

REPORT OF EXAMINATION
OF THE
CALIFORNIA AUTOMOBILE INSURANCE COMPANY
AS OF
DECEMBER 31, 2017

Filed on June 17, 2019

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Los Angeles, California
May 17, 2019

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA AUTOMOBILE INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 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, 2013. This examination covers the period from January 1, 2014, through December 31, 2017. 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 an adjustment was identified during the course of the examination, the impact of such adjustment would 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
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
Mercury National Insurance Company	Illinois
American Mercury Insurance Company	Oklahoma

Mercury County Mutual Insurance Company
American Mercury Lloyds Insurance Company

Texas
Texas

COMPANY HISTORY

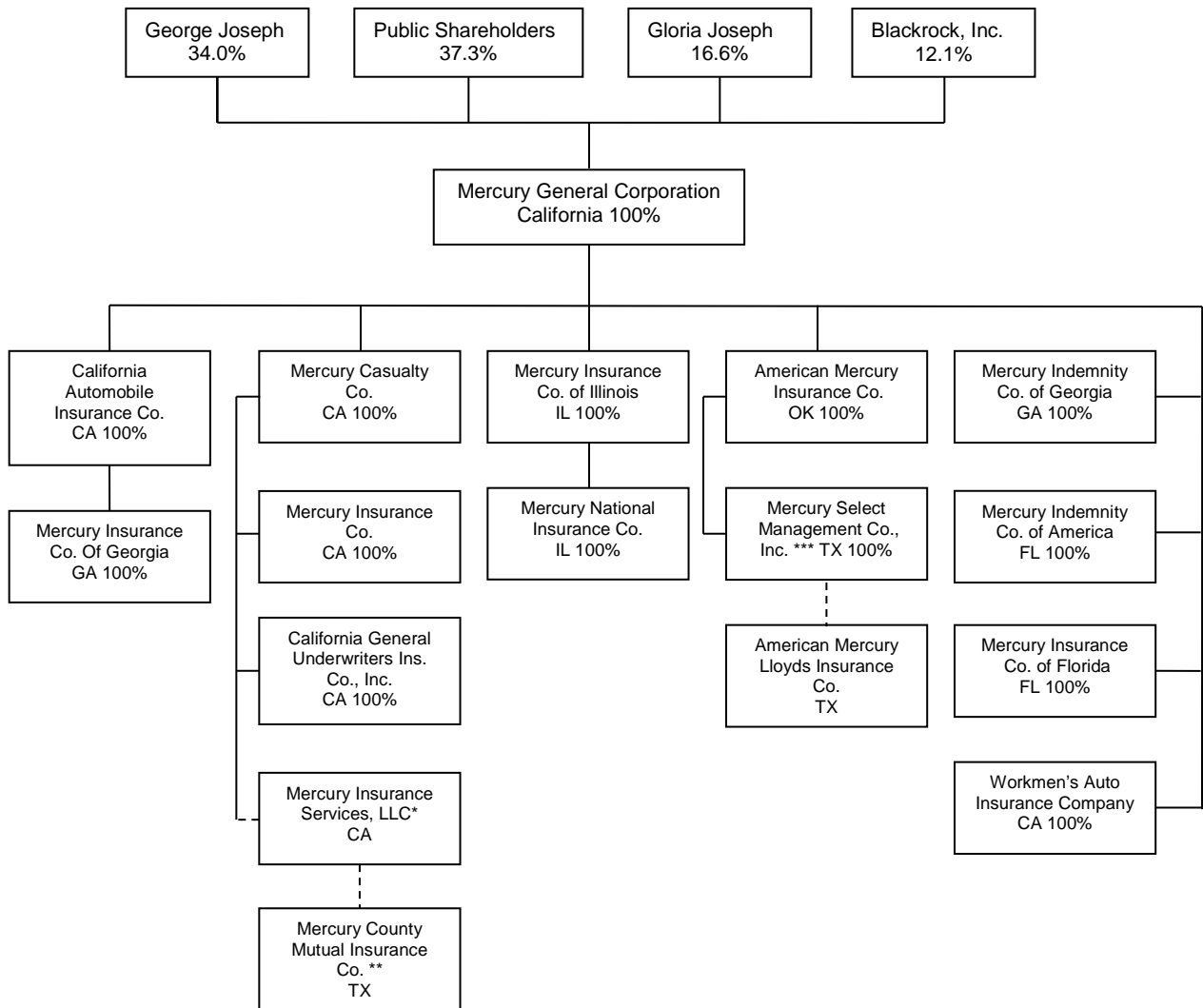
The Company was incorporated in the state of California on June 11, 1975 as Mercury Indemnity Company. The Company's name was changed from Mercury Indemnity Company to California Automobile Insurance Company on December 29, 1988. The Company is a wholly-owned subsidiary of Mercury General Corporation (MGC) and the parent company of Mercury Insurance Company of Georgia, a Georgia domiciled insurance company.

Capital Contributions

During 2015, the Company received cash contributions to surplus of \$10,000,000, \$20,000,000, \$10,000,000, and \$30,000,000 on February 6th, May 1st, September 18th, and December 15th, respectively, from MGC. The Company received an additional cash contribution to surplus of \$30,000,000 from MGC on December 29, 2016.

MANAGEMENT AND CONTROL

Mercury General Corporation (MGC) is a publicly traded insurance holding company. The controlling stockholders, George Joseph and Gloria Joseph, own 34.0% and 16.6%, respectively, of MGC's stock with the remaining 49.4% held by public shareholders and Blackrock, Inc. The following organizational chart depicts the Company's relationship within the holding company system:



* 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.

The nine members of the 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 at December 31, 2017:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Michael D. Curtius *** Carlsbad, California	Retired President Mercury General Corporation
James G. Ellis Carlsbad, California	Dean of the Marshall School of Business The University of Southern California
George Joseph Los Angeles, California	Chairman of the Board Mercury General Corporation
Joshua E. Little St. George, Utah	Attorney and Managing Shareholder Durham Jones & Pinegar, P.C.
Martha E. Marcon Glendale, California	Retired Partner KPMG, LLP
John G. Nackel (**) Pasadena, California	Chairman and Chief Executive Officer Three-Sixty Advisory Group, LLC
Glenn S. Shafer (**) Irvine, California	Retired President Pacific Life Insurance Company
Donald R. Spuehler (*) Los Angeles, California	Retired Partner Law Firm of O'Melveny & Meyers, LLP
Gabriel Tirador Tustin, California	President and Chief Executive Officer Mercury General Corporation

(*) In December 2017, Donald R. Spuehler resigned from the board of directors.

(**) Subsequent to the examination period, in May 2018, the Company amended its bylaws to reduce the size of the board of directors from eight to fifteen members to six to eleven members. In February 2018, both Glenn S. Shafer and John G. Nackel resigned from the board of directors.

(***) In January 2019, Michael D. Curtius resigned from the board of directors.

(****) Ramona L. Cappello and George G. Braunegg were elected as members of the board of directors effective April 26, 2019.

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

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 California Department of Insurance (CDI) on January 1, 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. The agreement was amended, effective October 1, 2013, authorizing MIS to pay certain expense items that were previously reserved to the insurers, including agent commissions and audit fees. The amendment also added 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. Effective July 1, 2015, the agreement was amended to allow MIS to pursue salvage and subrogation claims on behalf of the insurers, with MIS remitting the recoveries to the insurers. The amendment was approved by the CDI on June 11, 2015. The Company incurred management fees of \$71,330,868, \$199,268,771,

\$257,672,750, and \$284,018,654 during the years 2014, 2015, 2016, and 2017, respectively.

Service Agreement: Since January 17, 2005, the Company has been party to a service agreement with Mercury Insurance Company (MIC) and MCC. Under the terms of this agreement, MCC collects all premiums and pays claims, commissions, and return premiums on behalf of the Company and MIC. MCC does not charge for these services as there are no additional incurred costs for the provider. Approval of the agreement was granted by the CDI on January 11, 2005.

Tax Allocation Agreement: Since January 1, 1983, the Company and various affiliates have been parties to a consolidated federal income 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. On July 29, 2015, the agreement was amended to add newly-acquired affiliate Workmen's Auto Insurance Company (WAIC), and to delete three dissolved entities: Concord Insurance Services, Inc., Mercury Group, Inc., and American Mercury MGA, Inc. The amendment was effective as of January 2, 2015. The amendment also included several technical provisions required by the 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 \$(3,513,378), \$(3,359,221), \$5,602,856, and \$(12,105,349) for the years 2014, 2015, 2016, and 2017, respectively.

Multiple-Cedents Reinsurance Allocation Agreement: On July 1, 2014, the Company, American Mercury Insurance Company (AMIC), California General Underwriters Insurance Company, Inc. (CGU), MIC 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 was effective as of July 1, 2013. The Agreement was submitted for approval to the Oklahoma Department of Insurance and the CDI, and approval was granted on March 28, 2014 and June 26, 2014, respectively. The Company paid \$52,022 to MCC in 2015 as reimbursement for its respective portion of installment premium advanced by MCC. The California Registrants recovered \$31,534,032 under reinsurance for losses in 2017, of which the Company was allocated \$29,902,840.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Company was licensed to write various property and casualty coverages solely in California. The Company writes both standard and nonstandard private passenger automobile liability and physical damage. In April 2012, the Company began writing commercial automobile business in California. In addition, beginning May 2012, the Company began renewing California private passenger automobile business from its affiliate, Mercury Casualty Company (MCC). In August 2014, the Company began writing homeowners business and, in September 2015, began renewing homeowners business from MCC. The Company also wrote involuntary assigned risk business that amounted to less than 1% of total premiums written. During 2017, the Company's top three lines of business written were homeowners multiple peril, private passenger automobile liability, and private passenger automobile physical damage, which made up 42.4%, 27.6%, and 20.6%, respectively, of the Company's total direct premiums written of \$914.2 million. 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

Effective July 1, 1999, California General Underwriters Insurance Company, Inc. (CGU) was a party to a 100% quota share agreement with Mercury Casualty Company (MCC), under which CGU assumed the fleet automobile policies written by MCC for substantially all vehicles owned by affiliates. This agreement was terminated effective January 1, 2015, coinciding with the termination date of the fleet policies issued by MCC. The fleet policies issued by MCC were replaced by policies issued by the Company as of January 1, 2015. The Company entered into a 100% quota share reinsurance agreement with CGU, under which CGU assumes the fleet automobile policies written by the Company for substantially all vehicles owned by affiliates. Premium ceded by the Company under this agreement totaled \$465,094, \$404,157, \$390,349, and \$204,625 for the years 2014, 2015, 2016, and 2017, respectively.

The Company and MCC entered into a 50% quota share reinsurance agreement effective February 1, 2016, under which MCC reinsures the Company's Private Passenger Automobile Liability and Automobile Physical Damage lines of business. Effective July 1, 2018, the Company amended the agreement to increase the ceding percentage from 50% to 100%. Premium ceded by the Company under this agreement totaled \$207,478,307 and \$224,483,608 for the years 2016 and 2017, respectively.

As of December 31, 2017, the Company and all other insurance companies under the ownership, control or management of Mercury General Corporation were party to a Catastrophe Reinsurance Treaty (Treaty) consisting of two reinsurance agreements and four layers of coverage. The agreements were effective from July 1, 2017 through

June 30, 2018 and provided for \$205 million coverage on a per occurrence basis after covered catastrophe losses exceed a \$10 million retention limit for all insurance companies combined. The Treaty specifically excluded coverage for any Florida business and for California earthquake losses on fixed property policies, such as homeowners, but did cover losses from fires following an earthquake. Subsequently, the Company entered into agreements effective from July 1, 2018 through June 30, 2019 under the same terms as the prior year.

ACCOUNTS AND RECORDS

Automobile Assessment File

California Code of Regulations 10 (CCR) § 2698.62(d) states in order to verify the number of vehicles for which an assessment is due and has been paid under this section, each insurer shall maintain a file known as the Automobile Assessment File. The Automobile Assessment File shall contain the vehicle identification, policy number and transaction date for every vehicle for which a policy of insurance was in force for each quarter or any part thereof. For group insurers, the information shall be maintained on an individual company basis. The data shall be kept in a computer format that allows for the insurer to place each calendar year quarter data on a computer media format in a format specified by the Commissioner. The data in the file shall be kept for a minimum of five years after each calendar year quarter. During the course of this examination, it was found the Company did not maintain an automobile assessment file as required by 10 CCR § 2698.62(d).

It is recommended the Company maintain an automobile assessment file in compliance with 10 CCR § 2698.62(d). The Company advised that it has implemented procedures to assure future compliance with the requirements of 10 CCR § 2698.62(d).

Vehicle Fraud Assessment Fees

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

During the course of this examination, it was found that the Company failed to include replacement vehicles in its vehicle counts. The total amount of vehicle fraud assessment fees determined to be due from the Company as a result of this error during the examination period was \$57,593, plus additional late charges assessed based on CIC Section 12995. The Company remitted payment for the additional vehicle fraud assessment fees due on March 11, 2019. The Company and the California Department of Insurance are in the process of settling the additional late charges.

It is recommended the Company include replacement vehicles in its vehicle counts in accordance with CIC Section 1872.8(a). Since the amount was deemed not material, no adjustment was made to the Company's financial statements. The Company advised that it has implemented procedures to assure future compliance.

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, 2017. No adjustments were made to the statutory financial statements filed by the Company.

Statement of Financial Condition as of December 31, 2017

Underwriting and Investment Exhibit for the Year Ended December 31, 2017

Reconciliation of Surplus as Regards Policyholders from December 31, 2013 through December 31, 2017

Statement of Financial Condition as of December 31, 2017

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 471,737,409	\$	\$ 471,737,409	
Preferred stocks	2,702,000		2,702,000	
Common stocks	98,617,875		98,617,875	
Cash and short-term investments	39,770,651		39,770,651	
Other invested assets	10,148,084		10,148,084	
Receivables for securities	803		803	
Investment income due and accrued	6,423,377		6,423,377	
Premiums and agents' balances in course of collection	18,819,398	483,466	18,335,932	
Premiums, agents' balances and installments booked but deferred and not yet due (including \$0 earned but unbilled premiums)	110,583,158		110,583,158	
Amounts recoverable from reinsurers	6,334,808		6,334,808	
Current federal and foreign income tax recoverable and interest thereon	5,449,392		5,449,392	
Net deferred tax asset	3,605,158		3,605,158	
Receivable from parent, subsidiaries and affiliates	27,509,713		27,509,713	
Aggregate write-ins for other-than-invested assets	<u>902,986</u>		<u>902,986</u>	
 Total assets	 <u>\$ 802,604,812</u>	 <u>\$ 483,466</u>	 <u>\$ 802,121,346</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 225,046,069	(1)
Loss adjustment expenses			50,455,368	(1)
Commissions payable, contingent commissions and other similar charges			3,234,773	
Other expenses			1,508,896	
Taxes, licenses and fees			4,598,411	(2)
Unearned premiums			295,799,945	
Advance premiums			13,895,718	
Ceded reinsurance premiums payable			13,267,371	
Remittances and items not allocated			2,680,820	
Provision for reinsurance			274,000	
Payable to parent, subsidiaries and affiliates			23,095	
Derivatives			96,170	
Aggregate write-ins for liabilities			<u>3,009,153</u>	
 Total liabilities			 613,889,789	
Common capital stock		\$ 5,000,000		
Gross paid-in and contributed surplus		119,777,923		
Unassigned funds (surplus)		<u>63,453,634</u>		
 Surplus as regards policyholders			 <u>188,231,557</u>	
 Total liabilities, surplus and other funds			 <u>\$ 802,121,346</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2017

Statement of Income

Underwriting Income

Premiums earned		\$ 650,193,848
Deductions:		
Losses and loss expenses incurred	\$ 555,673,466	
Other underwriting expenses incurred	<u>163,467,064</u>	
Total underwriting deductions		<u>719,140,530</u>
Net underwriting loss		(68,946,682)

Investment Income

Net investment income earned	\$ 18,214,198	
Net realized capital losses	<u>1,308,662</u>	
Net investment gain		19,522,860

Other Income

Net loss from agents' or premium balances charged off (amount recovered \$78,030 amount charged off \$439,276)	\$ (361,246)	
Finance and service charges not included in premiums	5,606,836	
Aggregate write-ins for miscellaneous income	<u>1,045,022</u>	
Total other income		<u>6,290,612</u>
Net loss before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		(43,133,210)
Federal and foreign income taxes incurred		<u>(16,765,683)</u>
Net loss		<u>\$ (26,367,527)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2016		\$ 206,597,841
Net loss	\$ (26,367,527)	
Change in net unrealized capital gains	3,864,088	
Change in net deferred income tax	4,227,933	
Change in nonadmitted assets	183,222	
Change in provision for reinsurance	<u>(274,000)</u>	
Change in surplus as regards policyholders for the year		<u>(18,366,284)</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 188,231,557</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2013 through December 31, 2017

Surplus as regards policyholders, December 31, 2013 per Examination			\$ 119,861,634
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net loss		\$ 39,819,963	
Change in unrealized capital gains	\$ 4,397,499		
Change in net deferred income tax	4,251,189		
Change in nonadmitted assets		185,802	
Provision for reinsurance		273,000	
Surplus adjustments: Paid-in	<u>100,000,000</u>		
Total gains and losses	<u>\$ 108,648,688</u>	<u>\$ 40,278,765</u>	
Net increase in surplus as regards policyholders			<u>68,369,923</u>
Surplus as regards policyholders, December 31, 2017, per Examination			<u>\$ 188,231,557</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 (CDI), the Company's loss and loss adjustment expense reserves as of December 31, 2017 were found to be reasonably stated and have been accepted for the purpose of this examination.

(2) Taxes, Licenses and Fees

As discussed in the Accounts and Records section of this report, it was found that the Company failed to include replacement vehicles in its vehicle counts. The total amount of vehicle fraud assessment fees determined to be due from the Company as a result of this error during the examination period was \$57,593, plus additional late charges assessed based on CIC Section 12995. The Company remitted payment for the additional vehicle fraud assessment fees due on March 11, 2019. The Company and the CDI are in the process of settling the additional late charges.

SUBSEQUENT EVENTS

Two major catastrophe events occurred in the fourth quarter of 2018, the Camp Fire in Northern California and the Woolsey Fire in Southern California, which caused approximately \$206 million and \$43 million, respectively, in losses to the Mercury Insurance Group (Group), before reinsurance benefits. The combined loss to the Group from these two events, net of reinsurance benefits, totaled approximately \$37 million as follows: \$20 million for the Group's initial reinsurance retention for the two catastrophe events (\$10 million for each event); approximately \$11 million Group retention from the first layer of reinstated reinsurance limit previously used up; and approximately \$6 million Group retention on the Camp Fire losses in excess of \$200 million. The Group recorded a total of approximately \$18 million in ceded reinstatement premiums written and \$5 million in ceded reinstatement premiums earned in 2018 for reinstatement of the

reinsurance benefits used under the Treaty related to these two catastrophe events.

The Group incurred a total of approximately \$21 million in losses, before reinsurance benefits, resulting from a wildfire, known as the Carr Fire, that occurred in Shasta County of Northern California in the third quarter of 2018. The loss to the Group, net of reinsurance benefits, was \$10 million, which is the Group's retention on the catastrophe event. The Group recorded approximately \$3 million in ceded reinstatement premiums written and \$1 million in ceded reinstatement premiums earned in 2018 for reinstatement of the reinsurance benefits used under the Treaty related to this catastrophe event.

As a result of reinsurance benefits used for the catastrophes described above under the Treaty ending June 30, 2019, the Group has exhausted the reinstated limit on the first layer of the Treaty, and a second reinstatement is not available under the current terms of the Treaty. Should there be another major catastrophe event within the Treaty period ending June 30, 2019, the Group would retain the first \$10 million of losses, retain the following \$30 million of losses reflecting that the reinstated first layer limit has been used up, and have available approximately \$57 million in reinsurance coverage for losses above \$40 million up to \$100 million, 100% reinsurance coverage for losses above \$100 million up to \$200 million and 5% reinsurance coverage for losses above \$200 million up to \$500 million.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records - Automobile Assessment File (Page 10): It is recommended the Company maintain an automobile assessment file in compliance California Code of Regulations 10 CCR § 2698.62(d).

Accounts and Records – Vehicle Fraud Assessment Fees (Page 10): It is recommended the Company include replacement vehicles in its vehicle counts in accordance with

California Insurance Code, Section 1872.8(a).

Previous Report of Examination

Accounts and Records – Information System Controls (Page 9): The Company should evaluate the recommendations from the information systems controls review and make appropriate changes to strengthen its controls over its information systems. The Company has implemented changes to strengthen its controls over information systems.

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,

/S/

Bradley R. Hazelwood, CFE, CPA
Examiner-In-Charge
Contract Examiner
Department of Insurance
State of California

/S/

Edward Aros, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California