

REPORT OF EXAMINATION
OF THE
FARMERS REINSURANCE COMPANY
AS OF
DECEMBER 31, 2009

Participating State
and Zone:

California

Filed June 28, 2011

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
MANAGEMENT AND CONTROL:	2
Management Agreements	10
Tax Sharing Agreement	10
TERRITORY AND PLAN OF OPERATION.....	10
REINSURANCE:	11
Assumed.....	11
Ceded	12
FINANCIAL STATEMENTS:.....	12
Statement of Financial Condition as of December 31, 2009	13
Underwriting and Investment Exhibit for the Year Ended December 31, 2009	14
Reconciliation of Surplus as Regards Policyholders	15
from December 31, 2006 through December 31, 2009	15
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	16
Losses and Loss Adjustment Expenses.....	16
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	16
Current Report of Examination.....	16
Previous Report of Examination.....	16
ACKNOWLEDGEMENT	18

Los Angeles, California
May 9, 2011

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

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

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

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

FARMERS REINSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office and main administrative office located at 4680 Wilshire Boulevard, Los Angeles, California 90010.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2009, as deemed necessary under the circumstances.

This examination was conducted concurrently with examinations of the Company's California affiliates, namely: Farmers Insurance Exchange, Truck Insurance Exchange, Fire Insurance Exchange, Mid-Century Insurance Company, Civic Property and Casualty Company, Exact Property and Casualty Company, and Neighborhood Spirit Property and Casualty Company.

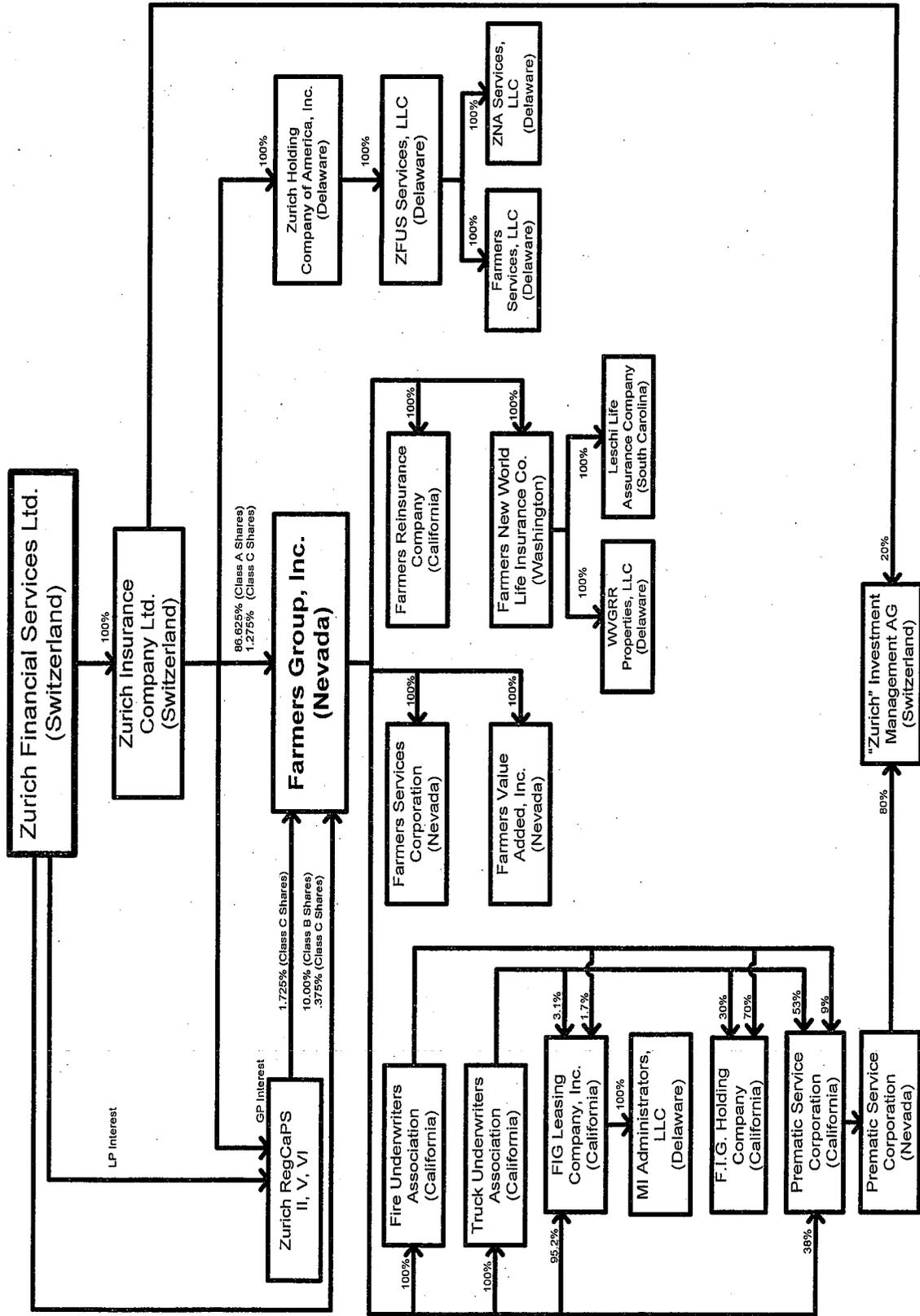
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

MANAGEMENT AND CONTROL

As of December 31, 2009, the Company is 100% owned by Farmers Group, Inc. (FGI), a Nevada holding company.

FGI is a U.S. subsidiary of Zurich Financial Services Ltd. (ZFS), a Swiss holding company. On May 8, 2008, the intermediate level holding structure was reorganized and FGI became owned 87.9% by Zurich Insurance Company (ZIC), 10.375% by Zurich Group Holdings (ZGH), and 1.725% by three Partnerships (Zurich RegCaPs II, V, VI) having ZIC as the General Partner and ZGH as the Limited Partner. On November 30, 2009, another restructuring occurred, as a result of which FGI became directly owned 87.9% by ZIC, 10.375% by ZFS, and 1.725% by three Partnerships (Zurich RegCaPs II, V, VI). ZFS continues to be the ultimate controlling party.

The following abridged organizational chart show the relationships of the Company to both FGI and to its ultimate parent, ZFS, and of the three Exchanges to their affiliates within the holding company system as of December 31, 2009:



FARMERS EXCHANGES ORGANIZATION

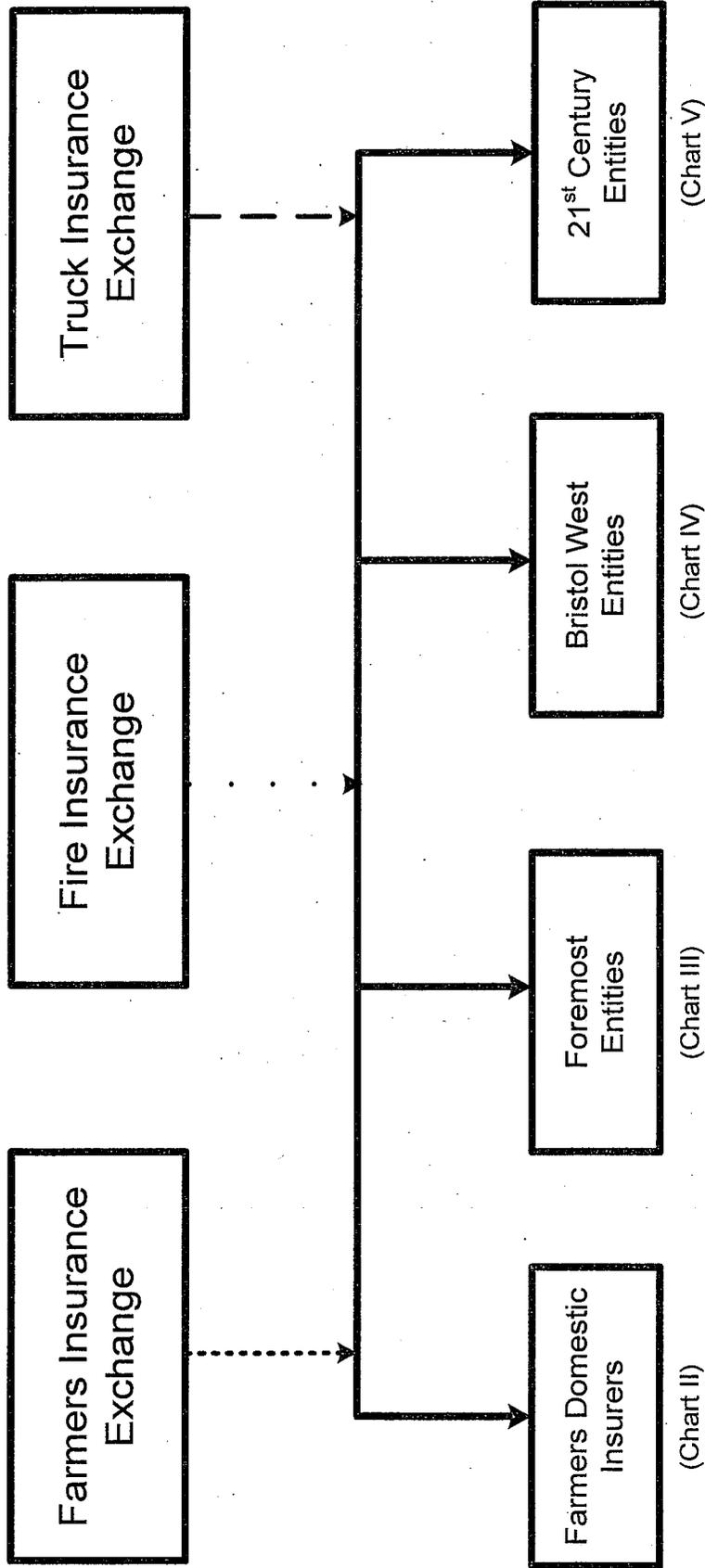


CHART II: EXCHANGES/FARMERS ENTITIES ORGANIZATION

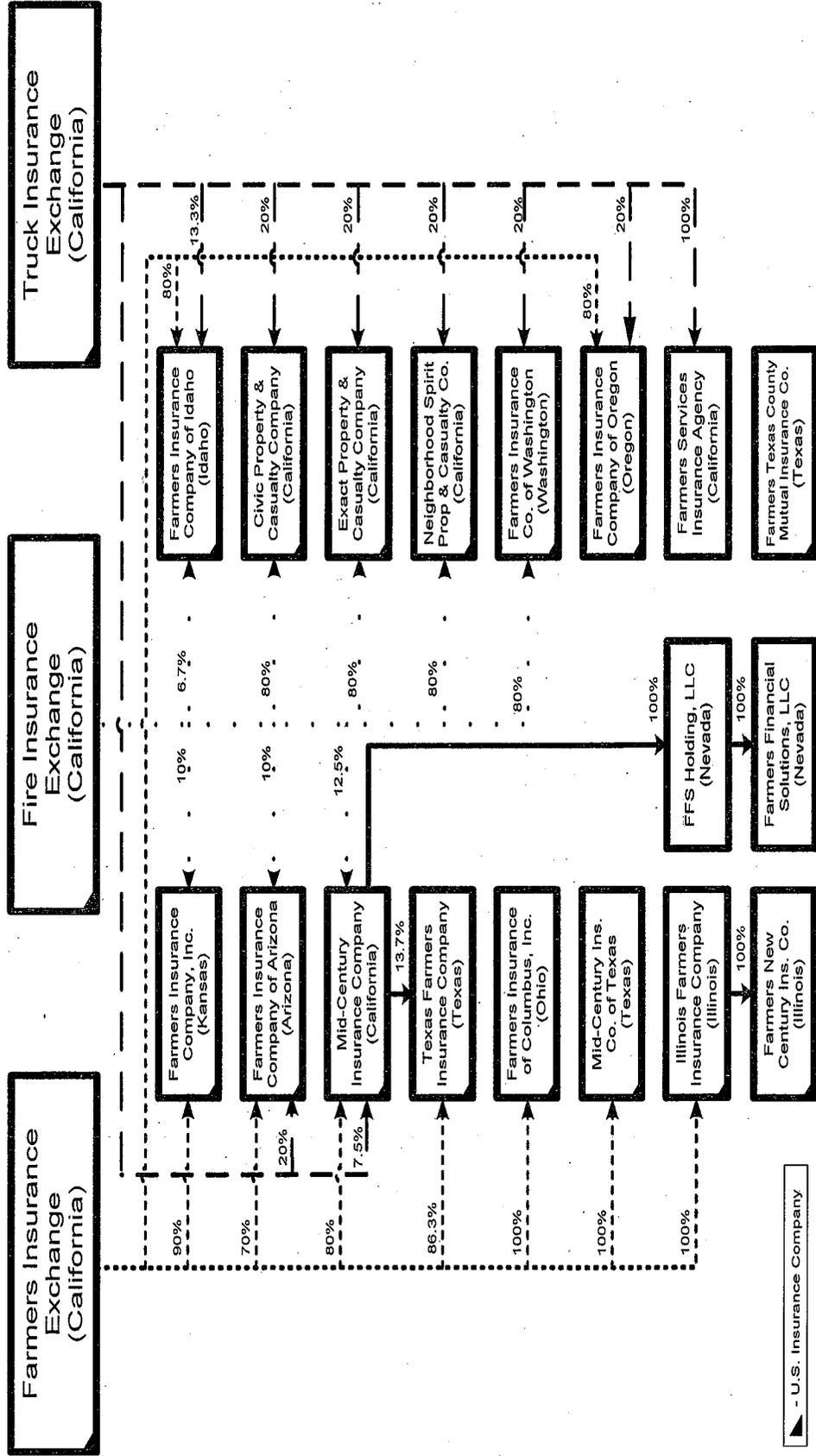
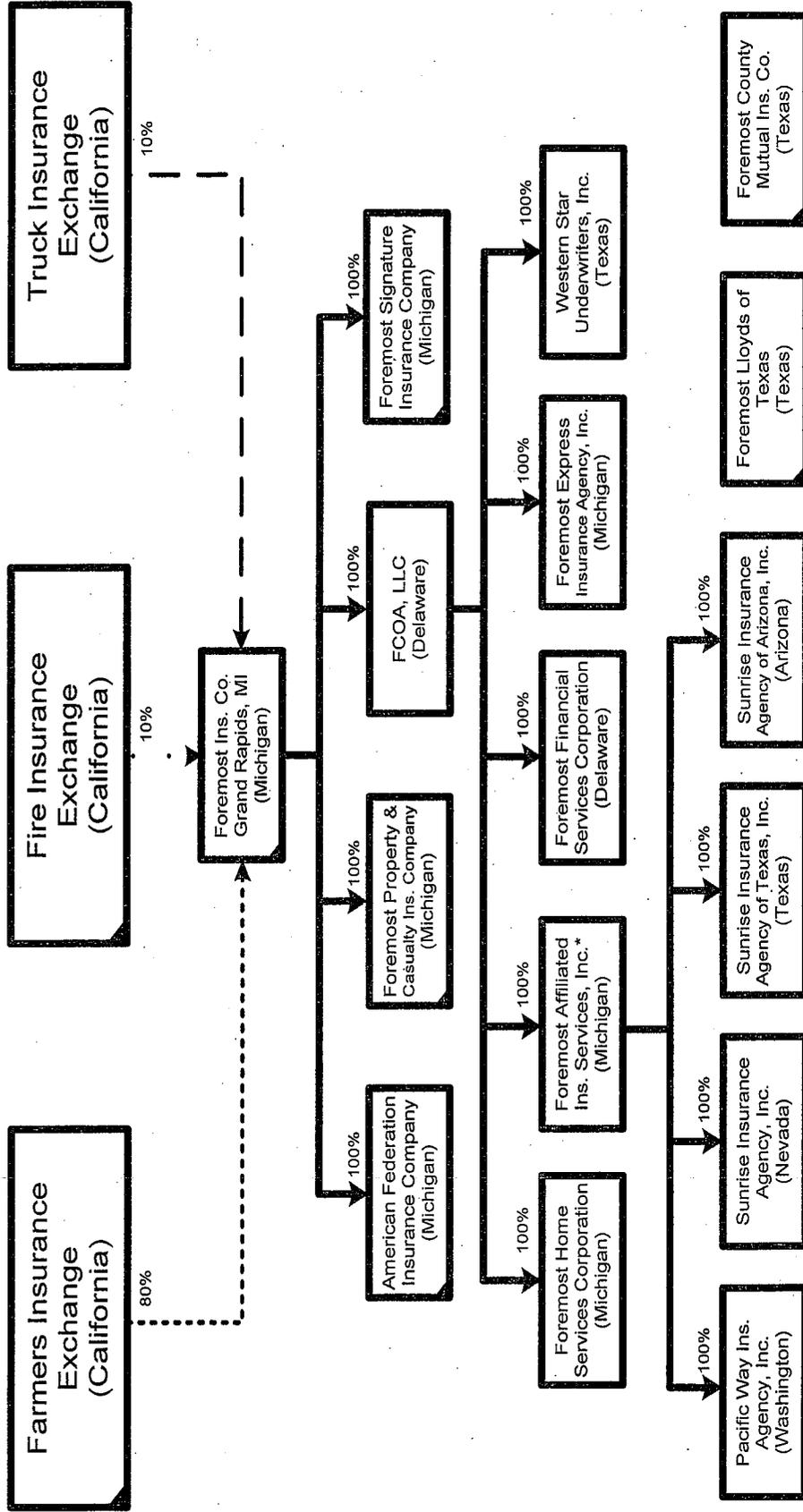


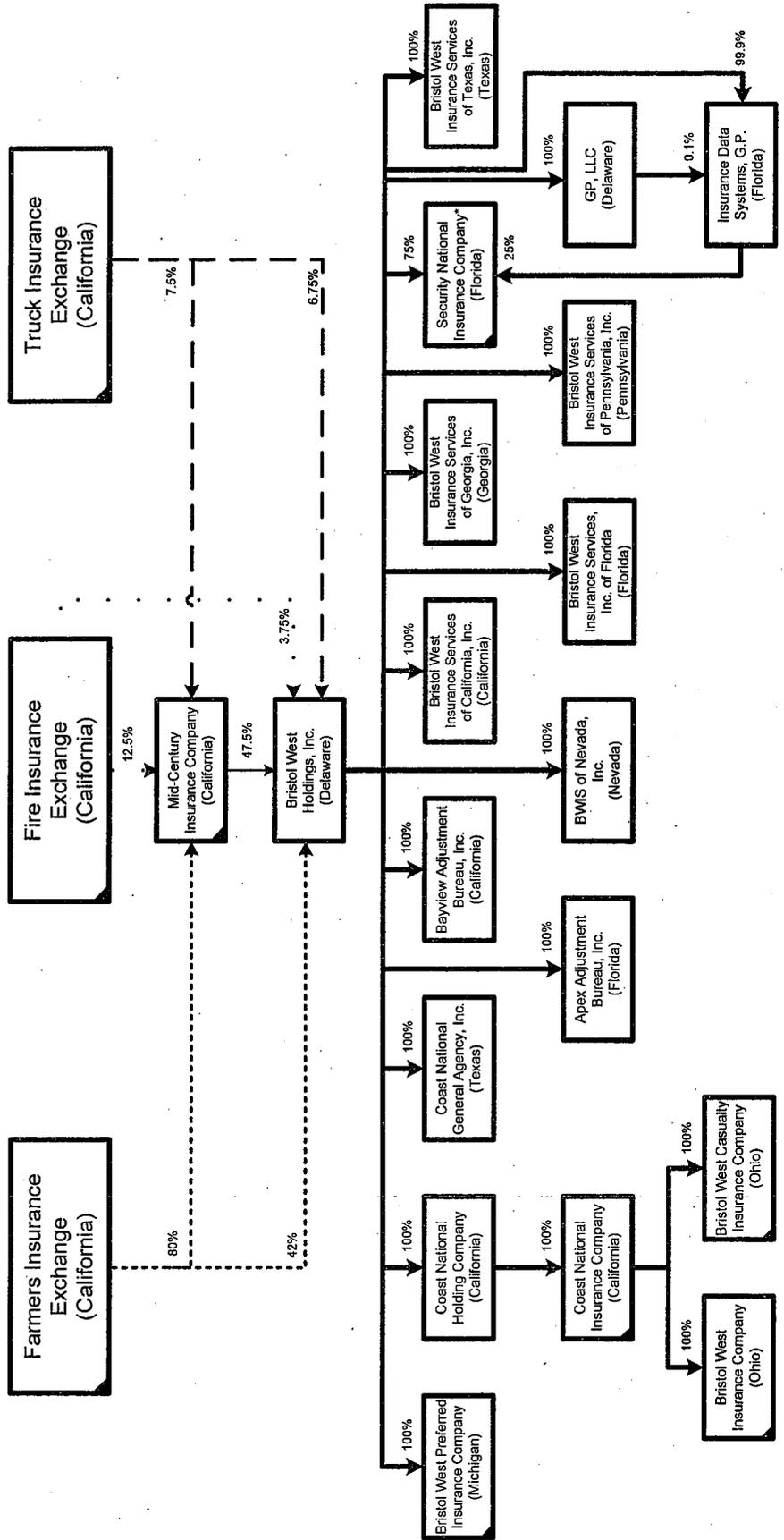
CHART III: EXCHANGES/FOREMOST ORGANIZATION



▲ - U.S. Insurance Company

* dba Kraft Lake Insurance Agency

CHART IV: EXCHANGES/BRISTOL WEST ORGANIZATION



* Shares held by Bristol West Holdings, Inc. are voting shares, while those held by Insurance Data Systems, G.P. are non-voting shares

▲ - U.S. Insurance Company

During the examination period management of the Company was vested in a four member board of directors, elected annually. Company By-Laws specify the number of directors to be “not less than three directors in number”. A listing of the members of the board and principal officers serving on December 31, 2009 follows:

Board of Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Jeffrey John Dailey Los Angeles, California	Executive Vice President Farmers Group, Inc.
Scott Robert Lindquist Westlake Village, California	Executive Vice President, Chief Financial Officer and Director Farmers Group, Inc.
Mhayse Gokul Samalya Topanga, California	Executive Vice President Farmers Group, Inc.
F. Robert Woudstra Los Angeles, California	President, Chief Executive Officer and Director Farmers Group, Inc.

Effective March 19, 2010, David Anthony Travers was added as a fifth board member.

Principal Officers

<u>Name</u>	<u>Title</u>
F. Robert Woudstra	President
Scott Robert Lindquist	Vice President and Treasurer
Doren Eugene Hohl	Secretary
Frank Joseph Ceglar, Jr.	Vice President
Jeffrey John Dailey	Vice President
Dan Curtis Dunmoyer *	Vice President
Bryan Francis Murphy	Vice President
Ronald Gregory Myhan	Vice President
James Leslie Nutting	Vice President
Mark Bailey Smith	Vice President

(* Replaced by Denise Elaine Ruggiero on March 19, 2010.

Management Agreements

An allocation of costs for specific time spent by Farmers Group, Inc. (FGI) employees on the Company is periodically made. The Company did not directly write any insurance business but only assumed business on a quota share basis. As such, its operating costs were relatively immaterial. There was no written management service agreement provided during the examination. It is recommended that the Company execute a written management service agreement with FGI and submit the agreement to the California Department of Insurance (CDI) for approval pursuant to California Insurance Code (CIC) Section 1215.5. For 2007, 2008 and 2009, fees paid by the Company to FGI for such services were \$212,810, \$214,410, and \$252,196, respectively.

Tax Sharing Agreement

The Company's federal income tax return was consolidated with Farmers Group, Inc. (FGI) and several of its subsidiaries effective February 9, 1998. The tax allocation was based on separate return calculations with current credit for net losses. In the prior examination it was recommended that the Company submit the existing affiliated tax sharing agreement to the CDI pursuant to CIC Section 1215.5 for approval. Effective January 13, 2011, the Company entered into a new tax sharing agreement with FGI. The recently CDI approved (August 17, 2010) tax sharing agreement between Fire Insurance Exchange and an affiliate was used as a template for the new agreement for the Company, and the CDI indicated no separate approval of this additional agreement was necessary. The Company's portion of the federal income taxes paid for 2007, 2008, and 2009, was \$20,993,000, \$12,148,000, and \$6,036,000, respectively.

TERRITORY AND PLAN OF OPERATION

The Company was licensed to transact insurance business only in California as a multiple line property and casualty insurer including, but not limited to, aircraft, boiler & machinery, burglary, fire, automobile, commercial, and workers compensation business. The Company had not written any direct business, but had assumed multiple lines of business from affiliates.

REINSURANCE

Assumed

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

An auto physical damage (APD agreement) 100% quota share agreement effective January 1, 2006, with two participants: the affiliated Zurich Insurance Company (Zurich) and the Company. The premium for this APD agreement was \$1 billion annually with Zurich assuming an 80% participation and the Company assuming a 20% participation. The California Department of Insurance (CDI) approved this agreement on December 28, 2005. This 2006 APD agreement was renewed with the same terms, effective January 1, 2009, for a three-year term. The CDI approved this latest APD agreement on April 27, 2009.

The Company, along with Zurich, were also were engaged in an "all-lines" quota share reinsurance agreement assuming business from their property and casualty affiliates including Farmers, Fire, Truck, and their subsidiaries. The agreement as amended, effective December 31, 2005, reinsured a 6% quota share (4.8% to Zurich and 1.2% to the Company). The CDI approved this 2005 amendment on December 28, 2005. The agreement was amended, effective December 31, 2007 to decrease the percentage to 5% (Zurich 4% and Farmers Re 1%) and extend the duration to December 31, 2010. The 2007 amendment was approved by the CDI on December 28, 2007. An amendment, effective September 30, 2008, increased the percentage to 25%. This 25% all lines quota share agreement was then terminated effective June 30, 2009, and replaced with a new 37.5% all lines quota share agreement (Zurich 30% and Farmers Re 7.5%). An amendment, effective December 31, 2009, decreased the percentage ceded to 35%. The CDI approved the December 31, 2009, amendment on May 25, 2010.

The Company's assumed premiums during 2007, 2008, and 2009, were \$ 346.1 million, \$ 676.1 million, and \$ 1.3 billion, respectively, from participation in the aforementioned quota share treaties.

Ceded

The Company does not cede any reinsurance.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

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

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

Statement of Financial Condition
as of December 31, 2009

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$1,284,431,539	\$	\$1,284,431,539	
Stocks:				
Preferred stocks	875,200		875,200	
Common stocks	36,728		36,728	
Cash, cash equivalents and short-term investments	35,033,949		35,033,949	
Other invested assets	385,410,850		385,410,850	
Investment income due and accrued	11,696,275		11,696,275	
Premiums and consideration:				
Uncollected premiums and agents balances in the course of collection	166,724,040		166,724,040	
Reinsurance:				
Funds held by or deposited with reinsured companies	16,539,292		16,539,292	
Current federal and foreign income tax recoverable and interest thereon	16,921,589		16,921,589	
Net deferred tax asset	<u>42,521,297</u>	<u>1,858,105</u>	<u>40,663,192</u>	
 Total assets	 <u>\$1,960,190,759</u>	 <u>\$ 1,858,105</u>	 <u>\$1,958,332,654</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 320,915,920	(1)
Reinsurance payable on paid losses and loss adjustment expenses			120,052,998	
Loss adjustment expenses			37,767,487	(1)
Unearned premiums			430,581,841	
Payable to parent, subsidiaries and affiliates			21,334	
Aggregate write-ins for liabilities			<u>29,599,403</u>	
 Total liabilities			 938,938,983	
Common capital stock		\$ 5,000,000		
Preferred capital stock		53,800,000		
Gross paid in and contributed surplus		575,600,000		
Unassigned funds (surplus)		<u>384,993,671</u>		
 Surplus as regards policyholders			 <u>1,019,393,671</u>	
 Total liabilities, surplus and other funds			 <u>\$1,958,332,654</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$1,144,444,926
Deductions:		
Losses incurred	\$652,699,875	
Loss adjustment expenses incurred	128,195,750	
Other underwriting expenses incurred	<u>396,773,640</u>	
Total underwriting deductions		<u>1,177,669,265</u>
Net underwriting loss		(33,224,339)

Investment Income

Net investment income earned	\$57,942,081	
Net realized capital losses	<u>(17,060,473)</u>	
Net investment gain		40,881,608

Other Income

Aggregate write-ins for miscellaneous income	<u>\$ 158,968</u>	
Total other income		<u>158,968</u>
Net income before all other federal and foreign income taxes		7,816,237
Federal and foreign income taxes incurred		<u>26,927,324</u>
Net loss		<u>\$ (19,111,087)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008		\$ 985,513,157
Net loss	\$(19,111,087)	
Change in net unrealized capital gains less capital gains tax	19,430,334	
Change in net deferred income tax	13,912,987	
Change in nonadmitted assets	17,441,530	
Cumulative effect of changes in accounting principles	2,272,750	
Aggregate write-ins for losses in surplus	<u>(66,000)</u>	
Change in surplus as regards policyholders		<u>33,880,514</u>
Surplus as regards policyholders, December 31, 2009		<u>\$1,019,393,671</u>

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

Surplus as regards policyholders, December 31, 2006, per Examination			\$ 996,334,995
	Gain in Surplus	Loss in Surplus	
Net income	\$ 7,434,056	\$	
Change in net unrealized capital loss		20,192,014	
Change in net deferred income tax	34,571,492		
Change in nonadmitted assets		1,858,105	
Cumulative effect of change in accounting principles	2,272,750		
Aggregate write-ins for gain in surplus	830,497		
Totals	<u>\$45,108,795</u>	<u>\$ 22,050,119</u>	
Net increase in surplus as regards policyholders for the examination			<u>23,058,676</u>
Surplus as regards policyholders, December 31, 2009, per Examination			<u>\$1,019,393,671</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company was directed by the California Department of Insurance (CDI), under California Insurance Code (CIC) Section 733(g), to retain the American Actuarial Consulting Group, LLC, (AACG) for the purpose of assisting this examination in determining the reasonableness of the Company's loss and loss adjustment expense reserves. The entire loss and loss adjustment expense reserve was for reinsurance assumed from Farmers Insurance Exchange and affiliates on various lines of business, mainly private passenger auto liability and auto physical damage business. Based on the analysis by AACG and the review of their work by a Casualty Actuary from the CDI, the Company's December 31, 2009, reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control - Management Agreement (Page 10): It is recommended that the Company execute a written management agreement with Farmers Group, Inc. (FGI) and submit the agreement to the California Department of Insurance (CDI) for approval pursuant to California Insurance Code (CIC) Section 1215.5.

Previous Report of Examination

Management and Control - Tax Sharing Agreement (Page 7): The Company's federal income tax return was consolidated with FGI and several of its subsidiaries. It was recommended that the Company submit the affiliated tax sharing agreement to the CDI pursuant to CIC Section 1215.5 for approval. Effective January 13, 2011, the Company entered into a new tax sharing agreement with

FGI. The recently CDI approved (August 17, 2010) tax sharing agreement between Fire Insurance Exchange and an affiliate was used as a template for the new agreement for the Company, and based on CDI legal department correspondence no separate approval for this virtually identical agreement is necessary.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/_____
Gary W. McMurray, CFE
Examiner-In-Charge
Contract Insurance Examiner
Department of Insurance
State of California