

REPORT OF EXAMINATION
OF THE
CALIFORNIA GENERAL UNDERWRITERS
INSURANCE COMPANY, INC
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 GENERAL UNDERWRITERS INSURANCE COMPANY, INC.

(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

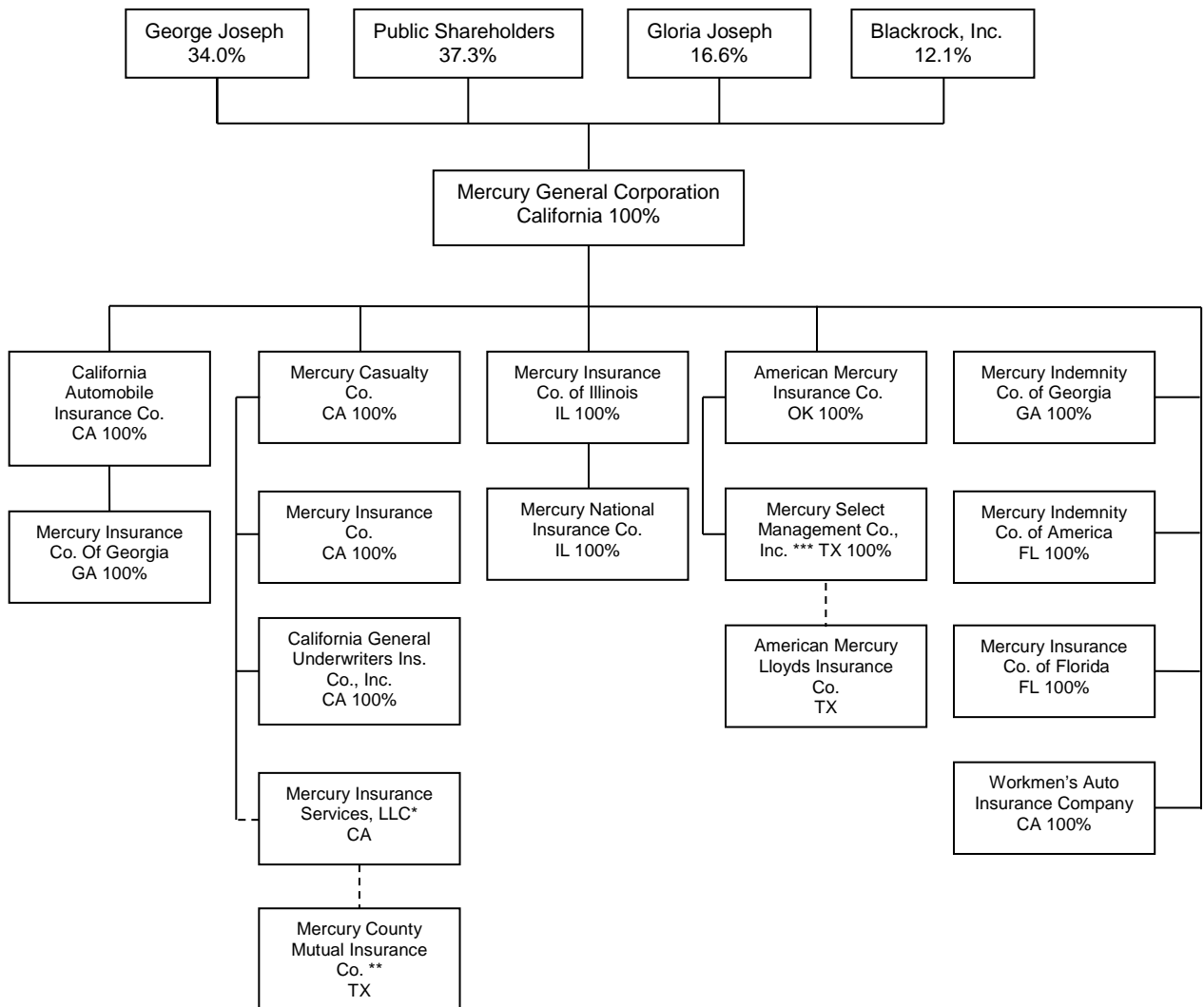
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Texas

COMPANY HISTORY

The Company was incorporated in the state of California on April 15, 1985 as Mercury General Insurance Company (MGIC). The name was changed from MGIC to California General Underwriters Insurance Company, Inc. on December 29, 1988. The Company is a wholly-owned subsidiary of Mercury Casualty Company (MCC). MCC in turn, is a wholly-owned subsidiary of Mercury General Corporation.

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
Donald R. Spuehler (*) Los Angeles, California	Retired Partner Law Firm of O'Melveny & Meyers, LLP
Glenn S. Shafer (**) Irvine, California	Retired President Pacific Life Insurance Company
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 \$37,516, \$54,119, \$50,329, and \$58,305 during the years 2014, 2015, 2016, and 2017, respectively.

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, 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 \$616,910, \$(100,829), \$(89,116), and \$(8,869) for the years 2014, 2015, 2016, and 2017, respectively.

Multiple-Cedents Reinsurance Allocation Agreement: On July 1, 2014, the Company, American Mercury Insurance Company, California Automobile Insurance Company, MCC and Mercury Insurance Company 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. There were no premiums or recoveries allocated to the Company during the examination period.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Company was licensed as a multiple line casualty insurer in California. As depicted within the “REINSURANCE” section below, the Company's operations are limited to business assumed from California Automobile Insurance Company.

REINSURANCE

Assumed

Effective July 1, 1999, the Company was a party to a 100% quota share agreement with Mercury Casualty Company (MCC), under which the Company 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 California Automobile Insurance Company (CAIC) as of January 1, 2015. The Company entered into a 100% quota share Reinsurance Agreement with CAIC, under which the Company assumed the fleet automobile policies written by CAIC for substantially all vehicles owned by affiliates. Premium assumed by the Company totaled \$465,094, \$404,157, \$390,349, and \$204,625 for the years 2014, 2015, 2016, and 2017, respectively.

Ceded

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. Although named in the agreement, it would only apply if the Company wrote direct business.

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>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 19,967,604	\$ 19,967,604	
Cash and short-term investments	1,424,527	1,424,527	
Investment income due and accrued	280,388	280,388	
Current federal and foreign income tax recoverable and interest thereon 153,592 153,592			
Net deferred tax asset	<u>1,345</u>	<u>1,345</u>	
 Total assets	 <u>\$ 21,827,456</u>	 <u>\$ 21,827,456</u>	
 <u>Liabilities, Surplus and Other Funds</u>			
Losses		\$ 433,400	(1)
Loss adjustment expenses		58,000	(1)
Reinsurance payable on paid losses and loss adjustment expenses		1,018	
Payable to parent, subsidiaries and affiliates		<u>4,361</u>	
 Total liabilities		 496,779	
Common capital stock	\$ 4,000,000		
Gross paid-in and contributed surplus	3,500,000		
Unassigned funds (surplus)	<u>13,830,677</u>		
 Surplus as regards policyholders		 <u>21,330,677</u>	
 Total liabilities, surplus and other funds		 <u>\$ 21,827,456</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ 204,625
Deductions:		
Losses and loss expenses incurred	\$ 362,489	
Other underwriting expenses incurred	<u>86,032</u>	
Total underwriting deductions		<u>448,521</u>
Net underwriting loss		(243,896)

Investment Income

Net investment income earned	625,963	
Net realized capital gains	<u>12,910</u>	
Net investment gain		<u>638,873</u>
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		394,977
Federal and foreign income taxes incurred		<u>(164,066)</u>
Net income		<u>\$ 559,043</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2016		\$ 20,746,510
Net income	\$ 559,043	
Change in net unrealized capital gains	15,799	
Change in net deferred income tax	(149,288)	
Change in nonadmitted assets	<u>158,613</u>	
Change in surplus as regards policyholders for the year		<u>584,167</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 21,330,677</u>

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

Surplus as regards policyholders, December 31, 2013 per Examination			\$ 18,976,243
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 2,353,088		
Change in unrealized capital gains		\$ 72,110	
Change in net deferred income tax	<u>73,456</u>		
Total gains and losses	<u>\$ 2,426,544</u>	<u>\$ 72,110</u>	
Net increase in surplus as regards policyholders			<u>2,354,434</u>
Surplus as regards policyholders, December 31, 2017, per Examination			<u>\$ 21,330,677</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, 2017 were found to be reasonably stated and have been accepted for the purpose of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Accounts and Records – Information System Controls (Page 7): 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/

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Examiner-In-Charge
Contract Examiner
Department of Insurance
State of California

/S/

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Senior Insurance Examiner, Supervisor
Department of Insurance
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