,256
Net underwriting gain	118,250,928
<u>Investment Income</u>	
Net investment income earned	\$ 54,158,188
Net realized capital gains	8,808,155
Net investment gain	62,966,343
<u>Other Income</u>	
Net loss from agents' or premium balances charged off (amount recovered \$12,010 amount charged off \$214,468)	\$ (202,458)
Net investment income earned	18,251,649
Aggregate write-ins for miscellaneous income	23,679
Total other income	18,072,870
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes	199,290,140
Federal and foreign income taxes incurred	32,102,463
Net income	\$ 167,187,677

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2020	\$ 808,691,310
Net income	\$ 167,187,677
Change in net unrealized capital gains	17,780,637
Change in net deferred income tax	(1,963,234)
Change in nonadmitted assets	(94,153)
Dividends to stockholders	(176,000,000)
Change in surplus as regards policyholders for the year	<u>6,910,927</u>
Surplus as regards policyholders, December 31, 2021	<u>\$ 815,602,237</u>

Reconciliation of Surplus as Regards to Policyholders from December 31, 2017 through
December 31, 2021

Surplus as regards policyholders, December 31, 2017			\$ 609,837,638
	Gain in Surplus	Loss in Surplus	
	<u> </u>	<u> </u>	
Net income	\$ 485,940,459	\$	
Net unrealized capital gains	30,126,310		
Change in net deferred income tax	13,889,569		
Change in nonadmitted assets		211,739	
Change in provision for reinsurance	20,000		
Dividends to stockholders		<u>324,000,000</u>	
Total gains and losses	<u>\$ 529,976,338</u>	<u>\$ 324,211,739</u>	
Net increase in surplus as regards policyholders			<u>205,764,599</u>
Surplus as regards policyholders, December 31, 2021			<u>\$ 815,602,237</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Senior Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2021 were found to be reasonably stated and have been accepted for the purpose of this examination.

SUBSEQUENT EVENTS

On September 10, 2021, the California Department of Insurance (CDI) served the Company a Notice of Non-Compliance (NNC), alleging violations in connection with its 2014 Rating & Underwriting Examination Report, which was adopted by the CDI in 2019. On August 1, 2022, the CDI publicly announced its intention to pursue an administrative action against the Company with respect to certain outstanding issues. The Company filed a written response to the NNC on September 29, 2022. On November 9, 2022, the CDI served objections and non-substantive responses to the Company's discovery requests. The Company is continuing settlement discussions with the CDI. The Company cannot reasonably predict the likelihood, timing or outcome of any hearing process or administrative action, nor can it reasonably estimate the amount of penalties, if any.

On October 5, 2021, the CDI requested additional information on the amount of premium refunds or credits that the Company has provided or plans to further provide to its private passenger automobile policyholders, and the methodology used in determining such refunds or credits for the time period of March 2020 through at least March 2021, due to reduced driving during the pandemic. On November 21, 2022, after review of loss and expense data requested from and provided by the Company, the CDI notified the Company that additional refunds should be provided to its private passenger automobile policyholders, based upon its analysis of the Company's data. The Company engaged in discussions with the CDI, and on April 24, 2023, the Company entered into a stipulated settlement agreement with the CDI. Under the terms of the agreement, the Company agreed to provide an aggregate credit amount of \$23.5 million to existing California private

passenger automobile policyholders, by means of a credit against future private passenger automobile renewal premium obligations over a period not to exceed 18 months. Credits due will start to be distributed when the 6.99% rate increase filing for the California private passenger automobile line of business is approved by the CDI and becomes effective.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Annual Statement Instructions (Page 11): It is recommended the Company implement procedures to ensure compliance with the National Association of Insurance Commissioners Annual Statement Instructions for Note 14D to the Financial Statements, Claims related extra contractual obligations and bad faith losses stemming from lawsuits.

Previous Report of Examination

Accounts and Records – Automobile Assessment File (Page 9): It was recommended the Company maintain an automobile assessment file in compliance with California Code of Regulations 10 § 2698.62(d). The Company has complied with this recommendation.

Accounts and Records – Vehicle Fraud Assessment Fees (Page 10): It was recommended the Company include replacement vehicles in its vehicle counts in accordance with California Insurance Code, Section 1872.8(a). The Company has complied with this recommendation.

ACKNOWLEDGMENT

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

Respectfully submitted,

Elizabeth Nielson, CFE, CPA
Examiner-In-Charge
Contract Examiner
Department of Insurance
State of California

Anjanette Briggs, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California