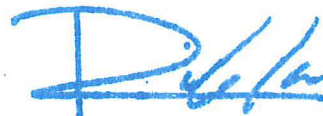


REPORT OF EXAMINATION  
OF THE  
FARMERS INSURANCE EXCHANGE  
AS OF  
DECEMBER 31, 2017



Insurance Commissioner

FILED 6-28-19

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Los Angeles, California  
May 16, 2019

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

### FARMERS INSURANCE EXCHANGE

(hereinafter also referred to as the Exchange) at its former administrative office located at 4680 Wilshire Boulevard, Los Angeles, California 91010. The Exchange's current statutory home office and main administrative office is located at 6301 Owensmouth Avenue, Woodland Hills, California 91367.

### SCOPE OF EXAMINATION

We have performed our multi-state examination of the Exchange. The previous examination of the Exchange 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 Exchange's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated, both currently and prospectively.

All accounts and activities of the Exchange were considered in accordance with the risk-focused examination process. This may include 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 Exchange's financial statements.

This examination report includes findings of fact and general information about the Exchange 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 Exchange.

This examination was a coordinated examination with California as the lead state of the Farmers Insurance Exchange subgroup of the Farmers Insurance Group. The states of Illinois and Washington participated on the examination, and it was conducted concurrently with the examinations of the following insurance entities in the holding company group:

<b>Group/Company</b>	<b>NAIC CoCode</b>	<b>Domiciled State</b>
<b>FARMERS INSURANCE EXCHANGE GROUP</b>		
Farmers Insurance Company of Arizona	21598	AZ
<b>Farmers Insurance Exchange (the Exchange)</b>	<b>21652</b>	<b>CA</b>
Truck Insurance Exchange	21709	CA
Fire Insurance Exchange	21660	CA
Civic Property and Casualty Company	10315	CA
Neighborhood Spirit Property and Casualty Company	10317	CA
Exact Property and Casualty Company	10318	CA
Mid-Century Insurance Company	21687	CA
Farmers Insurance Company of Idaho	21601	ID
Farmers New Century Insurance Company	10806	IL
Illinois Farmers Insurance Company	21679	IL
Farmers Insurance Company Inc.	21628	KS
Farmers Insurance of Columbus, Inc.	36889	OH
Farmers Insurance Company of Oregon	21636	OR
Texas Farmers Insurance Company	21695	TX
Farmers Texas County Mutual Insurance Company	24392	TX
Mid Century Insurance Company of Texas	28673	TX
Farmers Insurance Company of Washington	21644	WA

<b>Group/Company</b>	<b>NAIC CoCode</b>	<b>Domiciled State</b>
<b>COAST NATIONAL/BRISTOL WEST GROUP</b>		
Coast National Insurance Company	25089	CA
Security National Insurance Company	33120	FL
Bristol West Preferred Insurance Company	12774	MI
Bristol West Casualty Insurance Company	11034	OH
Bristol West Insurance Company	19658	OH

<b>Group/Company</b>	<b>NAIC CoCode</b>	<b>Domiciled State</b>
<b>FOREMOST GROUP</b>		
Foremost Insurance Company Grand Rapids, Michigan	11185	MI
Foremost Property and Casualty Insurance Company	11800	MI
Foremost Signature Insurance Company	41513	MI
Farmers Specialty Insurance Company	43699	MI
Foremost County Mutual Insurance Company	29254	TX
Foremost Lloyds of Texas	41688	TX

<b>Group/Company</b>	<b>NAIC CoCode</b>	<b>Domiciled State</b>
<b>21ST CENTURY INSURANCE GROUP</b>		
21st Century Casualty Company	36404	CA
21st Century Insurance Company	12963	CA
21st Century Superior Insurance Company	43761	CA
21st Century Pacific Insurance Company	23795	CO
21st Century Assurance Company	44245	DE
American Pacific Insurance Company, Inc.	10805	HI
Farmers Insurance Hawaii, Inc.	28487	HI
21st Century Advantage Insurance Company	25232	MN
21st Century Auto Insurance Company of New Jersey	10184	NJ
21st Century Pinnacle Insurance Company	10710	NJ
21st Century National Insurance Company <b>(a)</b>	36587	NY
21st Century North America Insurance Company	32220	NY
21st Century Centennial Insurance Company	34789	PA
21st Century Indemnity Insurance Company	43974	PA
21st Century Preferred Insurance Company	22225	PA
21st Century Premier Insurance Company	20796	PA
21st Century Security Insurance Company <b>(b)</b>	23833	PA
21st Century Insurance Company of the Southwest	10245	TX

- (a) 21st Century National Insurance Company was sold to Plymouth Rock Assurance Corporation (Plymouth), effective April 1, 2018.
- (b) 21st Century Security Insurance Company (Security) was sold to Plymouth, which assigned its right to acquire Security to High Point Preferred Insurance Company, effective August 1, 2018.

Group/Company	NAIC CoCode	Domiciled State
<b>ZURICH GROUP</b>		
Farmers Reinsurance Company	10873	CA

With the exception of the Farmers Reinsurance Company, which is part of the Zurich Group, all the above companies are part of the Farmers Insurance Group of companies. Although owned by Farmers Group, Inc. (FGI), the attorney-in-fact for the Farmers Insurance Group, the Farmers Reinsurance Company operates as one of the Farmers property and casualty companies.

### EXCHANGE HISTORY

The Exchange was organized in the state of California on March 28, 1928 and commenced business on April 6, 1928. The Exchange, Fire Insurance Exchange and Truck Insurance Exchange (the Farmers Exchanges), along with their subsidiaries, comprise the Farmers Insurance Group.

### Surplus Notes and Contribution Certificates

A significant portion of the Exchange's reported surplus as regards policyholders at the examination date was comprised of surplus notes issued to non-affiliates, and certificates of contribution, issued to Zurich American Insurance Company (ZAIC) affiliates. The following schedule depicts the specific issuances, interest rates, par values, maturity dates, and carrying values outstanding at December 31, 2017:

<u>Ref. #</u>	<u>Date Issued</u>	<u>Interest Rate</u>	<u>Par Value</u>	<u>Carrying Value</u>	<u>Maturity Date</u>
1)	05/11/94	8.63%	\$ 203,444,000	\$ 203,444,000	05/01/24
2)	07/10/98	7.05%	373,077,923	279,776,923	07/15/28
3)	07/10/98	7.20%	111,923,077	103,316,077	07/15/48
4)	06/30/11	6.15%	200,000,000	200,000,000	06/30/21
5)	11/05/13	6.15%	312,000,000	312,000,000	11/01/53
6)	10/07/14	5.45%	399,000,000	399,000,000	10/15/54
7)	10/10/17	4.75%	400,000,000	396,000,000	11/01/57
8)	12/20/17	3.76%	100,000,000	100,000,000	12/20/27
	Totals		<u>\$2,099,445,000</u>	<u>\$1,993,537,000</u>	

The notes and certificates listed have restrictions, which require the approval of the California Department of Insurance (CDI) before payment of any interest and principal. Interest can be paid out of earned (unassigned) surplus only. There were no unapproved principal and/or interest payments made during the examination period.

# 1) Surplus notes in the amount of \$203.4 million were issued to qualified institutional buyers in the open market on May 11, 1994 and are administered by JP Morgan Chase Bank (JP Morgan). The notes are unsecured and subordinated to all present and future senior indebtedness and policy claims. The notes mature on May 1, 2024.

The original issued amount of these notes was \$300 million but notes with a par value of \$96.6 million were redeemed in November 2013 by the Exchange for \$130.9 million, a premium of \$34.3 million. These surplus notes were redeemed with the approval of the CDI on November 5, 2013, and the liability for those notes has been extinguished.

# 2) Trust surplus notes in the amount of \$279.8 million were issued to qualified institutional buyers in the open market on July 10, 1998 and are administered by JP Morgan. The notes are unsecured and subordinated to all present and future senior indebtedness and policy claims. The notes mature on July 15, 2028.



The original issued amount of these notes was \$373.1 million but notes with a par value of \$93.3 million were repurchased in November 2013 by the Exchange for \$116.8 million, a premium of \$23.5 million. The CDI approved the repurchase on October 9, 2013. Under the terms of the note indentures, these notes could not be redeemed, and the liabilities for the obligations cannot be extinguished until maturity.

# 3) Trust surplus notes in the amount of \$103.3 million were issued to qualified institutional buyers in the open market on July 10, 1998 and are administered by JP Morgan. The notes are unsecured and subordinated to all present and future senior indebtedness and policy claims. The notes mature on July 15, 2048.

The original issued amount of these notes was \$111.9 million but notes with a par value of \$8.6 million were repurchased in November 2013 by the Exchange for \$10.0 million, a premium of \$1.4 million. The CDI approved the repurchase on October 9, 2013. Under the terms of the note indentures, these notes could not be redeemed, and the liabilities for the obligations cannot be extinguished until maturity.

# 4) A certificate of contribution in the amount of \$200 million was originally issued at \$707 million to ZAIC on June 30, 2011, as part of a refinancing and redistribution transaction. On December 29, 2017, the Exchange partially repaid \$507 million of the certificate of contribution to ZAIC. This repayment was made with the approval of the CDI on December 27, 2017. The certificate was scheduled to mature on June 30, 2021. On June 14, 2018, the CDI approved the repayment of the remaining \$200 million of the certificate of contribution. On June 30, 2018, the Exchange repaid in full the remaining \$200 million.

# 5) The trust surplus notes, approved by the CDI on October 23, 2013, in the amount of \$312 million was issued to qualified institutional buyers in the open market on November 5, 2013, and are administered by The Bank of New York Mellon Trust Company, NA (BNY).

# 6) Trust surplus notes in the amount of \$399 million were issued to qualified institutional buyers in the open market on October 7, 2014 and are administered by BNY. The notes are unsecured and subordinated to all present and future senior indebtedness and policy claims. The notes were approved by the CDI on September 15, 2014.

# 7) Surplus notes in the amount of \$400 million were issued to private qualified institutional investors and are administered by BNY. The notes are unsecured and subordinated to all present and future senior indebtedness and policy claims. The notes mature on November 1, 2057. These notes were approved by the CDI on October 3, 2017.

Together with available operating cash (and the proceeds received from surplus notes issued to Farmers New World Life Insurance (FNWLI) (see #8 below), the Exchange utilized the proceeds from these newly issued surplus notes to partially repay \$507 million of the \$707 million in funds borrowed from ZAIC (see # 4 above).

# 8) Surplus notes in the amount of \$100 million were issued to FNWLI, which is owned by Farmers Group, Inc. (FGI), the Attorney-In-Fact of the Exchanges. The notes are unsecured and subordinated to all present and future senior indebtedness and policy claims. These new surplus notes were approved by the CDI on December 13, 2017. Proceeds from these notes were used to partially repay the certificate of contribution to ZAIC (see # 4 and # 7 above).

From January 1, 2014 through December 31, 2017, the Farmers Exchanges paid a total of \$605.7 million in interest expenses to the surplus note holders of which the Exchange paid \$494.6 million. In 2018, the Exchange paid interest totaling \$113.8 million.

#### Surplus Loan Note Facility

The Farmers Exchanges acquired the right to issue \$500 million in securities to provide additional regulatory capital to cover catastrophic losses in the years 2012 to 2015. A Surplus Loan Note Facility (Facility) was established by a Credit Agreement among the Farmers Exchanges and a consortium of financial institutions (lenders). A securities permit authorizing this Facility was approved by the CDI on April 26, 2012.

In January 2015 the CDI approved a renewal of the \$500 million Facility, which offers broader coverage than the prior Facility, including the ability to issue 5-year surplus notes at any time during a three-year period in the event of a specified major catastrophe loss at a pre-agreed price (see also the “REINSURANCE” section in this examination report).

The Exchange has not borrowed against the current or prior lines of credit on this Facility. Fees paid by the Farmers Exchanges for the right to access this Facility were \$4.3 million and \$4.4 million in 2017 and 2016, respectively.

### MANAGEMENT AND CONTROL

The Exchange, a reciprocal insurer organized under California Insurance Code (CIC) Section 1300 et. seq. is provided certain non-claims services by its Attorney-In-Fact, Farmers Group, Inc. (FGI), dba Farmers Underwriters Association (FUA). FGI is a U.S. subsidiary of Zurich Insurance Group Ltd. (ZIG), a Swiss holding company. ZIG was formerly known as Zurich Financial Services until it changed its name in 2012.

FGI is held in three discrete classes of Common Stock as follows:

- Class A shares, representing 86.625% of the voting rights, are held by Zurich Insurance Company (ZIC). ZIC is a wholly owned subsidiary of ZIG.
- Class B shares, representing 10% of the voting rights, are held by ZIG.
- Class C shares were issued in 2001 in six subclasses, C-1 through C-6. Initially issued to certain RegCaPS Partnerships, these shares were subsequently repurchased within the ZIG as follows:

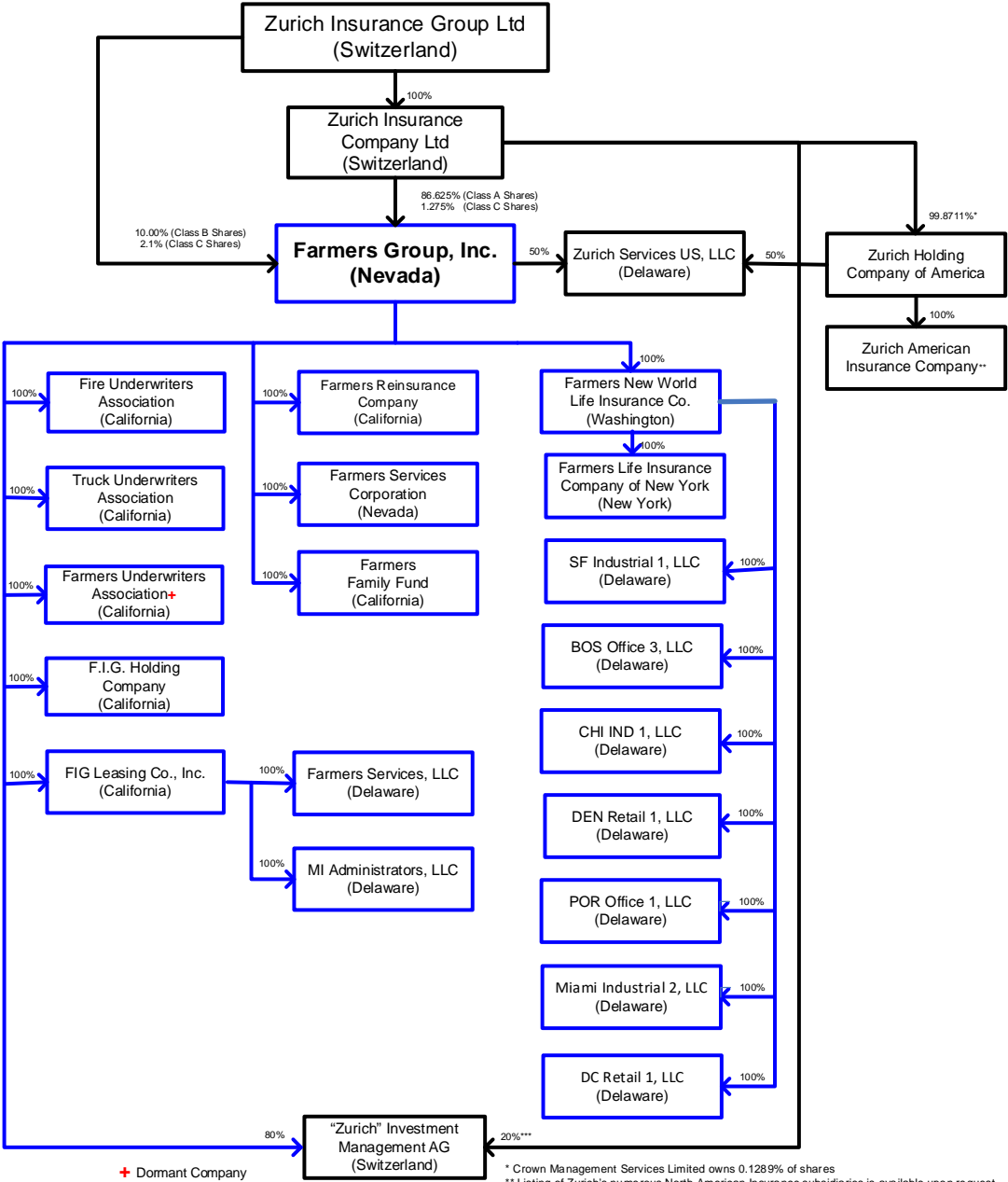
- Class C-1 and C-3 shares were re-acquired by ZIC, representing 1.275% of the voting rights.
- Class C-2, C-4, C-5 and C-6 shares were re-acquired by Zurich Group Holding, which subsequently merged into Zurich Financial Services (which, as noted above was renamed as Zurich Insurance Group Ltd.).

Thus, during the examination period, 12.1% of the voting rights were held directly by ZIG, and the remaining 87.9% of the voting rights were held by ZIC and thus indirectly controlled by ZIG.

With the approval of the California Department of Insurance (CDI) in December 2013, a unique National Association of Insurance Commissioners (NAIC) Group Code has been assigned to the Farmers Group of companies (previously part of the Zurich NAIC Group Code 0212 and now included in the Farmers Group Code 0069). As such ZIC, is no longer named as an Ultimate Controlling Party for the Farmers Group of companies. However, disclosure continues to be provided in the Holding Company Annual Registration Statements regarding the relationship with ZIG and transactions involving entities with the ZIC NAIC Group Code 0212.

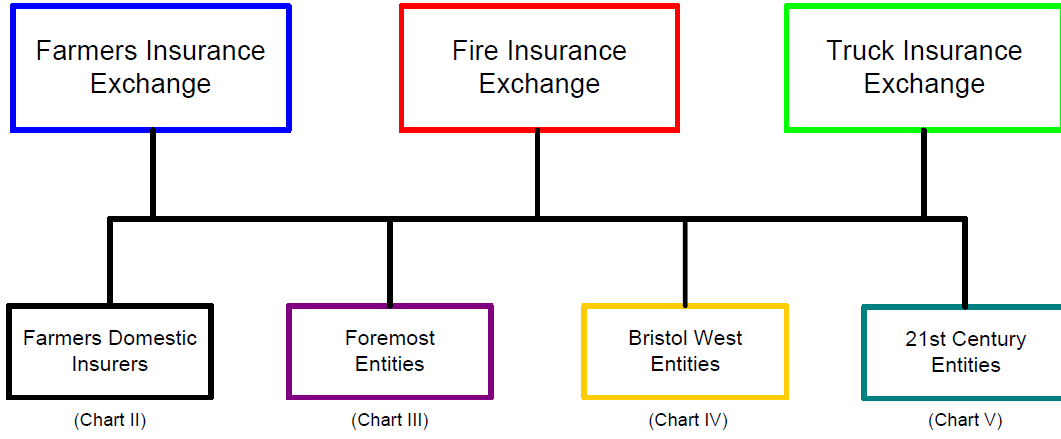
The following abridged organizational charts show the relationships of FUA, FGI to its ultimate parent ZIG, and of the Farmers Exchanges to their subsidiaries and affiliates as of December 31, 2017:

# ZURICH ORGANIZATION (NAIC GROUP CODE 0212)

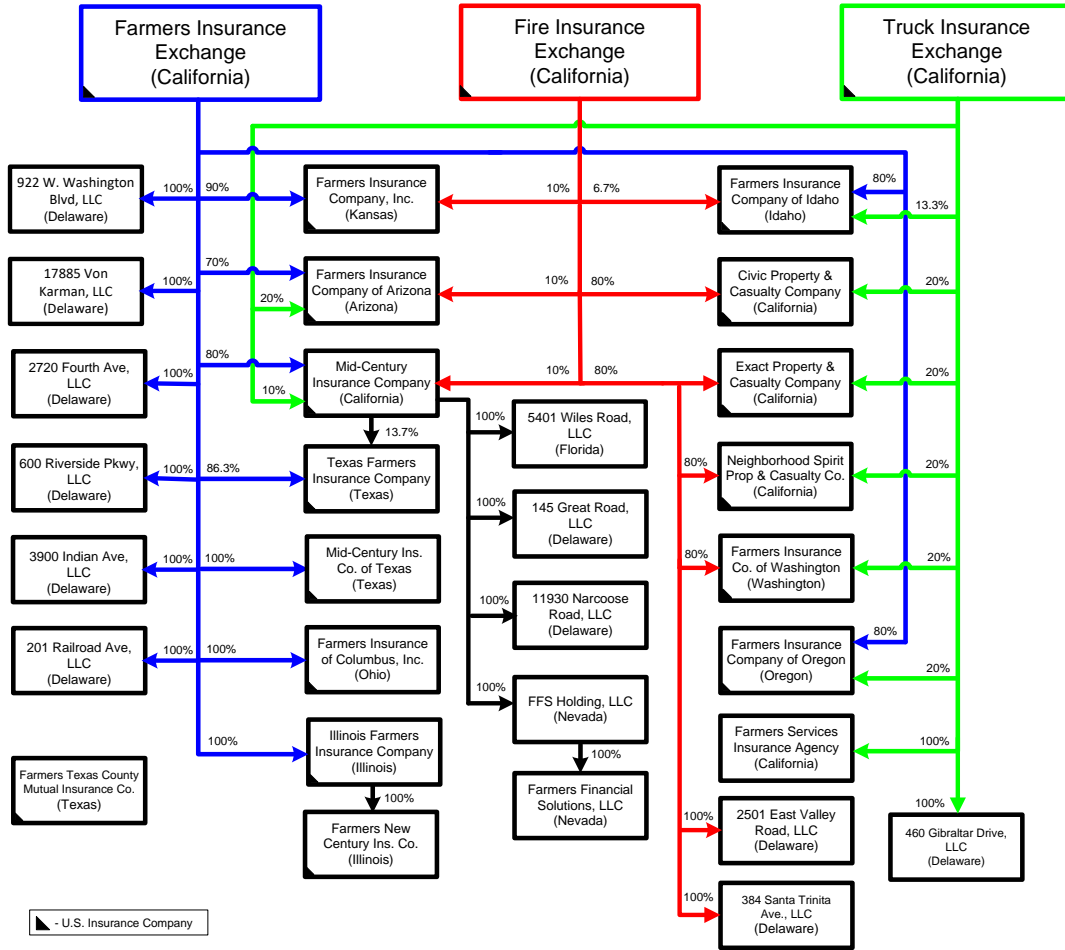




**FARMERS EXCHANGES ORGANIZATION  
(NAIC GROUP CODE 0069)**

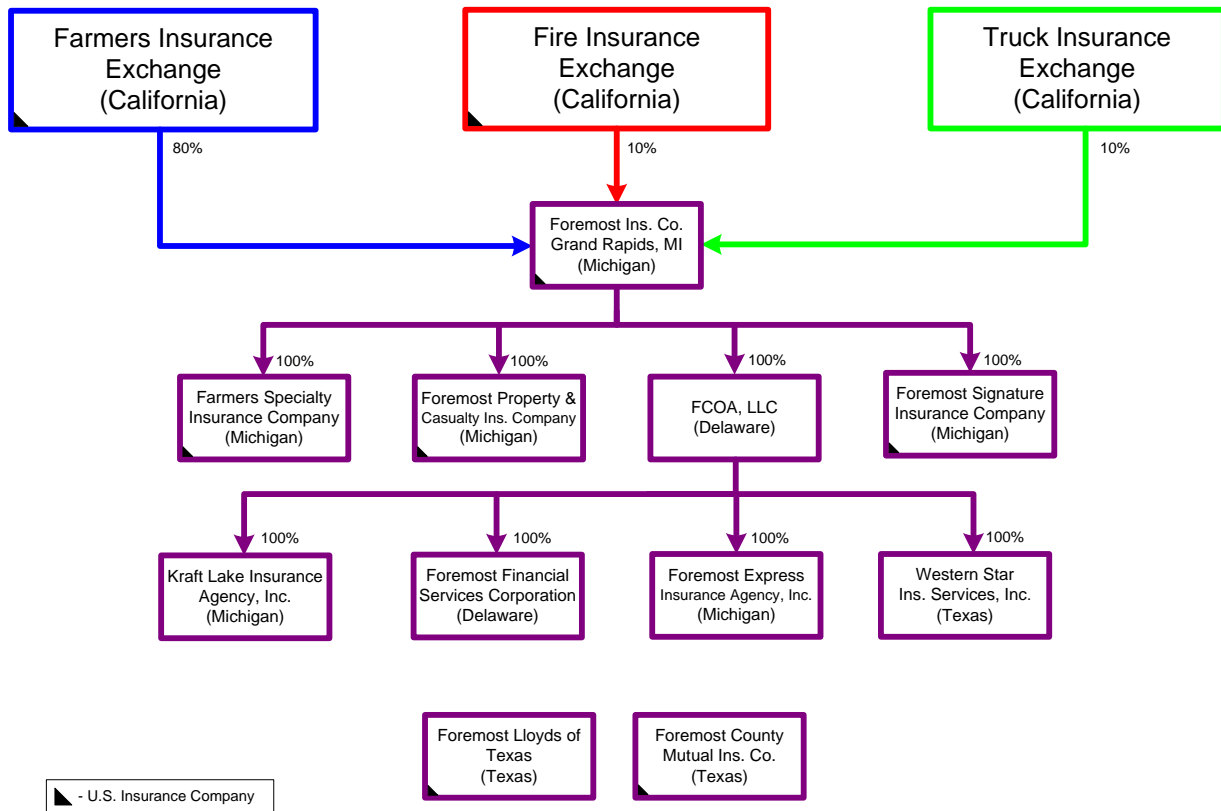


## CHART II: EXCHANGES/FARMERS ENTITIES ORGANIZATION

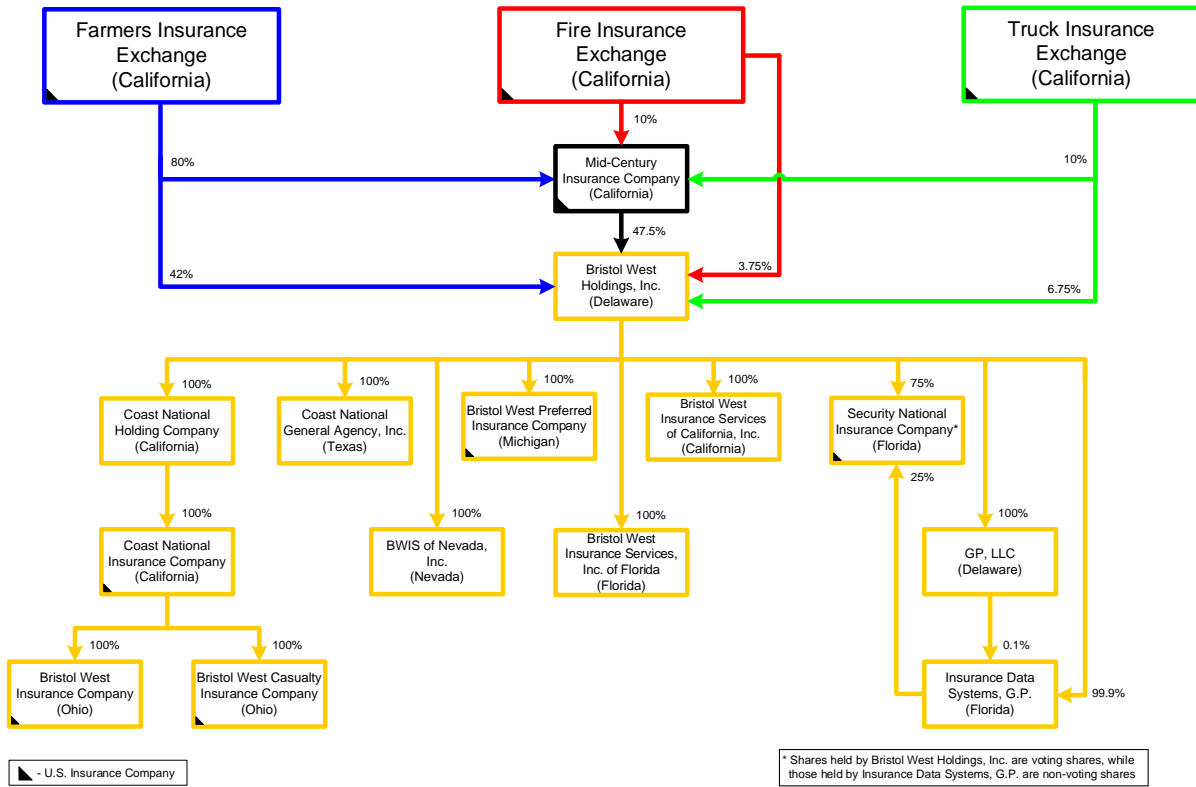




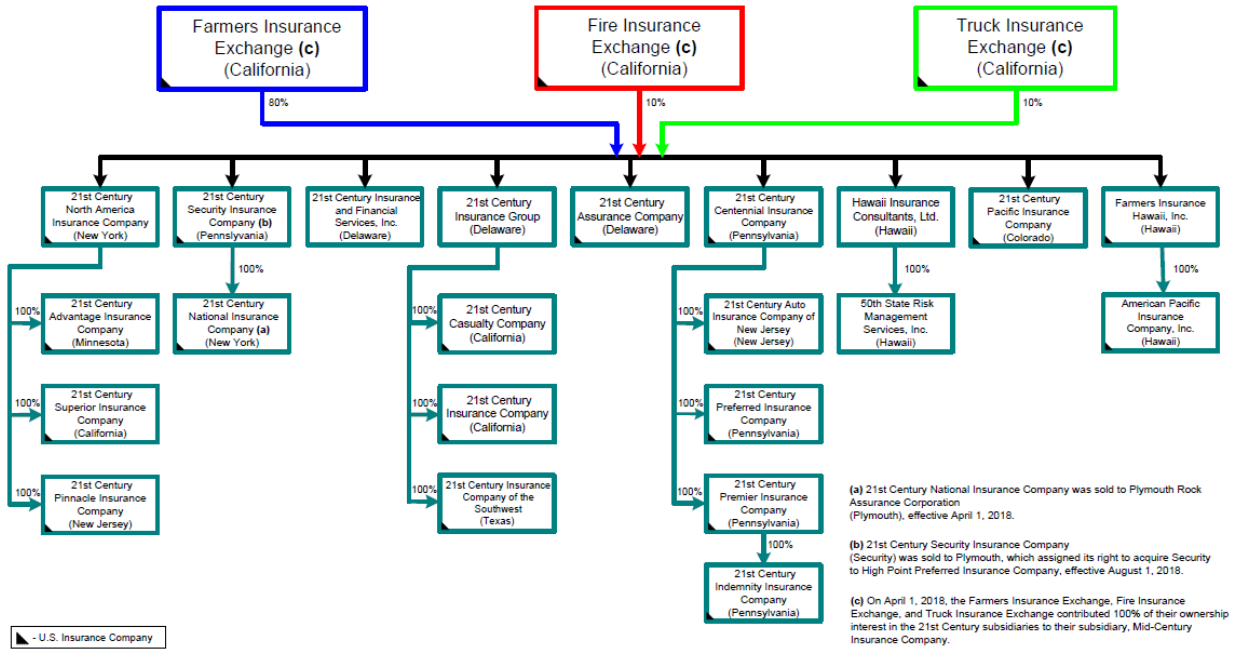
### CHART III: EXCHANGES/FOREMOST ORGANIZATION



# CHART IV: EXCHANGES/BRISTOL WEST ORGANIZATION



# CHART V: EXCHANGES/21st CENTURY ORGANIZATION



Management of the Exchange is vested in a board of governors elected annually, composed of not less than five nor more than twelve members. A listing of the members of the board and principal officers serving on December 31, 2017 follows:

Board of Governors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Joe D. Bryant Moore, Oklahoma	Owner Military Medal Manufacturing
Alan R. Gildemeister Batavia, Illinois	Secretary Gentler Times Stitching, Inc.
Donald Jue San Marino, California	Retired
Frederick H. Kruse Fort Myers, Florida	Board Member Community Foundation of the Lake
Dennis J. Lorch (a) Advance, Missouri	Retired
Dale A. Marlin Naples Florida	Retired
Ronald L. Marrone Pitsberg, Kansas	Co-Owner Family Food Services Corporation
Gary R. Martin Escondido, California	President Marstan Management Corporation
Donald E. Rodriguez (b) Long Beach, California	Executive Director Boys and Girls Club
Stanley R. Smith (c) Oxnard, California	Retired
O. Joel Wallace Merced, California	President Wallace Service Co., Inc.

Name and Location

Principal Business Affiliation

John T. Wuo (d)  
Arcadia, California

President  
Real Estate Agency

(a) Replaced by Thomas G. Allen, effective March 19, 2018

(b) Replaced by Julio A. Da Silva, effective March 19, 2018

(c) Deceased, not replaced

(d) Replaced by Scott W. Hood, effective March 19, 2018

Principal Officers of the Exchange

Name

Title

Ronald G. Myhan (a)

Chief Financial Officer  
and Treasurer

Keith G. Daly (b)

Chief Claims Officer

Robert P. Howard (c)

Claims Executive,  
Head of Claims Shared Services

Timothy P. Felks

Claims Executive,  
Head of Property Claims

(a) Replaced by Thomas S. Noh, effective June 1, 2019

(b) Replaced by Robert P. Howard, effective June 11, 2018

(c) Replaced by Frank A. Carni, effective June 11, 2018

Principal Officers of the Attorney-In-Fact of the Exchange

Name

Title

Jeffrey J. Dailey

President and Chief Executive Officer

Doren E. Hohl

Secretary

## Audit Committee

In 2009, the Farmers Exchanges jointly formed the Exchange Audit Committee. This Committee conforms to the Model Audit Rule and acts as the Audit Committee for the three Exchanges and their subsidiaries. As of December 31, 2017, the seven members serving on the Exchange Audit Committee are as follows:

<b>Name</b>	<b>Exchange</b>	<b>Independent Status</b>
Guy Hanson, Chair	Fire Insurance Exchange Truck Insurance Exchange	Independent
Donald Jue	Farmers Insurance Exchange	Independent
Frederick Kruse	Farmers Insurance Exchange Fire Insurance Exchange	Independent
Dennis Lorch	Farmers Insurance Exchange Fire Insurance Exchange Truck Insurance Exchange	Independent
Dale A. Marlin	Fire Insurance Exchange	Independent
Gary Martin	Farmers Insurance Exchange Truck Insurance Exchange	Independent
Stanley Smith	Farmers Insurance Exchange Fire Insurance Exchange	Independent

## Management Agreements

Attorney-In-Fact Arrangement: Farmers Group, Inc. (FGI), as the Attorney-In-Fact (AIF), provides operating services, including staffing and occupancy to the Exchange. The operating services do not include claims adjustment services, nor do they include the payment of claims, commissions, and the payment of premium and income taxes, all of which are the responsibility of the Exchange. These operating services are provided to

the Exchange by FGI pursuant to Subscription Agreements (Agreements) entered into between FGI and each of the Exchange's individual policyholders. There is no specific management services agreement required between the Exchange and FGI for these services provided.

The compensation to the AIF for these services is derived through membership fees and subscription fees under the terms of these Agreements. In accordance with the Agreements, compensation to the AIF is to be calculated based on a percentage of the insurance premium deposited by the policyholder. The Agreements specify that 20% of the insurance premiums deposited can be charged for Exchange issued policies. Although the Agreements specify 20% of premiums deposited, a review of the actual calculation disclosed that (1) all direct and reinsurance premiums earned by the Exchange are used and (2) the rate used to calculate the compensation has been historically less than 20%. For the period of this examination, the average rate charged for the Farmers Insurance Group was 14.34%, 14.11%, 14.06%, and 13.99% for 2014, 2015, 2016, and 2017, respectively.

Service Agreements: On July 1, 2015, the Exchange and its subsidiaries entered into separate Service Agreements. In accordance with the terms of the agreements, the Exchange provides various services which include policy and premium administration, agents and commissions, including claims adjustment services, accounting and financial reporting services, investment management services, and other administrative services. The Exchange provides these services at a cost, which are allocated in accordance with the methods prescribed in the NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principle (SSAP) No. 70. Allocations occur prior to the Intercompany Reinsurance and Pooling Agreement (see the "REINSURANCE" section of this examination report).

The parties acknowledge that the Exchange shall provide these services either directly or through its attorney-in-fact, agents, representatives or affiliates. However, the Exchange shall continue to be liable at all times. The parties to the Service Agreements are:

Bristol West Casualty Insurance Company	Bristol West Insurance Company
Bristol West Preferred Insurance Company	Civic Property and Casualty Company
Coast National Insurance Company	Exact Property and Casualty Company
Farmers Insurance Company of Arizona	Farmers Insurance of Columbus, Inc.
Farmers Insurance Company of Idaho	Farmers Insurance Company of Oregon
Farmers Insurance Company of Washington	Farmers New Century Insurance Company
Farmers New World Life	Foremost Insurance Company, Grand Rapids, Michigan
Illinois Farmers Insurance Company	Mid-Century Insurance Company
Mid-Century Insurance Company of Texas	Neighborhood Spirit Property and Casualty Company
Security National Insurance Company	Texas Farmers Insurance Company

These Service Agreements were approved by the California Department of Insurance (CDI) on December 9, 2015.

The Exchange charges a portion of the compensation it pays FGI to its subsidiaries based on each company's percentage participation in the Intercompany Reinsurance and Pooling Agreement.

For 2014, 2015, 2016, and 2017, the pooled share of the compensation paid by the Exchange and its subsidiaries to FGI for its services was as follows (including membership, installment, and policy fees):



<u>Company</u>	<u>Compensation Paid to Farmers Group, Inc. (for Exchange Issued Policies)</u>			
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Farmers Insurance Exchange	\$ 1,431,844,943	\$ 1,414,798,318	\$ 1,371,514,957	\$ 1,370,276,762
Truck Insurance Exchange	214,430,885	211,878,009	205,395,960	205,210,530
Fire Insurance Exchange	207,513,760	205,043,235	198,770,284	198,590,835
Mid-Century Insurance Company	442,696,021	437,425,567	424,043,272	423,660,448
Civic Property and Casualty Company	27,668,501	27,339,098	26,502,704	26,478,778
Exact Property and Casualty Company	27,668,501	27,339,098	26,502,704	26,478,778
Neighborhood Spirit Property and Casualty Company	27,668,501	27,339,098	26,502,704	26,478,778
Subtotals	\$ 2,379,491,112	\$ 2,351,162,423	\$ 2,279,232,585	\$ 2,277,174,909
All Other Subsidiaries	387,359,018	382,747,371	371,037,863	370,702,891
Totals - Compensation Paid	\$ 2,766,850,130	\$ 2,733,909,794	\$ 2,650,270,448	\$ 2,647,877,800
Totals - Membership, Installment, and Policy Fees Paid	\$ 94,726,319	\$ 104,002,073	\$ 104,490,270	\$ 101,774,982

As previously noted, the above amounts paid to FGI by the Exchange and its subsidiaries do not include the cost of claims adjustment services, nor do they include the payment of claims, commissions, and the payment of premium and income taxes, all of which are the responsibility of the Exchange and its subsidiaries.

**Service Agreement:** Effective March 1, 2017, the Exchange and FFS Holding, LLC (FFS Holding), entered into a Service Agreement pursuant to which the Exchange will provide, or arrange for the provision of, management, administrative services and facilities to FFS Holding which includes, but is not limited to, marketing, legal services, warehouse and distribution services, audit and training. The Exchange indirectly owns 80% of FFS Holding. The CDI approved this agreement on January 27, 2017.

**Investment Services Agreement:** Effective September 6, 2016, the Exchange entered into an Investment Services Agreement with 21st Century North American Insurance Company (21st CNAIC). Under the terms of the agreement, the Exchange provides or arranges for the provision of investment management services to 21st CNAIC in exchange for an annual fee equal to one-twentieth of one percent (.05%) of net invested assets. The agreement was approved by the CDI on October 19, 2016, and by the New York Department of Financial Services on January 8, 2016.

Service Agreement: On December 21, 2015, the Exchange and Farmers New World Life Insurance Company entered into a Service Agreement pursuant to which the Exchange will provide various services, including advertising and marketing services related to the Farmers brand, training, support and promotion of Farmers agents, billing, and calculating and paying commissions, subsidies and contract values for Farmers agents. This agreement was approved by the CDI on January 13, 2016.

Service Agreement: On July 1, 2015, the Exchange and 21st CNAIC entered into a Service Agreement pursuant to which the Exchange will provide or arrange for the provision of various services to 21st CNAIC, at cost, including, but not limited to, policy administration, producer appointments, records retention, claims adjustment, accounting, reinsurance administration, and regulatory reporting. This agreement was approved by the CDI on December 9, 2015.

Tax Sharing Agreement: Effective September 1, 2013, the Exchange entered into a Tax Sharing Agreement with its various insurance and non-insurance affiliates and subsidiaries. The Exchange is the party primarily responsible for filing and making all tax payments on behalf of the parties to this Agreement. Allocation of taxes is based upon separate return calculations, with intercompany tax balances payable or receivable being settled in amounts equal to the amounts which would be due to or from federal taxing authorities as if separate returns were filed. Intercompany balances are settled monthly, and the final settlement is made within 30 days after the filing date of the consolidated return. The Agreement was approved by the CDI on February 18, 2014. The Exchange's portion of the federal income taxes paid or (recovered) under the agreement for 2014, 2015, 2016, and 2017 was (\$429,490,206), \$151,420,724, (\$60,047,915), and (\$5,938,222), respectively.

Premium Collection and Accounting Agreement: Effective May 22, 2007, the Exchange and Mid-Century Insurance Company of Texas (MCICT) entered into a Premium Collection and Accounting Agreement – HCS 35929. The terms of the agreement provide

for the Exchange to collect premium receipts and provide for appropriate accounting for premiums collected by MCICT. Also, policyholder records will be reconciled daily, and balances will be settled monthly.

Premium Collection and Accounting Agreement: Effective May 22, 2007, the Exchange and Texas Farmers Insurance Company (TFIC) entered into a Premium Collection and Accounting Agreement – HCS 35930. The terms of the agreement provide for the Exchange to collect premium receipts and provide for appropriate accounting for premiums collected by TFIC. Also, policyholder records will be reconciled daily, and balances will be settled monthly.

Service Agreement: Effective April 1, 2001, the Exchange and Farmers Insurance Company, Inc. (FICI), entered into a Service Agreement whereby FICI will provide claims handling and support services for the Exchange at its facilities located in Olathe, Kansas, and Oklahoma City, Oklahoma, and receive compensation on a cost reimbursement basis. Under the terms of this agreement, the Exchange paid \$278,858, \$262,305, \$264,667, and \$386,808 for 2014, 2015, 2016, and 2017, respectively.

Agreements for Adjustment Services: The Exchange entered into separate Agreements for Adjustment Services (Agreements) with the Fire Insurance Exchange and the Truck Insurance Exchange to utilize the services of the employees of the Exchange in the handling of their claims. The method by which the Exchange is compensated for the use of its employees is provided for in the Agreements dated August 25, 1964, which were amended and restated in September 1968 and November 1976.

#### Agreements with Non-Affiliates

Consultancy Agreement: Effective August 12, 2010, the Exchange entered into a Consultancy Agreement with Zurich Services Corporation (ZSC), pursuant to which ZSC provides risk engineering assessment services to the Exchange.

Service Agreement: Effective December 7, 2009, the Exchange entered into a Service Agreement whereby it provides collision claim services for Zurich, Compañía de Seguros, S.A. (Zurich Mexico) policyholders who wish to have their motor vehicles repaired in the United States for losses which occur in Mexico and which are covered by Zurich Mexico's Zmart insurance policies.

Service Agreement: The Exchange provides certain claims adjusting services for the benefit of Zurich American Insurance Company (ZAIC) and its United States affiliated insurers (collectively, Zurich U.S.), pursuant to a Service Agreement entered into between the parties in November 2000. Under this agreement, the Exchange handles, adjudicates, and adjusts Zurich U.S. private passenger auto claims, and is reimbursed for services provided.

Service Agreement: Effective January 1, 1999 the Exchange entered into a Service Agreement which provides marketing, underwriting, reinsurance, operational and related services to the Zurich Personal Insurance business of Maryland Casualty Company, Assurance Company of America, National Standard Insurance Company, Northern Insurance Company of New York, and Universal Underwriters Insurance Company.

Service, Third-Party Administrative, and Managed Care Agreements: ZAIC or its affiliates provide administrative, underwriting, policy issuance and related services to the Exchange, Fire Insurance Exchange (Fire), Truck Insurance Exchange (Truck), and Mid-Century Insurance Company (Mid-Century), in conjunction with the following specific insurance programs:

- Effective September 1, 1998, a Service Agreement was entered into between Universal Underwriters Insurance Company (UUIC) and the Exchange. UUIC underwrites and administers for the Exchange a mechanical Breakdown Insurance Program. The Exchange pays UUIC a reinsurance premium amount which is not contingent on claims experience.

- Effective November 1, 2000 ZSC entered into a Third-Party Administrator Agreement with the Exchange and other affiliates (Truck, Mid-Century, Exact Property and Casualty Company, and Civic Property and Casualty Company, Neighborhood Spirit Property and Casualty). Under this agreement, ZSC provides claims administration and risk engineering services, which are subject to a reinsurance agreement for equipment breakdown coverage provided by ZAIC.
- Effective November 6, 2000, a Managed Care Services Agreement was entered into between ZSC and the Exchange, Fire, Truck, and Mid-Century. Under this agreement, ZSC makes available a provider network and managed care services to the named insured of this agreement.

Investment Management Agreement: FGI, acting on behalf of the Exchanges (Farmers Insurance Exchange, Fire Insurance Exchange, Truck Insurance Exchange, and the subsidiaries of these Exchanges), entered into an Investment Management Agreement with the following third-party advisors to act as the investment manager:

- Deutsche Investment Management Americas, Inc: FGI entered into an Investment Management Agreement dated July 1, 1998 with its affiliate, Scudder Kemper Investments Inc. (Scudder). There have been multiple amendments since then, mostly related to Schedule III, of which the latest is dated April 12, 2011. In 2002, Scudder was acquired and replaced by Deutsche Asset Management (DeAM), and the name changed to Deutsche Investment Management Americas, Inc. (now called DWS Investment Management Americas, Inc. since March 2018) (DWS). DWS, a non-affiliate, manages the fixed income and equity asset portfolios. Fees are based on a sliding scale percentage on the value of the portfolio being managed.
- Clarion Partners, LLC.: FGI entered into an Investment Management Agreement dated October 14, 2014 and amended July 17, 2017 with Clarion Partners, LLC, a non-affiliate, to manage the investment of certain real estate assets.
- Medley SMA Advisors, LLC.: FGI entered into an Investment Management Agreement dated December 14, 2016 with Medley SMA Advisors, LLC, a non-affiliate, to manage the senior loan securities portfolio.
- Prudential Private Placement Investors, L.P.: FGI entered into an Investment Management Agreement dated January 30, 2013, and amended June 9, 2017 with

Prudential Private Placement Investors, L.P., a non-affiliate, to manage the private placement securities portfolio.

- Wells Capital Management, Inc.: FGI entered into an Investment Management Agreement, dated March 6, 2015, with Wells Capital Management, Inc., a non-affiliate, to manage the municipal and tax-exempt securities portfolio.

Service Level Agreement: FGI was also a party to the Service Level Agreement dated November 4, 1998 with Scudder, which was replaced in 2002 by DeAM. DeAM, a non-affiliate, provided accounting and reporting services in connection with the Farmers Exchanges and their stock subsidiaries' investment portfolios, including Securities Valuation Office reporting. DeAM was given the authority to vote the proxies of the common stock. The services under this agreement are no longer provided as of 2015.

#### Related Party Transactions

Revolving Credit Facility Framework Agreement: Effective January 25, 2017, the Farmers Companies, all of whom are affiliate insurers within the Farmers Insurance Holding Company system, became signatories to a Revolving Credit Facility Framework Agreement for the purposes of eliminating the need to maintain large cash balances, or unnecessarily liquidating investments during the monthly reinsurance cash settlement process among participating affiliates.

The revolving credit framework allows participating affiliates to make short-term loans to each other to cover debt arising from the monthly reinsurance settlement process. The loans, executed on an as-needed basis, mature in ninety (90) days, and cannot exceed in the cumulative aggregate three percent (3%) of a borrower's or lenders admitted assets. Loans may be collateralized with a pledge of securities at lender's option, and in any event, must be collateralized if the loan crosses from one calendar year into the next calendar year, such that the loan is secured and perfected as of December 31 of the year the loan was made.

Parties to the agreement will renegotiate the terms of the agreement at least once every three (3) years. The agreement was approved by the CDI on January 18, 2017, pursuant to California Insurance Code (CIC) Section 1215.5(b)(1)(A), as well as by the regulators of the domiciliary states of the Exchange's affiliates outside of California. The parties to the agreement are:

21st Century Advantage Insurance Company	21st Century Assurance Company
21st Century Casualty Company	21st Century Centennial Insurance Company
21st Century Indemnity Insurance Company	21st Century Insurance Company
21st Century National Insurance Company	21st Century North America Insurance Company
21st Century Pacific Insurance Company	21st Century Pinnacle Insurance Company
21st Century Preferred Insurance Company	21st Century Premier Insurance Company
21st Century Security Insurance Company	American Pacific Insurance Company
Bristol West Casualty Insurance Company	Bristol West Insurance Company
Bristol West Preferred Insurance Company	Civic Property and Casualty Company
Coast National Insurance Company	Exact Property and Casualty Company
Farmers Insurance Company, Inc.	Farmers Insurance Company of Arizona
Farmers Insurance of Columbus, Inc.	Farmers Insurance Company of Idaho
Farmers Insurance Company of Oregon	Farmers Insurance Company of Washington
<b>Farmers Insurance Exchange</b>	Farmers Insurance Hawaii, Inc.
Farmers New Century Insurance Company	Farmers Specialty Insurance Company
Farmers Texas County Mutual	Foremost County Mutual Insurance Company
Foremost Insurance Company Grand Rapids, Michigan	Foremost Lloyds of Texas
Foremost Property & Casualty Insurance Company	Foremost Signature Insurance Company
Fire Insurance Exchange	Illinois Farmers Insurance Company
Mid-Century Insurance Company	Mid-Century Insurance Company of Texas
Neighborhood Spirit Property and Casualty Company	Security National Insurance Company
Texas Farmers Insurance Company	Truck Insurance Exchange

Effective January 31, 2017, Mid-Century entered into a promissory note pursuant to the terms of this agreement as a borrower, with the Exchange as a lender for a loan in the amount of \$71.2 million. In addition, on the same date, Truck entered into a promissory note with the Exchange for a loan in the amount of \$45.9 million. All promissory notes related balances were settled within 90 days in 2017 per terms of the underlying agreements. The loan transaction and settlement were consistent with the terms of the agreement and in accordance with CIC Section 1215.5(b)(1)(A).

### TERRITORY AND PLAN OF OPERATION

The Exchange is licensed to transact insurance business in the District of Columbia and the following 47 states:

Alabama	Kentucky	New Jersey	Texas
Arizona	Louisiana	New Mexico	Utah
Arkansas	Maine	New York	Vermont
California	Maryland	North Carolina	Virginia
Colorado	Massachusetts	North Dakota	Washington
Delaware	Michigan	Ohio	West Virginia
Florida	Minnesota	Oklahoma	Wisconsin
Georgia	Mississippi	Oregon	Wyoming
Idaho	Missouri	Pennsylvania	
Illinois	Montana	Rhode Island	
Indiana	Nebraska	South Carolina	
Iowa	Nevada	South Dakota	
Kansas	New Hampshire	Tennessee	

In 2017, the Exchange wrote \$4.4 billion of direct premiums. Of the direct premiums written, \$2.1 billion (47.8%) was written in California, \$441 million (9.9%) was written in Colorado, \$181 million (4.1%) was written in Michigan, and \$1.7 billion (38.2%) was written in the remaining states.

The homeowner multiple peril (33.3%), private passenger automobile liability (31.2%), automobile physical damage (19.4%) and the commercial multiple peril lines (10.1%) account for 94% of the direct writings of the Exchange. The Exchange is also the lead insurer in the Intercompany Reinsurance and Pooling Agreement (Pooling Agreement), with a 51.75% participation. The Exchange and its pooled subsidiaries and affiliates write most of the property and casualty lines of business, with a heavy emphasis on personal lines.

Business is produced by an agency force of more than 48,000 agents (including nearly 13,800 exclusive agents), and is supported by 15 territory offices, 5 service operation segments, and 11,000 claims employees.

On March 1, 2018, the Exchange entered into an Insurance Program Agreement (Agreement) with Rasier, LLC (Uber), to provide commercial automobile insurance protection for Uber and their independent contractor drivers, while engaging in official company ridesharing activities in the states of Georgia and Pennsylvania. Insurance coverage provided by the Exchange includes commercial automobile liability, commercial



automobile physical damage, and related coverages for Uber, its affiliates, and independent contractors, utilizing digital networks operated by Uber.

Concurrent with this Agreement, also effective March 1, 2018, the Exchange entered into a quota share agreement with Aleka Insurance, Inc. (Aleka), to cede 30% of the underwritten policies issued to Uber.

### LOSS EXPERIENCE

The following schedule reflects the net underwriting and net investment results along with the net income and losses as reported by the Exchange in its financial statements for the years under examination and through December 31, 2018:

Year	Net Premiums Written	Net Underwriting Gains/(Losses)	Net Investment Gains/(Losses)	Net Income/(Losses)
2014	\$ 7,277,238,577	\$ (126,589,478)	\$ 83,518,330	\$ 2,472,316
2015	7,726,634,444	(216,237,919)	75,940,826	(113,670,348)
2016	7,639,250,510	(393,112,964)	45,877,088	(147,946,539)
2017	7,340,602,729	(221,277,131)	53,308,206	(65,414,126)
Sub-totals	\$ 29,983,726,260	\$ (957,217,492)	\$ 258,644,450	\$ (324,558,697)
2018	7,160,925,814	(109,252,076)	45,729,708	(70,475,902)
Totals	<u>\$ 37,144,652,074</u>	<u>\$(1,066,469,568)</u>	<u>\$ 304,374,158</u>	<u>\$ (395,034,599)</u>

The Exchange reported net underwriting losses in all years under examination and through December 31, 2018. In aggregate, the Exchange reported \$1.1 billion of net underwriting losses for the five years from 2014 through 2018. Also, as noted, the Exchange reported net losses in four of the last five years.

Underwriting performance deteriorated during the intervening years subsequent to the prior examination in 2013 due to several factors, mainly because of the heightened susceptibility to the industry-wide catastrophe losses that significantly impacted the

Exchange's property lines. Weather and storm-related catastrophe losses added an average of over 6.0 percentage points to the Exchange's overall combined ratios reported during the years subsequent to the prior examination.

Another factor for the poor underwriting performance experienced in recent years was principally the result of higher severity and frequency in non-catastrophe related activities that impacted the industry as a whole, driven primarily by loss trends in personal lines automobile, which management believes is due to higher vehicle miles traveled, distracted drivers, and an improved economy (newer cars on the road). Lower gas prices and more miles driven have also contributed to higher losses paid, along with adverse loss development in the prior accident years.

Also contributing to increased underwriting losses was the strengthening of reserves on defense and cost containment costs due to relatively higher litigation and attorney costs incurred, as well as higher adjusting and other expenses incurred to indemnify and settle claims.

Lastly, increased other expenses in 2017 partially resulting from the seed money expended to support the expansion of the Farmers brand and products to states in the eastern third of the country, including Florida and South Carolina, as well as increased advertising and other operating costs during 2017.

Net underwriting losses totaled \$109.3 million in 2018 compared to an underwriting loss of \$221.3 million in 2017, representing an underwriting loss reduction of \$112.0 million between years, primarily due to rate and underwriting actions.

In addition to the net investment gains of \$258.6 million noted above, the Exchange has maintained its surplus as regards policyholders for the period covered by this examination primarily through unrealized capital gains of \$578.8 million, changes in its surplus notes of \$148.1 million, and changes in its non-admitted assets of \$99.3 million. The majority

(approximately 85%) of the unrealized capital gains are attributable to common stocks of affiliates.

## REINSURANCE

### Intercompany Reinsurance and Pooling Agreement

The Exchange is the lead insurer in an Intercompany Reinsurance and Pooling Agreement (Pooling Agreement), under which the insurers listed below pool their risks and obtain a proportional share of profits and/or losses of the pooled business. The Pooling Agreement became effective on January 1, 1999. Under the Pooling Agreement, business is allocated among the pool participants as follows:

<u>Pool Participant</u>	<u>Percentage</u>
<b>Farmers Insurance Exchange (Lead Insurer)</b>	<b>51.75</b>
Mid-Century Insurance Company	16.00
Truck Insurance Exchange	7.75
Fire Insurance Exchange	7.50
Farmers Insurance Company of Oregon	7.00
Farmers Insurance Company of Washington	2.00
Civic Property and Casualty Company	1.00
Exact Property and Casualty Company	1.00
Neighborhood Spirit Property and Casualty Company	1.00
Texas Farmers Insurance Company	1.00
Farmers Insurance of Columbus, Inc.	1.00
Farmers Insurance Company, Inc.	0.75
Illinois Farmers Insurance Company	0.75
Farmers New Century Insurance Company	0.75
Farmers Insurance Company of Idaho	<u>0.75</u>
<b>Total</b>	<u>100.00</u>

The last amendment to this long-standing Pooling Agreement was approved by the California Department of Insurance (CDI) on January 12, 1999.

## Assumed

Through a combination of affiliated Fronting or Reinsurance Indemnity Agreements, and a series of long-standing 100% affiliated Reinsurance Assumption Agreements, all of the business written in certain affiliated property and casualty companies not participating in the Pooling Agreement is ceded to the Exchange. The ceding companies not participating in the Pooling Agreement are as follows: Farmers Insurance Company of Arizona, Mid-Century Insurance Company of Texas, Farmers Texas County Mutual Insurance Company, the Foremost Group, the Bristol West Group, and the 21st Century Group of companies.

In addition, there are also a series of affiliated 100% Quota Share Reinsurance Agreements under which the Exchange reinsures Bristol West Casualty Insurance Company, Bristol West Preferred Insurance Company, Bristol West Insurance Company, Coast National Insurance Company, and Security National Insurance Company (Bristol West Group).

Effective January 1, 2000, and amended on December 31, 2010, the Exchange entered into a 100% Quota Share Reinsurance Agreement with its affiliate, Foremost Insurance Company, Grand Rapids, Michigan (Foremost), wherein Foremost cedes to the Exchange 100% of its in-force business as of the effective date, and 100% of its new and renewal business after the effective date.

Effective June 30, 2009, the Exchange entered into a 100% Quota Share Reinsurance Agreement with its affiliate, 21st Century North America Insurance Company (21CNAIC). Pursuant to the agreement, 21CNAIC cedes to the Exchange 100% of the pooled premiums with respect to its in-force, new and renewal insurance, and reinsurance contracts covering business earned on or after the effective date, and 100% of its obligations for losses incurred with respect to such contracts on or after the effective date.

In addition, effective January 1, 1999, the Exchange reinsured all of the Zurich Insurance Company's (ZIC) personal lines insurance business. This includes policies of Maryland Casualty Company (MCC), and business ceded to MCC by its affiliates. Effective September 7, 2004, this reinsurance assumption agreement was amended to carve out Antique Automobile and Modified Automobile policies ceded to the Exchange, and cede such policies to Foremost.

Lastly, the Exchange maintains certain 100% fronting quota share agreements, which are historically long-standing reinsurance agreements with affiliates initiated variously between 1950 and 1995, and by which all the property business it writes is ceded prior to the Pooling Agreement to Fire Insurance Exchange (Fire). Similarly, all of its commercial business is ceded to Truck Insurance Exchange (Truck) under these treaties. The only exception is that Texas Farmers Insurance Company cedes its property business directly to Fire, and its commercial business directly to Truck. Fire and Truck, then, retrocede 100% of this business back to the Exchange, in accordance with the Pooling Agreement.

As a result of the above Pooling Agreement and the reinsurance assumed agreements, the Exchange assumed 100% of the business written by all members of the Farmers Group of companies prior to the retrocession to all the pool participants.

#### Ceded - Affiliated

Automobile Physical Damage Reinsurance Agreement (APD Agreement): A quota share reinsurance agreement, which has been amended over the years, and initially entered into on April 1, 2001 between the Exchange, Farmers Reinsurance Company (Farmers Re), and ZIC. Under the APD Agreement, the Exchange, on behalf of itself and its pooling participants, cedes up to \$1 billion per year of its automobile physical damage premiums. Through December 31, 2014, the subscribing reinsurers were Farmers Re, with a 10% quota share participation, ZIC, with an 80% quota share participation and Swiss Reinsurance Company Ltd. (Swiss Re), a third-party reinsurer, assuming the remaining

10%. Effective January 1, 2015, Farmers Re reduced its quota share participation to 7.14%, ZIC decreased its participation to 64.29%, and Swiss Re increased its participation to 28.57%. The APD Agreement was not renewed in 2016 and all recoveries and prior year's business in run-off were settled in 2017.

All Lines Quota Share Reinsurance Agreement (ALQS Agreement): Effective December 31, 2002, the Exchange, on behalf of itself and its pooling participants, began participating in an ALQS Agreement with Farmers Re and ZIC, which has been amended over the years. The ALQS Agreement covers all lines after the APD Agreement has been applied. The aggregate participation percentage was originally at 10% in 2002, and through amendments approved by the California Department of Insurance (CDI), the aggregate participation percentage and participants have varied over the years. The following are the amendments during the examination period:

- Effective December 31, 2014, the aggregate participation percentage was decreased by 6% from 20% to 14%. Farmers Re reduced its participation to 1.0% and ZIC to 9.0%. In addition to this change, Swiss Re replaced Swiss Reinsurance America Corporation with a participation percentage of 4.0%. The CDI approved this amendment on March 26, 2015.
- Effective December 31, 2015, the aggregate participation percentage was increased by 6% from 14% to 20%. Farmers Re was removed as a participant and Transatlantic Reinsurance Company (Trans Re) and Ariel Re Bermuda Limited (Ariel Re) were added as participants at 4.0% and 1.0%, respectively. In addition, ZIC and Swiss Re changed their participation to 8% and 7%, respectively. The CDI approved this amendment on May 3, 2016.
- Effective December 31, 2016, the participation percentage was increased by 4% from 20% to 24%. In addition, Hannover Rueck SE (Hannover Re) and Catlin Reinsurance Switzerland Limited (Catlin Re) were added as new participants at 2% each. The CDI approved this amendment on September 26, 2017.
- Effective December 31, 2017, the participation percentage was increased by 5% from 24% to 29%. In addition, ZIC was removed as a participant, and Farmers Re and Munich Reinsurance America, Inc., were added as 1% and 5% participants, respectively. In addition, Hannover Re and Catlin Re increased their participation

to 7% and 4%, respectively. The CDI approved this amendment on March 19, 2018.

- Effective December 31, 2018, Trans Re decreased its participation percentage from 4% to 3.5%, and Catlin Re increased its participation percentages from 4% to 4.5%. The overall participation remains at 29% with all other participating reinsurers' percentages remaining the same. The CDI approval of this amendment is still pending.

There are also a series of 100% Equipment Breakdown Quota Share Reinsurance Agreements effective November 1, 2000, under which Zurich American Insurance Company reinsures the Exchange and certain of its affiliates for specified industry programs.

#### Ceded - Non-affiliated

##### Catastrophe Reinsurance

On a catastrophe per occurrence excess of loss basis, the Exchange retains the first \$200 million of loss after satisfying a \$100 million annual aggregate deductible. Coverage is in place up to \$2.5 billion in all states. The residential book in Florida has additional coverage purchased from the Florida Hurricane Catastrophe Fund currently estimated as \$133 million, excess of an \$8 million retention.

On a catastrophe aggregate basis, the Exchange has \$700 million of coverage, split into two \$350 million limits that attach at \$1.3 billion and \$1.85 billion retentions, net of the catastrophe per occurrence excess of loss reinsurance and a per-event deductible, that is either \$1.0 million or \$5.0 million, depending on whether the event is recognized by Property Claims Service.

The following is a summary of the in-force catastrophe treaties ceding risks to non-affiliated reinsurers that were written with the Exchange and all of its subsidiaries and

affiliates (excluding Farmers Reinsurance Company) as the cedents as of December 31, 2017:

<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
Underlying Property Catastrophe Excess of Loss	Renaissance Reinsurance Limited (20.47%)  Lloyd's Underwriters (17.13%)  Various Reinsurers (54.90%)	\$200 million per occurrence	92.50% of \$200 million excess of \$200 million, and excess of \$100 million annual aggregate deductible (AAD) retention per occurrence, subject to a maximum aggregate recovery of \$600 million during the term of the contract;  Coverage for property located in all states
Property Catastrophe Second Excess of Loss	Lloyd's Underwriters (20.49%)  Aspen Bermuda Limited (10.00%)  Various Reinsurers (59.51%)	\$400 million per occurrence	Coverage A: 90.0% of \$600 million excess of \$400 million per occurrence;  Coverage B: 90.0% of \$600 million excess of \$200 million excess of \$700 million on the underlying \$200 million excess of \$200 million excess of \$100 million retention per occurrence, subject to a maximum aggregate recovery of \$1.2 billion during the term of the contract
Property Catastrophe Third Excess of Loss	Lloyd's Underwriters (23.62%)  Everest Reinsurance Company (9.00%)  Various Reinsurers (61.38%)	\$1 billion per occurrence	Coverage A: 94.0% of \$500 million excess of \$1 billion per occurrence;  Coverage B: 94.0% of \$500 million excess of \$1.2 billion on \$600 million excess of \$400 million-layer, excess of \$700 million on the underlying \$200 million excess of \$200 million excess of \$100 million retention per occurrence,



<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
			subject to a maximum aggregate recovery of \$1 billion during the term of the contract
Property Catastrophe Fourth Excess of Loss	Lloyd's Underwriters (8.95%) Swiss Reinsurance America Corporation (7.50%) Various Reinsurers (77.30%)	\$1.5 billion per occurrence	93.75% of \$250 million excess of \$1.5 billion retention per occurrence, subject to a maximum aggregate recovery of \$500 million during the term of the contract
Property Catastrophe Fifth Excess of Loss	Lloyd's Underwriters (9.60%) Everest Reinsurance Company (5.00%) Various Reinsurers (31.65%)	\$1.75 billion per occurrence	Coverage A: 46.25% of \$250 million excess of \$1.75 billion per occurrence;  Coverage B: 46.25% of \$250 million excess of \$1 billion on \$500 million excess of \$1.5 billion layer, excess of \$1 billion on \$500 million excess of \$1 billion layer, excess of \$1.2 billion on \$600 million excess of \$400 million layer, excess of \$700 million on the underlying \$200 million excess of \$200 million excess of \$100, subject to a maximum aggregate recovery of \$500 million during the term of the contract
Property Catastrophe Sixth Excess of Loss	Fidelis Insurance Bermuda Limited (34.33%) Lancashire Insurance Company (U.K) Limited (18.67%) Various Reinsurers (39.50%)	\$2 billion per occurrence	92.50% of \$150 million excess of \$2 billion retention per occurrence, subject to a maximum aggregate recovery of \$300 million during the term of the contract
Property Catastrophe	Lloyd's Underwriters (16.57%)	\$2 billion per occurrence	92.50% of \$350 million excess of \$2.15 billion, subject to a maximum

<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
Aggregate Excess of Loss	Everest Reinsurance Company (8.57%)  Various Reinsurers (67.36%)		aggregate recovery of \$700 million during the term of the contract

As noted under the "Surplus Loan Note Facility" caption in this examination report, the Exchange has an additional \$500 million of capital available to cover catastrophic losses. The catastrophic losses/events include (1) weather-related losses to insured properties located in any of the contiguous 48 states and the District of Columbia or (2) wild fire and/or fires following an earthquake, but only for losses to insured properties located in California. The current attachment point for this additional facility is \$2.5 billion. The Exchange has not borrowed against the current or prior lines of credit on this facility.

For 2017 calendar year catastrophe losses, the total gross and net losses for the Farmers Insurance Group (Group) were \$3.1 billion and \$1.4 billion, respectively. Under the Intercompany Reinsurance and Pooling Agreement, the Exchange's participation is 51.75% of the pooled losses. As such, the Exchange's share of the Group's net catastrophe losses for 2017 was \$724.5 million.

### Other Reinsurance

Other reinsurance treaties ceding risks to non-affiliated reinsurers were written with the Exchange and all of its subsidiaries and affiliates as the cedents. The following is a summary of the principal non-affiliated ceded reinsurance treaties in-force as of December 31, 2017:

<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
Multiple Lines Excess of Loss (Property, Commercial Liability,	Layer 1: Lloyd's Underwriters (60.50%)	Layer 1: \$7.5 million per occurrence	Layer 1:100% of \$17.5 million excess of \$7.5 million, subject to \$17.5 million in occurrence limit and

<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
and Workers' Compensation)	Hannover Ruck SE (12.00%) Various Reinsurers (27.50%)  Layer 2: Lloyd's Underwriters (65.75%) Hannover Ruck SE (10.00%) Various Reinsurers (14.25%) Layer 3: Lloyd's Underwriters (69.50%) Hannover Ruck SE (10.00%) Various Reinsurers (10.50%)  Safety National Casualty Corporation (90.00%)	Layer 2: \$25 million per occurrence  Layer 3: \$50 million per occurrence  Workers' Compensation per person \$7.5 million per occurrence	terrorism sub-limit, and \$87.5 million annual treaty aggregate  Layer 2: 90% of \$25 million excess of \$25 million, subject to \$25 million in occurrence limit and terrorism sub-limit, and \$75 million annual treaty aggregate  Layer 3: 90% of \$50 million excess of \$50 million, subject to \$50 million in occurrence limit and terrorism sub-limit, and \$100 million annual treaty aggregate  Workers' Compensation Per Person: 90% of \$17.5 million excess of \$7.5 million, subject to \$35 million annual treaty aggregate
Equipment Breakdown Coverage 100% Quota Share	Factory Mutual Insurance Company (100%)	\$0	100% quota share up to \$100 million
Commercial Independent Agency Quota Share	Hannover Ruck SE (100%)	Variable quota share, net of All Lines Quota Share Treaty	Variable quota share, net of All Lines Quota Share Treaty
Cyber Liability Insurance Quota Share	Lloyd's Underwriters Syndicate No. 2623 (82.0%)  Lloyd's Underwriters Syndicate No. 0623 (18.0%)	Underwriting Year 1: 35% quota share  Underwriting Year 2: 40% quota share  Underwriting Year 3: 50% quota share	Underwriting Year 1: 65% quota share  Underwriting Year 2: 60% quota share  Underwriting Year 3: 50% quota share
General Liability and Liquor Liability Excess of Loss	General Reinsurance Corporation (100%)	\$500,000 per occurrence	100% of \$1.5 million excess of \$500 million retention per occurrence, subject to a

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
			maximum aggregate recovery of \$6 million during the term of the contract
Commercial Automobile Underlying Excess of Loss	Lloyd's Underwriters (86.25%) Aspen Insurance UK Limited (8.00%) Various Reinsurers (5.75%)	\$1 million per policy	100% of \$6.5 million excess of \$1 million retention per policy, subject to a maximum aggregate recovery of \$19.5 million for all events discovered during the term of the contract; and a maximum aggregate recovery of \$13 million for all events discovered during the extended discovery period

Effective July 1, 2016, the Exchange and certain Farmers companies entered into a quota share reinsurance agreement with Hannover Ruck SE (Hannover), a third-party reinsurer domiciled in Germany. This agreement provided for a cession of the quota share of the premiums written and the ultimate net losses sustained in all of the commercial independent agency block of business written by Farmers P&C Companies, after the all lines quota share reinsurance agreement has been applied. This agreement was terminated effective January 1, 2018 on a cut-off basis. Upon termination of the agreement, unearned premiums totaling \$70.1 million were transferred by Hannover to the Exchange. In addition, the Exchange remitted \$34.4 million of reinsurance commissions to Hannover Re, for acquisition expenses, due to the cancellation of this agreement.

As of December 31, 2017, reinsurance recoverables for all ceded reinsurance totaled \$17.6 billion, or 418% of surplus as regards policyholders. Of the reinsurance recoverables, 71.4% were from admitted affiliates, primarily resulting from the Intercompany Reinsurance and Pooling Agreement in which the Exchange is the lead insurer.

Included in the \$17.6 billion were recoverables from Swiss Re, a certified reinsurer, totaling \$1.2 billion (7.0%). Swiss Re placed \$134.9 million, or approximately 11% of its net reinsurance payables due the Exchange, in a multiple beneficiary trust, which satisfied a certified reinsurer status with a rating of secure 2 (10% collateral) requirement for allowing the Exchange to take full (100%) credit on the \$1.2 billion reinsurance recoverables due from Swiss Re.

#### New Reinsurance Agreements in 2018

On January 1, 2018, the Exchange and certain Farmers insurance companies entered into a two-year personal umbrella quota share and excess of loss reinsurance agreement with various third-party reinsurers, in which General Reinsurance Corporation is the lead reinsurer. The other subscribing reinsurers are Hannover, Swiss America Reinsurance Corporation, and Everest Reinsurance Bermuda Limited, each with varying participating percentages. Under this agreement, the Exchange cedes 100% of its personal umbrella exposure above \$500,000 for each and every loss, with all losses in excess of \$500,000 fully reinsured up to \$21 million. In addition, the agreement provides for the cession of 75.0% of all losses within the first \$500,000 and below.

As noted in this examination report under the “TERRITORY AND PLAN OF OPERATION” section, the Exchange entered into an Insurance Program Agreement (Agreement) with Rasier, LLC (Uber) on March 1, 2018, to provide commercial auto insurance protection for Uber and their independent contractor drivers. Concurrent with this Agreement, also effective March 1, 2018, the Exchange entered into a quota share agreement with Aleka Insurance, Inc. (Aleka) to cede 30% of the underwritten policies issued to Uber.

#### ACCOUNTS AND RECORDS

California Insurance Code (CIC) Section 734 requires that every company or person from whom information is sought, and its officers, directors, employees, and agents, shall

provide to the examiners appointed pursuant to this article, timely, convenient, and free access at all reasonable hours at its offices to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the company being examined. During the course of this examination, the examiners were not provided full access to all of the information requested from the Exchange. It is recommended that the Exchange adhere to CIC Section 734 by providing full access to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the companies being examined and implement procedures to ensure future compliance with CIC Section 734.

### FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Exchange with the California Department of Insurance and present the financial condition of the Exchange for the period ending December 31, 2017. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements.

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	\$ 4,083,253,181	\$	\$ 4,083,253,181	
Common stocks	5,364,773,532	127,221	5,364,646,311	
Real Estate:				
Properties occupied by the Company	56,688,589		56,688,589	
Properties held for production of income	311,246,274		311,246,274	
Properties held for sale	174,797		174,797	
Cash, cash equivalents and short-term investments	293,614,289		293,614,289	
Other invested assets	229,256,136		229,256,136	
Investment income due and accrued	39,820,190	124	39,820,066	
Uncollected premiums and agents' balances in course of collection	254,247,030	35,535,079	218,711,951	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	3,002,377,162		3,002,377,162	
Accrued retrospective premiums	569,240		569,240	
Amounts recoverable from reinsurers	966,062,415		966,062,415	
Current federal and foreign income tax recoverable and interest thereon	614,119,577		614,119,577	
Net deferred tax asset	231,474,903			
9,379,275	222,095,628	(1)		
Guaranty funds receivable or on deposit	248,288		248,288	
Electronic data processing equipment and software	6,777,114	6,777,114		
Furniture and equipment; including health care delivery assets (\$0)	33,327,328	33,327,328		
Receivable from parent, subsidiaries, and affiliates	211,434,560		211,434,560	
Aggregate write-ins for other than invested assets	<u>691,800,030</u>	<u>141,350,774</u>	<u>550,449,256</u>	
 Total assets	 <u>\$16,391,264,635</u>	 <u>\$226,496,915</u>	 <u>\$16,164,767,720</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 4,716,533,410	(2)
Reinsurance payable on paid loss and loss adjust. Expenses			1,199,075,953	
Other expenses			13,322,559	
Taxes, licenses and fees			15,174,401	
Unearned premiums			2,855,212,508	
Advance premiums			73,734,343	
Ceded reinsurance premiums payable			455,674,031	
Funds held by Company under reinsurance treaties			2,604,151,127	
Amounts withheld or retained by Company for account of others			392,805	
Remittances and items not allocated			39,658,893	
Provision for reinsurance			60,808	
Payable to securities			3,413,032	
Aggregate write-ins for liabilities			<u>(14,741,156)</u>	
 Total liabilities			 11,961,662,714	
 Surplus notes		\$1,993,536,999		
Unassigned funds (surplus)		<u>2,209,568,007</u>		
Surplus as regards policyholders			<u>4,203,105,006</u>	
 Total liabilities, surplus and other funds			 <u>\$16,164,767,720</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$7,514,579,950
Deductions:		
Losses incurred	\$ 4,493,392,919	
Loss adjustment expenses incurred	766,338,681	
Other underwriting expenses incurred	2,477,128,942	
Aggregate write-ins for underwriting deductions	<u>(1,003,461)</u>	
Total underwriting deductions		<u>7,735,857,081</u>
Net underwriting loss		(221,277,131)

Investment Income

Net investment income earned	\$ 38,094,143	
Net realized capital gains	<u>15,214,063</u>	
Net investment gain		53,308,206

Other Income

Net loss from agents' or premium balances charged off	\$ (44,898,281)	
Finance and service charges not included in premiums	108,041,810	
Aggregate write-ins for miscellaneous income	<u>(68,239,797)</u>	
Total other income		<u>(5,096,268)</u>
Net income before dividends to policyholders and before federal and foreign income taxes		(173,065,193)
Dividends to policyholders		347,996
Net income after dividends to policyholders but before federal and foreign income taxes		(173,413,189)
Federal and foreign income taxes incurred		(107,999,063)
Net loss		<u>\$ (65,414,126)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2013		\$4,218,839,820
Net loss	\$ (65,414,126)	
Change in net unrealized capital gains less capital gains tax	142,666,812	
Change in net deferred income tax	(188,153,337)	
Change in non-admitted assets	106,240,197	
Change in provision for reinsurance	(58,447)	
Change in surplus notes	(11,000,000)	
Aggregate write-ins for gains and losses in surplus	<u>(15,913)</u>	
Change in surplus as regards policyholders for the year		<u>(15,734,814)</u>
Surplus as regards policyholders, December 31, 2017		<u>\$4,203,105,006</u>



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

Surplus as regards policyholders, December 31, 2013 per Examination			\$3,879,721,103
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net loss	\$	\$ 324,558,697	
Change in net unrealized capital gains less capital gains tax	578,810,249		
Change in net deferred income tax		181,027,856	
Change in non-admitted assets	99,283,196		
Change in provision for reinsurance		9,695	
Change in surplus notes	148,064,999		
Cumulative effect of changes in accounting principles		4,187,091	
Aggregate write-ins for gains and losses in surplus	<u>7,008,798</u>		
Total gains and losses	<u>\$ 833,167,242</u>	<u>\$ 509,783,339</u>	
Net increase in surplus as regards policyholders			<u>323,383,903</u>
Surplus as regards policyholders, December 31, 2017, per Examination			<u>\$4,203,105,006</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Net Deferred Tax Asset:

The Tax Cuts and Jobs Act (H.R.1) was enacted into law on December 22, 2017. The Exchange re-valued the deferred tax assets and liabilities from a 35% corporate tax rate to the enacted 21% corporate tax rate at December 31, 2017. The re-valuation resulted in a decrease in net admitted deferred tax assets amounting to \$148.1 million and is reflected as a direct charge to surplus in the appropriate categories in the accompanying financial statements.

### (2) Losses and Loss Adjustment Expenses

Since the business of the Exchange was pooled, it was necessary to review the losses and loss adjustment expenses on a group-wide basis. Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Exchange's loss and loss adjustment expense reserves as of December 31, 2017 were found to be reasonably stated and have been accepted for purposes of this examination.

## SUBSEQUENT EVENTS

### Contribution of 21st Century Subsidiaries

On April 1, 2018, the Exchange, Fire Insurance Exchange, and Truck Insurance Exchange contributed 100% of their ownership interest in the 21st Century subsidiaries to their subsidiary, Mid-Century Insurance Company. This non-cash transaction was accounted for as a reorganization and change in ownership interest in all of the 21st Century subsidiaries.

The restructuring transaction qualified for an exemption to the Form A requirements under California Insurance Code Section 1215.2(g), and the exemption was granted by the California Department of Insurance on February 27, 2018. Following is a summary of the transfer/cost of the acquired equity for each of the acquired entities:

<b>Acquired Entity</b>	<b>Transfer/Cost of Acquired Equity</b>
21st Century North America Insurance Company and its subsidiaries	\$ 364,934,606
21st Century Assurance Company	49,764,837
21st Century Pacific Insurance Company	33,846,757
21st Centennial Insurance Company and its subsidiaries	303,797,480
Farmers Insurance of Hawaii, Inc. and its subsidiaries	61,674,560
21st Century Insurance Group and its subsidiaries	771,815,822
<b>Totals</b>	<u>\$ 1,585,834,062</u>

### Catastrophe Losses in 2018

#### Camp and Woolsey Fires

In November 2018, Camp and Woolsey fires had a major impact on Farmers Insurance Group (Group). The Camp Fire was the deadliest and most destructive fire in California history. The gross loss for the Group from the Camp and Woolsey fires was \$2.1 billion, and a net loss of \$324.8 million was recorded as of December 31, 2018. Under the Intercompany Reinsurance and Pooling Agreement, the Exchange's participation is 51.75% of the pooled losses. As such, the Exchange's share of the net loss was \$168.1 million.

#### All Catastrophe Losses

The gross and net losses for all catastrophes in the 2018 calendar year (including the Camp and Woolsey fires) were \$3.3 billion and \$1.3 billion, respectively. Under the Intercompany Reinsurance and Pooling Agreement, the Exchange's participation is

51.75% of the pooled losses. As such, the Exchange's share of the Group's gross and net catastrophe losses was \$1.7 billion and \$685.2 million, respectively.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records (Page 42): It is recommended that the Exchange adhere to California Insurance Code (CIC) Section 734 by providing full access to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the companies being examined and implement procedures to ensure future compliance with CIC Section 734.

### Previous Report of Examination

Corporate Records (Page 22): It was recommended that the Exchange implement procedures to ensure future compliance with CIC Section 735. The Exchange has complied with this recommendation.

Accounts and Records (Page 34): It was recommended that the Exchange continue to address the recommendations made regarding its information systems controls. The Exchange continues to address these recommendations.

ACKNOWLEDGMENT

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

Respectfully submitted,

/S/ \_\_\_\_\_

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/S/ \_\_\_\_\_

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