

REPORT OF EXAMINATION
OF THE
CITATION INSURANCE COMPANY
AS OF
DECEMBER 31, 2009

Participating State
and Zone:

California

Filed June 6, 2011

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San Francisco, California
April 19, 2011

Honorable Joseph Torti, III
Chairman of the NAIC Financial
Condition Subcommittee
Superintendent of Business Regulation
Division of Insurance
Cranston, Rhode Island

Honorable Linda S. Hall
Secretary, Zone IV-Western
Director of Insurance
Alaska Division of Insurance
Anchorage, Alaska

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

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

CITATION INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 399 Venture Drive, Suite D, Lewis Center, Ohio 43035. The Company's statutory home office and main administrative office is located at 875 Prospect Street, Suite 301, La Jolla, California 92037.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. 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

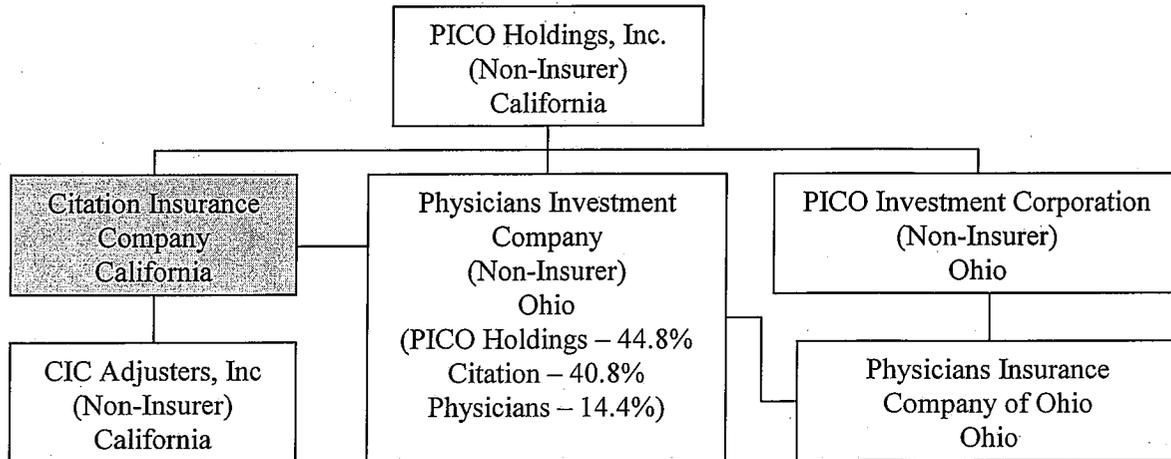
assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, 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: company history; corporate records; fidelity bonds and other insurance; employees' and agents' welfare and pension plans; stock ownership and insurance plans; and loss experience.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system in which PICO Holdings, Inc. (PICO), a California corporation, is the ultimate controlling entity. The Company is a wholly-owned subsidiary of PICO. Effective January 1, 2007, CIC Adjusters, Inc. was formed as a wholly-owned subsidiary of the Company.

The following chart depicts the interrelationship of the companies within the holding company system as of December 31, 2009 and is limited to PICO insurance operations (all ownership is 100% unless otherwise noted):



Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2009 follows:

Directors

Name and Residence

Principal Business Affiliation

John Russell Hart
La Jolla, California

President and Chief Executive Officer
PICO Holdings, Inc.

Richard Harold Sharpe
La Jolla, California

Chief Operating Officer
PICO Holdings, Inc.

Vacant*

(*)On April 5, 2011 Maxim Charles Wickham Webb, Treasurer and Chief Financial Officer was elected to fill the vacancy on the Board of Directors.

Principal Officers

<u>Name</u>	<u>Title</u>
John Russell Hart	President and Chief Executive Officer
James Frederick Mosier	Secretary
Maxim Charles Wickham Webb	Treasurer and Chief Financial Officer
Richard Harold Sharpe ^(a)	Chief Operating Officer
John Steven Bricker ^(b)	Controller

The following changes in management occurred subsequent to the examination date:

- (a) Richard Harold Sharpe retired on August 31, 2010 and is now a consultant.
- (b) John Steven Bricker retired on March 31, 2011 and his responsibilities were assumed by Brenda Jean Borgan, Senior Accountant.

Management Agreements

Management Agreement: This agreement, effective July 1, 2000, shall continue in effect until cancelled. The Company and its parent, PICO Holdings, Inc. (PICO) will be responsible for paying each company's own direct expenses. Such expenses include, but are not limited to: directors' fees and expenses; and travel and entertainment. PICO will charge the Company management fees based on actual time and expense that PICO's management spends on management functions of the Company. Management expenses include the pro-rated salary, benefits, and applicable overhead of PICO's executive management. This agreement was approved by the California Department of Insurance (CDI) on December 20, 2000. The amount of expenses incurred for management fees were \$84,111, \$101,352, and \$103,966 for 2007, 2008, and 2009, respectively.

Investment Management Agreement: The Company has appointed its parent, PICO, as the investment advisor and manager of its investment assets. The cost of investment services is based on actual time and expense of PICO employees. The agreement was effective July 1, 2000 and was approved by the CDI on December 20, 2000. The amount of expenses incurred for investment services were \$45,767, \$46,924, and \$48,459 for 2007, 2008, and 2009, respectively.

Tax Allocation Agreement: The Company, its parent and affiliates file a consolidated federal income tax return under the provisions of a tax allocation agreement, which was executed on October 5, 1999. Each subsidiary is required to compute its tax liability as if it filed a separate federal tax return. Payment of the consolidated tax liability is the responsibility of the parent. This agreement was approved by the CDI in August 2000.

Conflict of Interest

The Company has a "Code of Business Conduct and Ethics" policy which the board, management and key employees signed yearly acknowledging receipt of this policy. It was noted that the signed acknowledgement does not specifically disclose conflicts of interest. It is recommended that the Company establish written procedures to require annual conflict of interest reporting for its directors, officers, and key employees. This is a repeat finding from the prior examination.

CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the Commissioner. The board must also enter that fact in the board minutes. A review of the board minutes disclosed that, while the official file report was presented to the board, the first formally prepared draft by the examiners was not. It is recommended that the Company comply with CIC Section 735.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company is licensed to write business in Arizona, California, Colorado, Hawaii, Nevada, New Mexico, and Utah.

Effective June 30, 1996, the Company ceased writing workers' compensation business. On June 30, 1997, the Company ceded all workers' compensation loss reserves to its then subsidiary, Citation National Insurance Company, which was simultaneously sold to Fremont Indemnity Company (Fremont) as of the same date. In July of 2003, the California Commissioner placed Fremont into liquidation. As a result, the Company became liable for the remaining unpaid losses on the business it ceded to Fremont. At the time of the liquidation, claims were being paid by the California Insurance Guarantee Association (CIGA). Effective September 1, 2004, CIGA turned over all workers' compensation claims that had previously been reinsured and administered by Fremont to the Company and made a claim to the Company for all payments made on behalf of those policies from July 2003 until the Company began paying in September 2004. In 2008, the Company paid CIGA for all claim payments previously paid by CIGA on behalf of the Company. The Company has contracted with a third party to administer the claims going forward.

In 1997, the Company ceased writing commercial business in California. In 1998, the only business remaining was in Arizona, which consisted mainly of property coverage on apartments and merchants buildings coverage on restaurant businesses.

As of December 31, 2000, the Company ceased writing new business and its last policy expired on December 31, 2001. The Company continues to runoff its operations through managing its investments to meet future claims obligations.

REINSURANCE

Assumed

The Company did not assume any reinsurance during the examination period.

Ceded

The Company has been in runoff since January 1, 2001. The following is a summary of principal reinsurance agreements in effect as of December 31, 2009:

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
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Workers' Compensation:

First Excess Liability (1986-1987)	General Reinsurance Corporation	\$150,000	\$5 million per occurrence
First Excess Liability (1988-1989)	General Reinsurance Corporation	\$200,000	\$5 million per occurrence
First Excess Liability (1990-1998)	General Reinsurance Corporation	\$250,000	\$5 million per occurrence

Artisan and Contractors:

First Excess Liability	General Reinsurance Corporation	\$125,000	\$125,000 per occurrence
Second Excess Liability	General Reinsurance Corporation	\$250,000	\$2.75 million per occurrence
First Excess Liability	General Reinsurance Corporation	\$75,000	\$175,000 subject to a maximum of \$525,000 on all risks involved in one occurrence
Second Excess Liability	General Reinsurance Corporation	\$250,000	\$2.75 million subject to a maximum of \$4.125 million on all risks involved in one occurrence

ACCOUNTS AND RECORDS

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of the review of the Company's information systems controls, recommendations for improving the disaster recovery plan were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders from December 31, 2006
through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 9,870,427	\$	\$ 9,870,427	
Common stocks	21,532,348	6,482,715	15,049,633	
Cash and short-term investments	1,843,850		1,843,850	
Investment income due and accrued	121,068		121,068	
Amount recoverable from reinsurers	463,560		463,560	
Funds held by or deposited with reinsured companies	121,067		121,067	
Current federal and foreign income tax recoverable and interest thereon	792,511		792,511	
Net deferred tax asset	2,357,594		2,357,594	
Furniture and equipment	5,029	5,029	0	
Receivable from parent, subsidiaries, and affiliates	1,010,257	999,879	10,378	
Aggregate write-ins for other than invested assets	<u>27,644</u>	<u>27,643</u>	<u>1</u>	
Total assets	<u>\$ 38,145,355</u>	<u>\$ 7,515,266</u>	<u>\$ 30,630,089</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 4,874,966	(1)
Loss adjustment expenses			2,435,686	(1)
Other expenses			345,042	
Borrowed money			2,363,889	
Amounts withheld or retained by company for account of others			173,575	
Provision for reinsurance			59,389	
Payable to parent, subsidiaries and affiliates			<u>268,667</u>	
Total liabilities			10,521,214	
Common capital stock		\$ 5,000,000		
Gross paid-in and contributed surplus		26,553,731		
Unassigned funds (surplus)		<u>(11,444,856)</u>		
Surplus as regards policyholders			<u>20,108,875</u>	
Total liabilities, surplus and other funds			<u>\$ 30,630,089</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2009

Statement of Income

Underwriting Income

Premiums earned		\$ 0
Deductions:		
Losses incurred	\$ 45,147	
Loss expense incurred	(83,588)	
Other underwriting expenses incurred	<u>711,074</u>	
Total underwriting deductions		<u>672,633</u>
Net underwriting loss		(672,633)

Investment Income

Net investment income earned	\$ 486,084	
Net realized capital loss	<u>(1,925,177)</u>	
Net investment loss		(1,439,093)

Other Income

Aggregate write-ins for miscellaneous income	\$ <u>27</u>	
Total other income		<u>27</u>
Net loss before federal and foreign income taxes		(2,111,699)
Federal and foreign income taxes incurred		<u>(911,893)</u>
Net loss		<u>\$ (1,199,806)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008		\$ 15,242,226
Net loss	\$ (1,199,806)	
Change in net unrealized capital gains	2,004,146	
Change in net unrealized foreign exchange capital gain	924,479	
Change in net deferred income tax	(200,629)	
Change in nonadmitted assets	3,329,931	
Change in provision for reinsurance	<u>8,528</u>	
Change in surplus as regards policyholders for the year		<u>4,866,649</u>
Surplus as regards policyholders, December 31, 2009		<u>\$ 20,108,875</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2009

Surplus as regards policyholders, December 31, 2006 per Examination			\$ 23,906,035
	Gain in <u>Surplus</u>	Loss in <u>Surplus</u>	
Net income	\$ 348,259	\$	
Net unrealized capital loss		6,152,411	
Change in net foreign exchange capital gains	154,447		
Change in net deferred income tax		431,530	
Change in nonadmitted assets	2,331,281		
Change in provision for reinsurance		<u>47,206</u>	
Total gains and losses	<u>\$ 2,833,987</u>	<u>\$ 6,631,147</u>	
 Net decrease in surplus as regards policyholders			 <u>(3,797,160)</u>
 Surplus as regards policyholders, December 31, 2009, per Examination			 <u>\$ 20,108,875</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2009 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Conflict of Interest (Page 5): It is recommended that the Company establish written procedures to require annual conflict of interest reporting for its directors, officers, and key employees. This is a repeat finding from the prior examination.

Corporate Records – (Page 5): It is recommended that the Company implement procedures to ensure compliance with California Insurance Code (CIC) Section 735.

Accounts and Records – (Page 7): As a result of the review of the Company's information systems controls, recommendations for improving the disaster recovery plan were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Previous Report of Examination

Management and Control (Page 2): It was recommended that the Company establish written procedures to require annual conflict of interest reporting for its directors, officers, and key employees. The Company has not complied.

Accounts and Records (Page 6): 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.

Comments on Financial Statement Items – Bonds and Common Stocks (Page 12): It was recommended that that Company file its custodial agreement with California Department of Insurance as required by CIC Section 1104.9(c). The Company is now in compliance.

Comments on Financial Statement Items – Cash and Short-term Investments (Page 12): It was recommended that the Company develop a formal policy in regards to escheat procedures. It was recommended that the Company file reports with the California State Controller in accordance with California Unclaimed Property Act. The Company is now in compliance.

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/_____
Li Lim, CFE
Examiner-In-Charge
Department of Insurance
State of California