REPORT OF EXAMINATION
OF THE

ANCHOR GENERAL INSURANCE COMPANY

AS OF
DECEMBER 31, 2010

Filed December 28, 2011

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Los Angeles, California
November 23, 2011

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

ANCHOR GENERAL INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 10256 Meanley Drive, San Diego, California 92131.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The last examination was completed as of December 31, 2007. This examination covers the period from January 1, 2008 through December 31, 2010. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; statutory deposits; and sales and advertising.

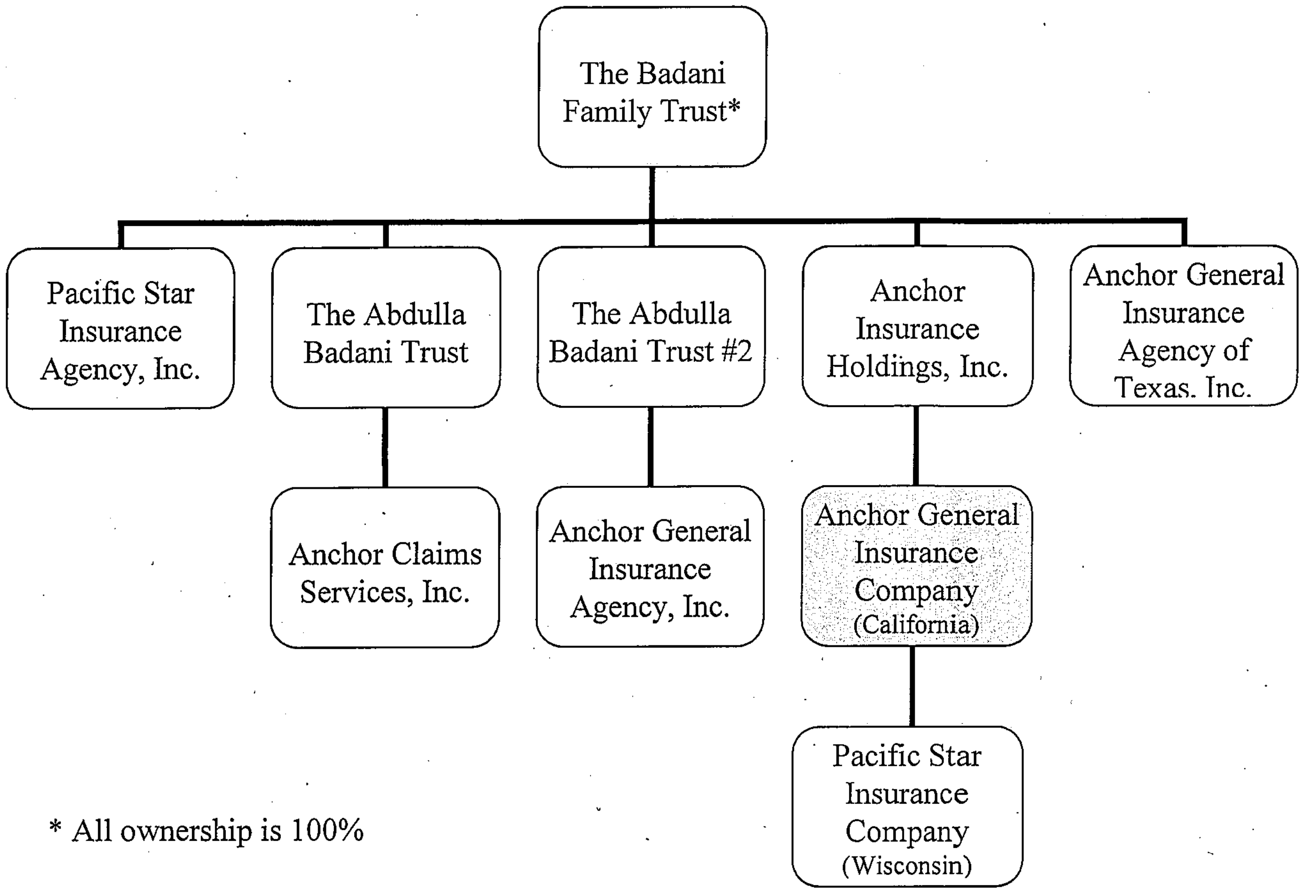
COMPANY HISTORY

On December 31, 2006, the Company acquired its wholly-owned subsidiary, Greatway Insurance Company (GIC), a Wisconsin domiciled property and casualty insurer for the purchase price of $8.27 million. On March 15, 2007, the name of GIC was changed to Pacific Star Insurance Company (PSIC). Currently, PSIC is licensed in sixteen states and writes non-standard automobile business in Arizona, Washington, and Oregon.

In October 2010, the Company amended its Articles of Incorporation to increase the par value of its common stock shares from $50 to $100 per share. This change increased the Company's common capital stock account to $3.2 million as of December 31, 2010, an increase of $1.6 million compared to its prior year December 31, 2009 balance. The $1.6 million increase was funded by a $1.6 million transfer of gross paid-in surplus to its capital stock account. The amendment was made to comply with 2009 legislation passed in the State of Texas requiring all authorized Texas property and casualty insurers to increase their common capital stock to a minimum of $2.5 million by December 31, 2010.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Anchor Insurance Holding, Inc., which in turn, is wholly-owned by the Badani Family Trust. The following organizational chart depicts the interrelationship of the Company within the holding company system:



Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2010 follows:

<u>Directors</u>

Name and Residence	Principal Business Affiliation
Abdulla Badani Rancho Santa Fe, California	President and Chief Executive Officer Anchor General Insurance Company
Shaukat Badani San Diego, California	Director Anchor General Insurance Company
Don Difabrizio Encinitas, California	Vice President Anchor General Insurance Company
Susan Stokes-Gibson Poway, California	Vice President Anchor General Insurance Company

Name and Residence	Principal Business Affiliation
Angie Van Cleaf Encinitas, California	Vice President and Chief Financial Officer Anchor General Insurance Company

Principal Officers

Name	Title
Abdulla Badani	President and Chief Executive Officer
Gretchen Allen	Secretary and Controller
Angie Van Cleaf	Vice President and Chief Financial Officer
Susan Stokes-Gibson	Vice President (Underwriting)
Don Difabrizio	Vice President (Claims)

Management Agreements

Program Administrator Agreement: Effective January 1, 2000, the Company and its affiliate, Anchor General Insurance Agency, Inc. (AGIA), were party to a Program Administrator Agreement that was approved by the California Department of Insurance (CDI) in October 2000. Under the terms of the agreement, AGIA provided the Company with services, such as, solicitating of risks, servicing its business, binding of risks, policy issuance, and the collection of premiums. AGIA was not responsible for obtaining reinsurance or settling claims. For compensation, the Company paid AGIA 21.5% of net written premiums for its services. On December 1, 2007, the Company and AGIA renegotiated the existing agreement to include the following services: sales, underwriting, policy issuance, policy servicing, and premium collections. On November 23, 2011, the CDI granted approval of the agreement with an effective date of December 1, 2010. During the years of 2008, 2009, and 2010, the Company paid AGIA $13,768,514, $22,721,921, and $20,653,291, respectively, for its services.

Subsequent to the examination date, on June 10, 2011, the Company filed an Amended Program Administrator Agreement with the CDI that reduced AGIA's commission to 20% of net written premiums, and added a provision which allows for an additional commission of up to 1.5% to AGIA, based on a contingent loss ratio. The CDI approved this agreement on November 23, 2011.

Program Administrator Agreement: Effective December 1, 2010, the Company and its affiliate, Anchor General Insurance Agency of Texas, Inc., (AGIAT), a Texas Corporation, entered into an agreement whereby AGIAT would serve as the exclusive Program Administrator for the Company's non-standard automobile business written in the State of Texas. The services provided and compensation paid under this agreement is exactly the same as disclosed above between the Company and AGIA, with the lone exception that this agreement only covers business written in the State of Texas. The CDI approved this agreement on November 23, 2011.

Cost Allocation Agreement: Effective December 1, 2003, the Company and its affiliate, AGIA entered into a Cost Allocation Agreement. Under the terms of the agreement, AGIA provides facilities and administrative services to the Company. AGIA is compensated by the Company on an actual cost basis. During the years of 2008, 2009, and 2010, the total paid by the Company to AGIA, under the terms of this agreement, was $1,612,973, $2,023,249, and $2,300,967, respectively. Approval of the agreement was granted by the CDI on April 6, 2004.

Cost Allocation Agreement: Effective January 1, 2007, the Company and its wholly-owned subsidiary, Pacific Star Insurance Company (PSIC), entered into a Cost Allocation Agreement. Under the terms of the agreement, the Company provides PSIC with the following administrative services: budget and cost accounting, legal, financial reporting, tax compliance, actuarial services, and investment management services. The services are provided to PSIC by the Company based on an actual cost basis. During the years of 2008, 2009, and 2010, PSIC paid the Company $48,901, $124,078, and $224,242, respectively, for the services rendered under this agreement. Approval of the agreement was granted by the CDI on November 14, 2007.

On December 28, 2010, the Company filed an Amended Cost Allocation Agreement, effective January 1, 2010, which added claims processing as one of the services provided to PSIC, at the request of the State of Wisconsin. The CDI approved this agreement on March 21, 2011.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2010, the Company was licensed to transact multiple lines of property and casualty insurance in the States of Arizona, California, Florida, Nevada, New Mexico, and Texas.

The Company specializes in non-standard private passenger automobile liability and physical damage insurance, as approximately 98.9% of its direct premiums written in 2010 were in these lines of business. In 2010, the Company wrote direct premiums totaling $98.1 million and the majority of the business was written in the following two states:

State	Direct Premium Written	Percentage of Total
California	$ 95,400,000	97.25%
Arizona	2,400,000	2.45%

The majority of policies are written at statutory minimum limits, and business is primarily marketed through Anchor General Insurance Agency, Inc., an affiliate, and produced by approximately 500 independent agents located throughout the State of California.

LOSS EXPERIENCE

A review of the Company's loss experience during the examination period, disclosed a trend of net underwriting losses and net losses as follows:

Year	Net Underwriting Gain/(Loss)	Net Income or (Loss)	Company Surplus
2008	$ 570,352	$ 1,927,391	$ 22,784,372
2009	(684,550)	(1,017,961)	22,727,101
2010	(1,383,819)	(808,087)	21,497,699
2011(*)	193,806	364,026	21,566,088

(*) Through September 30, 2011

The Company disclosed that its unfavorable loss experience trend since 2009 can be attributed to the following:

- As referenced within the accounts and records section, and based on a prior Report of Examination recommendation, the Company changed its methodology in recording written premiums. The conversion to the new methodology resulted in higher reported written premiums; unearned premiums; deferred agents receivables; federal taxes; and acquisition expenses on new policies. In addition, as a result of the conversion, seventy percent of the Company's business is now written on an annual twelve-month policy term as opposed to the previous one-month policy term;
- A higher loss ratio due to the frequency and severity of claims.

To address its adverse loss experience, the Company applied for and received a rate increase during May 2011. The Company also tightened up some underwriting policies, restricting the producers with excessive loss ratios from producing new business while continuing to offer renewals and service existing policies. The Company's loss experience improved during the subsequent period through September 30, 2011, as noted in the loss experience table above.

REINSURANCE

Assumed

Effective January 1, 2008, the Company entered into a quota share reinsurance agreement to assume 55% of the private passenger automobile business produced by its affiliate, Anchor General Insurance Agency of Texas, Inc., and written by Home State County Mutual Insurance Company (HSCMIC), a Texas domiciled insurer. The quota share participation increased to 60% in 2009, and then to 100% in 2010. The liability of the Company is subject to Texas statutory minimum limits. Under the terms of the agreement, the commission is adjusted according to the loss ratio on a sliding scale basis, subject to a minimum ceding commission of 22%. HSCMIC did not write any new business in 2010. As of December 31, 2010, the Company had assumed premiums of approximately $586,000 and losses and loss adjustment expense reserves of $1.7 million which are secured by a trust agreement.

<u>Ceded</u>

The Company's principal reinsurance agreements in force are renegotiated annually through an intermediary, Burns and Wilcox Re, Inc. All prior agreements remain in force until all claims are settled for the covered policies. The agreements are summarized as follows:

Effective January 1, 2008, the Company entered into a 40% quota share reinsurance agreement with authorized reinsurers. The primary reinsurers are Partner Reinsurance Company of the U.S. (32.5%), and Ace Property and Casualty Insurance Company (7.5%). The liability of the reinsurers is subject to the following policy limits: bodily injury per person, $15,000; bodily injury per accident, $30,000; property damage per accident, $10,000. Under the terms of this agreement a flat ceding commission of 23.5% is paid.

Effective January 1, 2009, the Company entered into a quota share reinsurance agreement with the authorized reinsurer, Partner Reinsurance Company of the U.S. (35%). The liability of the reinsurer is subject to the following policy limits: bodily injury per person, $15,000; bodily injury per accident, $30,000; property damage per accident, $10,000. Under the terms of this agreement a flat ceding commission of 24.5% is paid.

Effective January 1, 2010, the Company entered into two quota share reinsurance agreements with authorized reinsurers. The first agreement and sole reinsurer is with Partner Reinsurance Company of the U.S. (20%). An endorsement to this agreement effective April 1, 2010, added the TOA Reinsurance Company of America as a second reinsurer with 20% participation. The liability of the reinsurer is subject to the following policy limits: bodily injury per person, $15,000; bodily injury per accident, $30,000; property damage per accident, $10,000. Under the terms of the agreement, a flat ceding commission of 20% is paid.

A second separate 20% quota share reinsurance agreement was also entered on January 1, 2010. The sole reinsurer under this agreement is Maiden Reinsurance Company (20%), an authorized reinsurer. The liability of the reinsurer is subject to the following policy limits: bodily injury per person, $15,000; bodily injury per accident, $30,000; property damage per accident, $10,000. Under the terms of the agreement a flat ceding commission of 21% is paid.

As of year end 2010, the Company reported $46.9 million in reinsurance recoverables from four authorized reinsurers. The reinsurance recoverables represent 218% of the Company's surplus as regards policyholders.

In 2009, the Company commuted certain ceded reinsurance treaties, with Alea North America Insurance Company and QBE Reinsurance Corporation. The Company recognized the amounts received from the reinsurers as a reduction of losses and loss adjustment expenses paid, thereby reducing losses and loss adjustment expenses incurred in 2009. The Company also increased its loss and loss adjustment expense reserves, thereby increasing losses and loss adjustment expenses incurred to recognize the effect of releasing the reinsurers from their obligations under the treaties. The net effect of the commutation was an increase in losses and loss adjustment expenses of $133,146.

ACCOUNTS AND RECORDS

Recording Premiums

The previous Report of Examination as of December 31, 2007, recommended that the Company change its methodology concerning the manner in which it records written premiums in order to conform with the Statements of Statutory Accounting Principles (SSAP) No. 53. Historically, the Company had recorded premiums using a one-month policy term premise. The recommendation was that the Company's practice for recording premiums and related accounts, including the calculation of unearned premiums, be revised in accordance with the standard practice of booking full-term premiums, such as three (3), six (6), or twelve (12) month policy terms. The Company complied with the prior Report of Examination recommendation and the conversion was fully implemented by the fourth quarter of 2010.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2010

Underwriting and Investment Exhibit for the Year Ended December 31, 2010

Reconciliation of Surplus as Regards Policyholders
from December 31, 2007 through December 31, 2010

Statement of Financial Condition
as of December 31, 2010

Assets	Ledger and Nonledger Assets	Net Admitted Assets	Notes
Bonds	$ 3,223,767	$ 3,223,767	
Common stocks	7,944,441	7,944,441	
Cash and short-term investments	29,563,285	29,563,285	
Investment income due and accrued	40,615	40,615	
Premiums and agents' balances in course of collection	6,191,749	6,191,749	
Premiums, agents' balances and installments booked but deferred and not yet due	28,815,001	28,815,001	
Amount recoverable from reinsurers	6,713,042	6,713,042	
Current federal and foreign income tax recoverable and interest thereon	776,214	776,214	
Net deferred tax asset	1,199,319	1,199,319	
Receivable from parent, subsidiaries and affiliates	38,027	38,027	
Total assets	$ 84,505,460	$ 84,505,460	

Liabilities, Surplus and Other Funds			
Losses and loss adjustment expenses		$ 21,966,221	(1)
Reinsurance payable on paid loss and loss adjustment expenses		380,498	
Other expenses		114,840	
Taxes, licenses and fees		1,024,943	
Unearned premiums		15,086,668	
Ceded reinsurance premiums payable		24,183,910	
Amounts withheld or retained by company for account of others		19,128	
Payable to parent, subsidiaries and affiliates		231,553	
Total liabilities		63,007,761	
Common capital stock	$ 3,200,000		
Gross paid in and contributed surplus	10,675,400		
Unassigned funds (surplus)	7,622,299		
Surplus as regards policyholders		21,497,699	
Total liabilities, surplus and other funds		$ 84,505,460	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2010

Statement of Income

Underwriting Income		
Premiums earned		$ 49,084,664
Deductions:		
Losses and loss expenses incurred	$ 36,203,099	
Other underwriting expenses incurred	14,265,384	
Total underwriting deductions		50,468,483
Net underwriting loss		(1,383,819)
Investment Income		
Net investment income earned	$ 212,233	
Net investment gain		212,233
Other Income		
Aggregate write-ins for miscellaneous income	$ 642	
Total other income		642
Net loss before federal income taxes		(1,170,944)
Federal income taxes incurred		(362,857)
Net loss		$ (808,087)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2009		$ 22,727,101
Net loss	$ (808,087)	
Change in net unrealized capital losses	(369,858)	
Change in net deferred income tax	(51,457)	
Capital changes:		
Transferred from surplus	1,600,000	
Surplus adjustments:		
Transferred to capital	(1,600,000)	
Change in surplus as regards policyholders for the year		(1,229,402)
Surplus as regards policyholders, December 31, 2010		$ 21,497,699

Reconciliation of Surplus as Regards Policyholders
from December 31, 2007 through December 31, 2010

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2007 per Examination			$ 20,884,704
Net income	$ 101,343	$	
Change in net unrealized capital loss		444,969	
Change in net deferred income tax	956,621		
Capital changes – Transferred from surplus	1,600,000		
Surplus adjustments –Transferred to capital		1,600,000	
Total gains and losses	$ 2,657,964	$ 2,044,969	
Net increase in surplus as regards policyholders			612,995
Surplus as regards policyholders, December 31, 2010, per Examination			$ 21,497,699

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on the analysis performed by a Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expenses reserves as of December 31, 2010 were found to be reasonably stated and have been accepted for the purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Accounts and Records (Page 8): The previous examination's information systems review noted deficiencies in the Company's Business Continuity Plan. The Company remediated the weaknesses pertaining to these previously noted examination findings.

Comments on Financial Statement Items – Premiums and Agents' Balances in Course of Collection; Deferred Premiums, Agents' Balances Not Yet Due; Unearned Premiums (Page 13): It was recommended that the Company's practice for recording premiums and related accounts, including the calculation of unearned premiums, be revised to comply with Statements of Statutory Accounting Principles No. 53. The Company complied with the recommendation and the conversion was fully implemented by the fourth quarter of 2010.

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/____________
Hilary C. Solomon, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California