REPORT OF EXAMINATION

OF THE

FARMERS REINSURANCE COMPANY

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 REINSURANCE COMPANY

(hereinafter also referred to as the Company) at its former administrative office located at 4680 Wilshire Boulevard, Los Angeles, California 91010. The Company'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 Company. The previous examination of the Company was made as of December 31, 2013. This examination covers the period from January 1, 2014 through December 31, 2017.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Company’s financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. 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 Company 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 Company's financial statements.

This examination report includes findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Company.

This examination was a coordinated examination with California as the lead state of the Farmers Insurance Exchange subgroup of the Farmers Insurance Group of companies. The coordinated group examination also included the Company, which is part of the Zurich Group.

COMPANY HISTORY

The Company was organized on August 21, 1997 and commenced business on December 30, 1997. The Company is 100% owned by Farmers Group, Inc. (FGI).

Capitalization, Dividends, and Capital Contributions

At year-end 2013, the Company had 3,750,000 shares of $100 par value common stock authorized of which 50,000 shares were issued and outstanding. The Company also had 3,750,000 shares of $100 par value preferred stock authorized of which 538,000 shares were issued and outstanding.

In December 2014, the Company issued, in cash, ordinary dividends in the amount of $94,968,638 to FGI.

In December 2015, the Company issued, in cash, extraordinary dividends in the amount of $216,000,000 to FGI and redeemed the 538,000 shares of the preferred stock from FGI at $500 per share in cash for $269,000,000. The redemption of preferred stock was recorded as a reduction of paid-in capital of $53,800,000 (538,000 preferred shares at $100 par value) and a reduction of a paid-in surplus of $215,200,000. The extraordinary dividend and the redemption of the preferred capital stock were approved by the California Department of Insurance (CDI) on October 30, 2015.

In December 2016, the Company issued in cash, extraordinary dividends in the amount of $400,000,000 to FGI. $340,400,000 of this extraordinary dividend represented the return of gross paid in capital. This transaction was recorded as a reduction of a paid-in surplus of $340,400,000 and a dividend to stockholders of $59,600,000. The CDI approved this extraordinary dividend on November 3, 2016.

As of year-end 2017, the Company continues to have 3,750,000 shares of $100 par value common stock authorized of which 50,000 shares were issued and outstanding, but no longer has preferred stock authorized or outstanding.

As noted in the financial statements included in this examination report, the Company's surplus decreased by $872.2 million for the period of this examination. The decrease was primarily due to capital changes driven by a redemption of preferred stock ($53.8 million), surplus adjustments relating to return of paid-in capital ($555.6 million), and dividends ($370.6 million).

On December 13, 2018, the Company received $150 million in cash as an additional capital contribution from FGI.

MANAGEMENT AND CONTROL

As of December 31, 2017, the Company is 100% owned and managed by Farmers Group, Inc. (FGI), a Nevada holding company. 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:

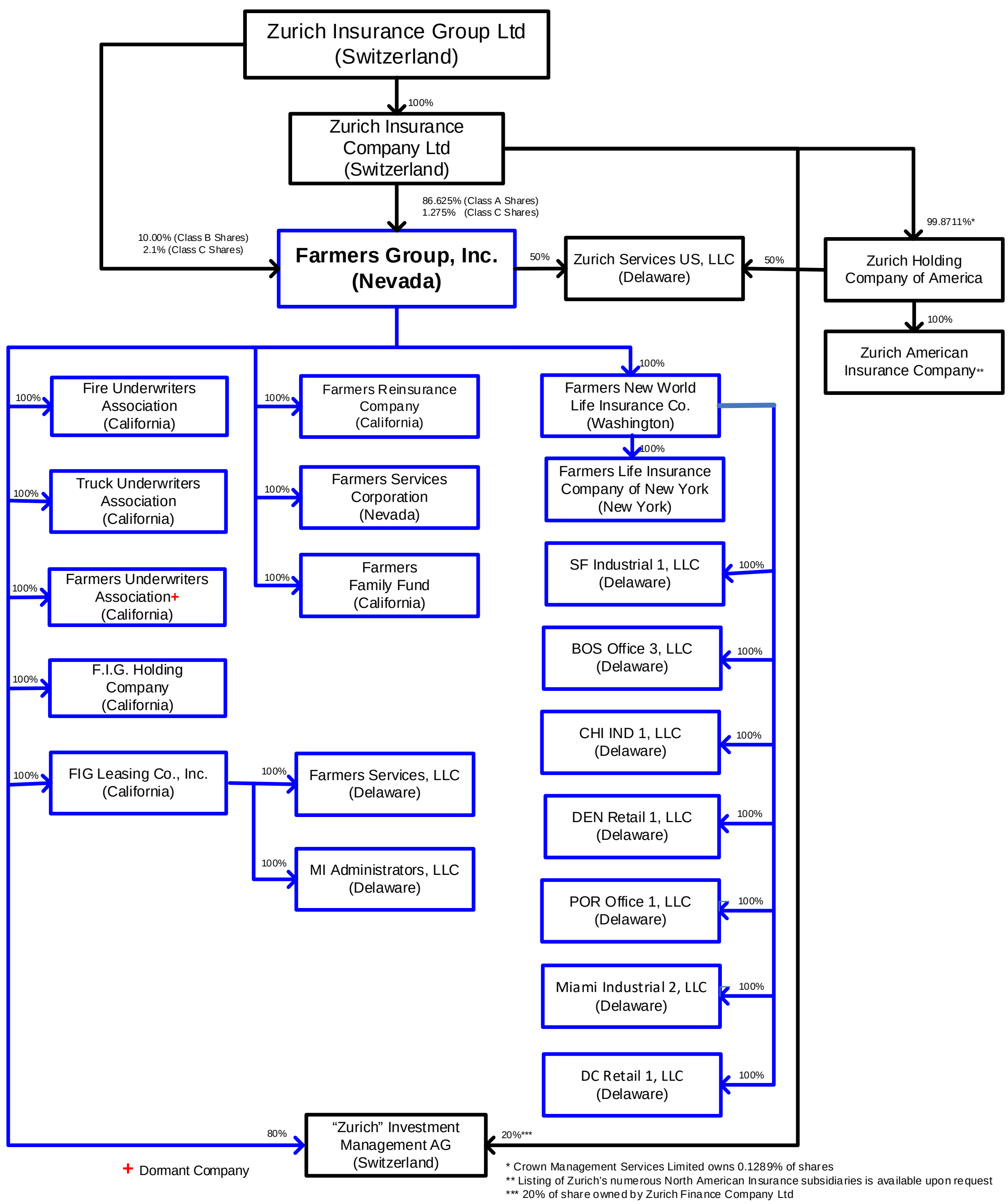
- Class A shares, representing 86.625% of the voting rights, are held by Zurich Insurance Company (ZIC). ZIC is a wholly owned subsidiary of ZIG.
- Class B shares, representing 10% of the voting rights, are held by ZIG.
- Class C shares were issued in 2001 in six subclasses, C-1 through C-6. Initially issued to certain RegCaPS Partnerships, these shares were subsequently repurchased within the Zurich Group 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 FGI to its ultimate parent ZIG as of December 31, 2017:

ZURICH ORGANIZATION
(NAIC GROUP CODE 0212)



Management of the Company is vested in a board of directors elected annually of not less than three members. A listing of the members of the board and principal officers serving on December 31, 2017 follows:

Board of Directors

Name and Location	Principal Business Affiliation
Kris M. Bildlingmaier Woodland Hills, California	Head of West Zone Product Farmers Group, Inc.
Kassie M. Keane (a) Los Angeles, California	Head of FGI, FAR and ICFR Farmers Group, Inc.
Pater A. Klute Redondo Beach, California	Head of Exchanges Finance Operations Farmers Group, Inc.
Scott R. Lindquist Westlake Village, California	Chief Financial Officer Farmers Group, Inc.

(a) Replaced by Linda M. Sanazaro, effective March 21, 2019

Principal Officers

Name	Title
Scott R. Lindquist	Chair and President
Kassie M. Keane (a)	Chief Financial Officer
James L. Nutting	Vice President and Actuary
Victoria L McCarthy	Vice President
Thomas A. Rodgers	Vice President
Anthony J. Morris	Treasurer
Doren E. Hohl	Secretary

(a) Replaced by Linda M. Sanazaro, effective March 21, 2019

Management Agreements

Service Agreement: On March 1, 2017 Farmers Group Inc. (FGI), and the Company (Farmers Re) entered into a Service Agreement (Agreement). According to terms of the Agreement, FGI will provide various services, including claims adjustment services, accounting and financial reporting services, investment management services, preparation of insurance policies, billing and collections, and other administrative services. The management fees for these services are calculated by the book of business based on direct and assumed earned premiums. The Company was not charged for these services during the examination period. This Agreement was approved by the California Department of Insurance (CDI) on January 23, 2017.

Service Agreement: Effective January 1, 2013 and amended January 1, 2014 FGI entered into a Service Agreement with Zurich Global Investment Management Inc. The Service Agreement by its terms applies to the subsidiaries of FGI, which includes the Company. Services include monitoring investments and various analytical services. The amendment includes monitoring the pension investment account.

Service Agreement: Effective October 1, 2009, and amended as of September 1, 2012, the Company and Zurich Alternative Asset Management, LLC entered into an Amended and Restated Service Agreement (Agreement). The Agreement pertains to a specific group of real estate investments with fund managers. The Agreement calls for evaluating and executing redemptions and sales of investments managed under this agreement, taking appropriate action with fund managers, monitoring of the fund managers, sign off on investment sales, providing performance information, maintaining records of capital calls and distributions for all investments managed under the Agreement and providing all necessary documentation for all operational funding aspects for each investment.

Investment Management Agreement: Effective September 30, 2005, the Company and Blackrock Financial Management, Inc. (Blackrock) entered into an investment management agreement in which Blackrock was appointed by the Company to supervise and manage the portfolio of invested assets of the Company.

Investment Advisory Services Agreement: Effective December 12, 1997, Farmers Group, Inc. (FGI) provided investment services to the Company pursuant to an Investment Advisory Services Agreement (Agreement). Under the terms of the Agreement, the Company paid FGI one-eighth of one percent of the average of invested assets. On March 1, 2010, FGI reduced the investment services fee to one twentieth of one percent of net invested assets.

Tax Sharing Agreement: Effective January 13, 2011, the Company entered into a Tax Sharing Agreement with FGI and various insurance and non-insurance subsidiaries of FGI. A tax sharing agreement utilized by Fire Insurance Exchange that was approved by the CDI on August 17, 2010, was used as a template for the Company's current agreement with FGI and, as such, the CDI indicated that no separate approval of this Agreement was necessary.

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.

The Company's portion of the federal income taxes paid under the tax sharing agreement for 2014, 2015, 2016, and 2017 was $12,575,338, $17,136,707, $2,119,457, and $5,918,668, respectively.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact insurance business only in California as a multiple line property and casualty insurer.

The Company does not write any direct business, and its book of business consists solely of the business it assumes from its affiliate, Farmers Insurance Exchange, under the terms of an Automobile Physical Damage (APD) and an All Lines Quota Share Reinsurance (ALQS) Agreements. Effective December 31, 2015 and January 1, 2016, the Company ceased participation in the APD and ALQS reinsurance contracts, respectively.

Effective December 31, 2017, the ALQS agreement was amended and the Company was added back as a 1% participant. The California Department of Insurance approved this amendment on March 19, 2018.

LOSS EXPERIENCE

The Company experienced an underwriting loss of $22.4 million in 2017 versus an underwriting loss of $3.2 million in 2016. The 2017 underwriting loss was primarily impacted by the ceded commissions expenses incurred on the assumed ALQS business as well as unfavorable loss development on prior year's business in run-off. For 2018, the Company reported an underwriting profit of $2.4 million.

REINSURANCE

Assumed

The Company assumed quota share risks from affiliated reinsurers, Farmers Insurance Exchange (FIE), Fire Insurance Exchange (Fire), Truck Insurance Exchange (Truck), and certain of their subsidiaries as cedents in the following treaties:

Automobile Physical Damage Reinsurance Agreement (APD Agreement): A quota share reinsurance agreement, which has been amended over the years, that covers automobile physical damage, was initially entered into on April 1, 2001, between the Company, FIE and Zurich Insurance Company (ZIC).

Under the APD Agreement, FIE, 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 the Company, 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, the Company 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, FIE, on behalf of itself and its pooling participants, began participating in an ALQS Agreement with the Company 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 10.0% 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%. The Company 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%. The Company 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 the Company 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.

The Company's assumed premiums during 2014, 2015, 2016, and 2017 were $373.4 million, $158.5 million, $-0-, and $78.7 million, respectively, from participation in the above-mentioned quota share treaties.

Ceded

The Company does not cede any reinsurance.

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 Company. It is recommended that the Company 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 Company with the California Department of Insurance and present the financial condition of the Company 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

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 80,966,563	$	$ 80,966,563	
Cash, cash equivalents and short-term investments	114,279,247		114,279,247	
Other invested assets	259,652		259,652	
Investment income due and accrued	916,190		916,190	
Current federal and foreign income tax recoverable and interest thereon	204,327		204,327	
Net deferred tax asset	7,761,937	2,413,581	5,348,356	(1)
Total assets	$ 204,387,916	$ 2,413,581	$ 201,974,335	

Liabilities, Surplus and Other Funds			
Losses and loss adjustment expenses		$ 38,158,251	(2)
Reinsurance payable on paid loss and loss adjustment expenses		6,099,527	
Unearned premiums		78,675,251	
Payable to parent, subsidiaries and affiliates		526,752	
Aggregate write-ins for liabilities		1,006,830	
Total liabilities		124,466,611	
Common capital stock	5,000,000		
Gross paid in and contributed surplus	20,000,000		
Unassigned funds (surplus)	52,507,724		
Surplus as regards policyholders		77,507,724	
Total liabilities, surplus and other funds		$201,974,335	

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

Statement of Income

Underwriting Income		
Premiums earned		$ 0
Deductions:		
Losses incurred	$ 1,267,601	
Loss adjustment expenses incurred	17,529	
Other underwriting expenses incurred	21,120,103	
Total underwriting deductions		22,405,233
Net underwriting loss		(22,405,233)
Investment Income		
Net investment income earned	$ 5,104,439	
Net realized capital gains	11,489,723	
Net investment gain		16,594,162
Other Income		
Aggregate write-ins for miscellaneous income	$ (1,152)	
Total other income		(1,152)
Net income after dividends to policyholders but before federal income taxes		(5,812,223)
Federal income taxes incurred		(2,523,028)
Net loss		$ (3,289,195)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2016		$ 91,543,462
Net loss	$ (3,289,195)	
Change in net unrealized capital losses	(7,477,311)	
Change in net deferred income tax	(1,936,194)	
Change in nonadmitted assets	(1,333,038)	
Change in surplus as regards policyholders for the year		(14,035,738)
Surplus as regards policyholders, December 31, 2017		$ 77,507,724

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

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2013 per Examination			$ 949,686,380
Net income	$ 135,903,690	$	
Change in net unrealized capital gains		10,957,361	
Change in net deferred income tax		14,742,766	
Change in nonadmitted assets		2,413,581	
Capital changes:			
Paid-in		53,800,000	
Surplus adjustments:			
Paid-in		555,600,000	
Dividends to stockholders		370,568,638	
Total gains and losses	$ 135,903,690	$1,008,082,346	
Net decrease in surplus as regards policyholders			(872,178,656)
Surplus as regards policyholders, December 31, 2017, per Examination			$ 77,507,724

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Net Deferred Tax Asset

The Tax Cuts and Jobs Act (Act) was enacted into law on December 22, 2017. The Company 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, which resulted in a decrease of admitted deferred tax assets (DTA) amounting to $3.5 million.

At December 31, 2017, the impact of the Act to the DTA admissibility under Statements of Statutory Principles (SSAP) 101 was under evaluation based on the reasonable estimates and guidance available. The Company was awaiting additional guidance and information from the Internal Revenue Service to determine the transition adjustment on the tax basis discounted unpaid loss reserves and no provisional amount for the tax basis unpaid loss reserves were recorded in the year-end 2017 statutory financial statements. Subsequent adjustments were recorded in the period when the information necessary to update the estimate was available.

(2) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's losses 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.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records (Page 11): It is recommended that the Company 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 15): It was recommended that the Company implement procedures to ensure future compliance with CIC Section 735. The Company complied with this recommendation.

Accounts and Records (Page 17): It was recommended that the Company continue to address the recommendations made regarding its information systems controls. The Company continues to address these recommendations.

ACKNOWLEDGMENT

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

Respectfully submitted,

__/S/__________________________

Richard M. Stone, CFE
Examiner-In-Charge
Contract Insurance Examiner
Department of Insurance
State of California

__/S/__________________________

Grace F. Asuncion, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California