

REPORT OF EXAMINATION
OF THE
INTERINSURANCE EXCHANGE
OF THE AUTOMOBILE CLUB

AS OF
DECEMBER 31, 2009.

Participating State
and Zone:

California

Filed November 8, 2010

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Los Angeles, California
August 27, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

INTERINSURANCE EXCHANGE OF THE AUTOMOBILE CLUB

(hereinafter also referred to as the Exchange) at the primary location of its books and records and its statutory home office at 3333 Fairview Road, Costa Mesa, California 92626.

SCOPE OF EXAMINATION

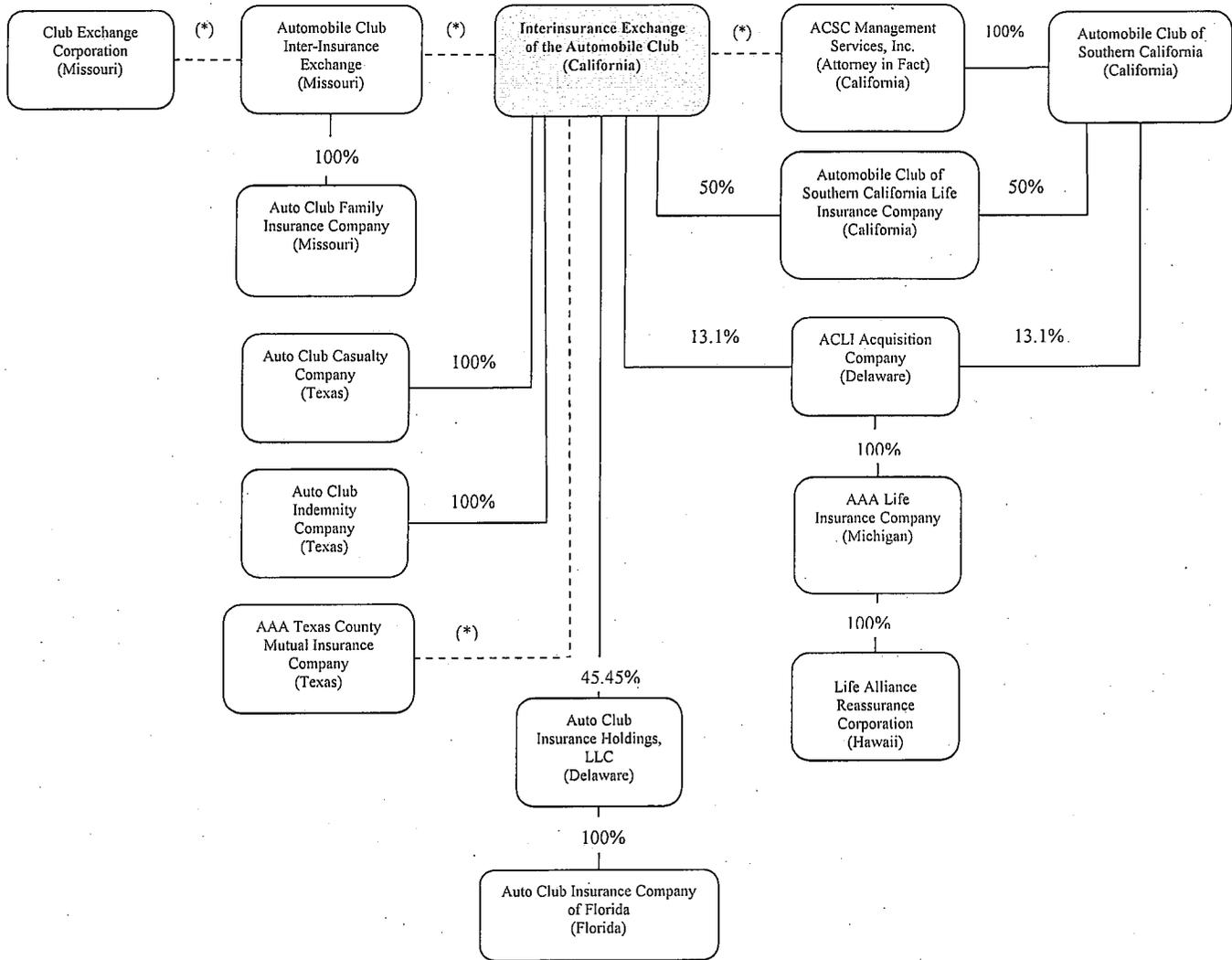
The previous examination of the Exchange was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Exchange'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.

The examination was conducted concurrently with the examinations of the Automobile Club of Southern California Life Insurance Company (ACSC Life) and with the Missouri Department of Insurance's examinations of the Automobile Club Inter-Insurance Exchange and the Auto Club Family Insurance Company. The Exchange and the Automobile Club of Southern California each have a 50% ownership interest in ACSC Life.

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

MANAGEMENT AND CONTROL

The following abridged organizational chart depicts the Exchange's relationship within the holding company system at December 31, 2009:



(*) Contractual or other relationship to operate the Exchange

Management of the Exchange is vested in a six-member Board of Governors appointed annually. A listing of the members of the board and principal officers of the Exchange serving on December 31, 2009 follows:

Governors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Peter K. Barker Santa Barbara, California	Retired Partner Goldman, Sachs & Company
David R. Carpenter Santa Barbara, California	Chairman of the Board and Chief Executive Officer UniHealth Foundation
Antonia Hernandez Pasadena, California	President and Chief Executive Officer California Community Foundation
Raymond R. Martin Rolling Hills Estates, California	Retired Chairman and Chief Executive Officer Coast Federal Bank
Gilbert T. Ray Los Angeles, California	Retired Partner O'Melveny & Myers LLP
Willis B. Wood, Jr. Irvine, California	Retired Chairman and Chief Executive Officer Pacific Enterprises

Principal Officers

<u>Name</u>	<u>Title</u>
Peter K. Barker	Chair
Antonia Hernandez	Vice Chair
Gail C. Louis	Corporate Secretary
Avery R. Brown	Assistant Secretary

Principal Officers (*)

<u>Name</u>	<u>Title</u>
Thomas V. McKernan, Jr.	Chief Executive Officer
Robert T. Bouttier	President, Chief Operating Officer, and Manager
John F. Boyle	Executive Vice President
Avery R. Brown	Senior Vice President, General Counsel, and

<u>Name</u>	<u>Title</u>
David M. Mattingly	Assistant Secretary Senior Vice President, Chief Financial Officer, and Treasurer
Christopher M. Baggaley	Senior Vice President
Gail C. Louis	Corporate Secretary
Alice C. Bisno	Senior Vice President
Michael A. Johnson	Senior Vice President
Rosemary W. Sabins	Senior Vice President
(*) Officers of ACSC Management Services, Inc., Attorney-in-Fact of the Interinsurance Exchange of the Automobile Club	

The Exchange is managed and controlled by its Board of Governors. The Exchange's Board of Governors is comprised of the Chairman and Vice Chairman of the Board of Directors of the Automobile Club of Southern California (ACSC) and other Governors appointed by ACSC Board of Directors.

Management Agreements

Management Agreement: Automobile Club of Southern California (ACSC) and its affiliates, including ACSC Management Services, Inc. (Management Services), as the attorney-in-fact for the Exchange, employ all personnel of the Exchange. The Exchange reimburses Management Services for salaries and other employee-related costs through the management service fee. A portion of the employee benefit costs is allocated directly to the Exchange.

Pursuant to the Management Agreement, Management Services performs all of the operations of the Exchange. Management Services provides services related to the acquisition and issuance of insurance and the administrative activities associated with the business of the Exchange. In consideration for services rendered, the Exchange pays Management Services the following:

- (1) A sum equal to 1% of the premiums earned less the tax computed according to the provisions of California Insurance Code (CIC) Section 1530; and

- (2) A sum equal to the amount of the operating expenses incurred (i.e. cost reimbursement) by Management Services for the performance of the above-indicated services. Each quarter a number of cost allocation studies are performed to determine the cost to be allocated to the Exchange.

The following fees were paid under the terms of the agreement: \$393,448,000 in 2007, \$391,817,000 in 2008, and \$418,868,000 in 2009. This agreement went into effect December 19, 1996, before the prior approval provisions of CIC Section 1215.5 (b)(4) went into effect and has never been amended.

The Exchange had a payable due to Management Services of \$18,289,771 at December 31, 2009. These payables included amounts related to unpaid vacation balances for employees providing services to the Exchange.

Administrative Service Agreement: Effective February 1, 2000, the Exchange entered into an Administrative Service Agreement with Auto Club Indemnity Company. Under the terms of the agreement, the Exchange provides the following services: personnel services, financial services, management information systems support, facilities support, procurement support, insurance support services, marketing, advertising and promotional activities, and legal services. This agreement was reviewed by the California Department of Insurance (CDI), which issued its letter of consent dated November 2, 1999. The services are provided on a cost allocation/reimbursement basis in accordance with insurance accounting principles. The actual costs incurred during the examination period were \$7.9 million.

Administrative Service Agreement: Effective February 1, 2000, the Exchange entered into an Administrative Service Agreement with Auto Club Casualty Company. Under the terms of the agreement, the Exchange provides the following services: personnel services, financial services, management information systems support, facilities support, procurement support, insurance support services, marketing, advertising and promotional activities, and legal services. This agreement was reviewed by the CDI, which issued its letter of consent dated November 2, 1999. The services are

provided on a cost allocation/reimbursement basis in accordance with insurance accounting principles. The actual costs incurred during the examination period were \$14,000.

Agency Agreements: The Exchange has agency agreements with its affiliates, AAA Texas, LLC, AAA New Mexico, LLC, AAA Northern New England, and AAA Hawaii, LLC to sell insurance policies and collect premiums on behalf of the Exchange. Under the terms of the agreements the commissions paid by the Exchange to these affiliates were:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
AAA Texas, LLC	\$ 190,052	\$ 282,100	\$ 398,827
AAA New Mexico, LLC	3,264,483	3,217,271	4,050,270
AAA Northern New England	6,088,033	5,670,414	4,869,630
AAA Hawaii, LLC	1,502,060	1,660,925	1,511,927

Managerial Service Agreement: On September 30, 2002, the Exchange purchased a management agreement for \$7,208,502 to operate Industrial County Mutual Insurance Company (ICM) from Countrywide Corporation (CC). On September 30, 2002, a Certificate of Advance (surplus notes for \$750,000) issued by ICM to CC was assigned to the Exchange. On the same date, the Exchange contributed \$172,440 as "Gross Paid-in Contributed Surplus" to ICM. Upon the assignment of the management agreement the name of Industrial County Mutual Insurance Company was changed to AAA Texas County Mutual Insurance Company (AAA TMC). This agreement was reviewed by the CDI, which issued its Notice of Nonobjection to Implementation on November 13, 2002. Effective December 31, 2009, the Exchange entered into an Amendment No. 1 to add new language to promote the timely settlement of amounts owed between the parties in accordance with Statements of Statutory Accounting Principles (SSAP) No. 96 and to provide a right of setoff clause between the parties under the agreement. The amendment was approved by the CDI on January 8, 2010.

Tax Sharing Agreement: The Exchange's federal income tax return is consolidated with Auto Club Casualty Company and Auto Club Indemnity Company. The CDI approved this agreement on August 27, 1999. The method of allocation between the companies is subject to written agreement.

Allocation is based upon separate return calculations with current credit for net losses. Intercompany tax balances are settled annually when tax payments are remitted to the Internal Revenue Service.

Affiliation Agreement: The Exchange assumed operational control of the Automobile Club Inter-Insurance Exchange (MO Exchange), a subsidiary of Automobile Club of Missouri (MO Club), and its subsidiary, Auto Club Family Insurance Company (ACFIC), through an Affiliation Agreement that was executed on March 1, 2006. The agreement is between the Exchange, ACSC, Auto Club Enterprises, MO Club, MO Exchange, Management Services, and Club Exchange Corporation, the attorney-in-fact appointed by the subscribers to the MO Exchange.

Pursuant to the Affiliation Agreement, on June 30, 2006 the Exchange purchased a \$50 million surplus note from the MO Exchange. The surplus note has been accounted for in accordance with SSAP No 41 and is reported as part of Other Invested Assets. The surplus note has a stated interest rate of prime plus 1% per annum on the unpaid balance until the scheduled maturity date of June 30, 2026. Any payment of principal and interest shall be paid only with the prior approval of the Director of Insurance of the Missouri Department of Insurance.

The Affiliation Agreement also provides for a pooling agreement. Through the pooling agreement, the Exchange assumes all of MO Exchange's and ACFIC's business and cedes back 4% and 1% to each of them, respectively. The CDI approved the Affiliation Agreement and the above related transactions on June 27, 2006.

Consulting Service Agreement: Effective date of June 1, 2007, the Exchange entered into a Consulting Services Agreement with its subsidiary company Auto Club Insurance Company of Florida (ACICF). Under the term of the agreement, the Exchange provides consulting and management services to ACICF who will reimburse the Exchange for both its direct and indirect expenses. The CDI approved this agreement on May 23, 2007. This agreement was terminated in August 2009. Under the terms of the agreement the following fees were paid: \$372,648 in 2008 and \$280,377 in 2009.

Multiple Cedant Allocation Agreement: Effective January 1, 2008, the Exchange entered into a Multiple Cedant Allocation Agreement with MO Exchange to allocate reinsurance premiums, reinstatement premiums, and reinsurance recoveries under their single reinsurance program. The allocation method for reinsurance premiums is based on the average annual losses and the reinsurance recoveries are based on the actual claim payments. This agreement was reviewed by the CDI, which issued its letter of consent dated March 28, 2008. No fees were paid under the agreement during the examination period.

Investment Management Agreements: The Exchange has agreements with various brokers, dealers, and investment managers. These brokers, dealers, and investment managers are hired for specific skills in managing certain types and classes of assets. In 2007, 2008, and 2009 the Exchange paid these brokers, dealers, and investment managers \$8,463,492, \$8,293,861, and \$7,923,853, respectively.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Exchange was licensed to write various lines of property and casualty business in the following states:

California	New Hampshire	Pennsylvania
Hawaii	New Mexico	Texas
Maine	Ohio	Vermont

In 2009, the Exchange wrote \$ 2.09 billion in direct premiums. Of the direct premiums written, \$2.0 billion (96.3%) was written in California and \$85 million (3.7%) was written in seven other states. The Exchange is licensed in Ohio, but does not write policies on a direct basis in this state. During 2009, \$2.05 billion (98.1%) of the Exchange's direct business written was automobile and homeowners insurance. Business is written through approximately 481 agents. The Exchange offers insurance to members of the Automobile Club of Southern California and its affiliated motor clubs as well as non-members in some states. The Exchange currently offers insurance to approximately 22.7% of the American Automobile Association national membership.

REINSURANCE

Assumed

The Exchange assumes 100% of the private passenger automobile business written by its subsidiary, Auto Club Casualty Company, and 100% of the homeowners, inland marine, other liability, and private passenger automobile business written by its subsidiary, Auto Club Indemnity Company, through two quota-share reinsurance agreements. The California Department of Insurance (CDI) allowed the Exchange to proceed with these agreements in a letter dated November 2, 1999.

The Exchange also assumes 100% of the private passenger automobile business written by AAA Texas County Mutual Insurance Company through a quota-share reinsurance agreement. The CDI issued a notice of non-objection to implementation of this agreement in a letter dated November 13, 2002.

Effective November 1, 2006, the Exchange entered into a 40% Quota Share Reinsurance Agreement where the Exchange assumes 40% private passenger automobile business written in Georgia by the Auto Club South Insurance Company, a non-affiliated company, domiciled in Florida. The Exchange is an accredited reinsurer in the State of Florida.

Effective January 1, 2007, the Exchange entered into a 50% Quota Share Reinsurance Agreement where the Exchange assumes 50% of the business written in the state of Ohio from Member Select Insurance Company, a non-affiliated insurance entity, domiciled in Michigan. The Exchange is an accredited reinsurer in the State of Michigan.

As an expansion of the above 50% Quota Share Reinsurance Agreement, effective June 1, 2007, the Exchange assumes 50% of the business written in the state of West Virginia and Kentucky by Auto Club Property-Casualty Insurance Company, a non-affiliated insurance entity, domiciled in Iowa. The Exchange is an accredited reinsurer in the State of Iowa.

In total for 2009, the Exchange assumed \$433.8 million in premiums written, which represented 11.8% of its surplus as regards policyholders.

Intercompany Pooling Agreement

Effective July 1, 2006, the Exchange is party to a pooling agreement with its affiliates, Automobile Club Inter-Insurance Exchange and Auto Club Family Insurance Company. This pooling agreement was a part of the previously noted Affiliation Agreement (see page 7), which was approved on June 27, 2006. The following are the pooling agreement participation percentages under the terms of this agreement:

Interinsurance Exchange of the Automobile Club (Exchange) -	95%
Automobile Club Inter-Insurance Exchange -	4%
Auto Club Family Insurance Company -	1%

Ceded

The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2009 (In thousands):

Type of Contracts	Reinsurer(s) Name	Exchange's Retention	Reinsurer's Maximum Limits
Property Catastrophe Excess of Loss (*)			
1 st Layer	Various/Authorized and Unauthorized	(A) \$150,000 per Risk (B) \$50,000 per Risk	\$50,000 per Risk
2 nd Layer	Various/Authorized and Unauthorized	(A) \$200,000 per Risk (B) \$100,000 per Risk	\$150,000 per Risk
3 rd Layer	Various/Authorized and Unauthorized	(A) \$350,000 per Risk (B) \$250,000 per Risk	\$200,000 per Risk
4 th Layer	Various/Authorized and	(A) \$550,000 per Risk	\$350,000 per Risk

Type of Contracts	Reinsurer(s) Name	Exchange's Retention	Reinsurer's Maximum Limits
	Unauthorized	(B) \$450,000 per Risk	
5 th Layer	Various/Authorized and Unauthorized	(A) \$900,000 per Risk (B) \$800,000 per Risk	\$50,000 per Risk
6 th Layer	Various/Authorized and Unauthorized	(A) \$950,000 per Risk (B) \$850,000 per Risk	\$25,000 per Risk
Property Per Risk Excess of Loss			
Property Per Risk Excess of Loss	Various/Authorized and Unauthorized	\$3,000 per Risk	\$5,000 per Risk \$10,000 per Occurrence
85% Personal Umbrella Quota Share			
1 st Layer	Various Authorized	15% Retention	85% of \$5,000 per Risk
2 nd Layer	Various Authorized	15% Retention	85% of \$5,000 in excess of \$5,000

(*) The Exchange participates at a rate of 50% in the 1st Layer and 5% in all other Layers.

(A) California Market

(B) All Other Markets

Effective January 1, 2007, the Exchange entered into a 50% Quota Share Reinsurance Agreement where the Exchange cedes 50% of the business written in the State of Pennsylvania to Auto Club Insurance Association (ACIA), a non-affiliated insurance entity, domiciled in Michigan. ACIA is an accredited reinsurer in the State of California.

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	\$3,805,218,595	\$	\$3,805,218,595	
Stocks:				
Preferred stocks	386,390		386,390	
Common stocks	1,335,300,396		1,335,300,396	
Real estate:				
Properties occupied by the company	92,792,438		92,792,438	
Cash and short-term investments	32,192,453		32,192,453	
Other invested assets	70,741,707	3,145	70,738,562	
Receivable for securities	4,911,899		4,911,899	
Investment income due and accrued	50,599,793		50,599,793	
Premiums and agents' balances in course of collection	132,910,614	558,841	132,351,773	
Premiums, agents' balances and installments booked but deferred and not yet due	347,235,788		347,235,788	
Amounts recoverable from reinsurers	21,090,525		21,090,525	
Guaranty funds receivable or on deposit	63,452		63,452	
Electronic data processing equipment and software	34,436,979	29,837,119	4,599,860	
Furniture and equipment, including health care delivery assets	7,505,625	7,505,625	0	
Receivable from parent, subsidiaries and affiliates	1,132,384	648,292	484,092	
Aggregate write-in for other than invested assets	<u>20,153,280</u>	<u>19,837,262</u>	<u>316,018</u>	
Total assets	<u>\$5,956,672,318</u>	<u>\$ 58,390,284</u>	<u>\$5,898,282,034</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 619,262,806	(1)
Reinsurance payable on paid loss and loss adjustment expenses			51,078,826	
Loss adjustment expenses			161,682,171	(1)
Other expenses			8,153,432	
Taxes, licenses and fees			8,160,264	
Current federal and foreign income taxes			4,042,044	
Net deferred tax liability			22,900,000	
Unearned premiums			1,120,915,249	
Advance premiums			22,834,081	
Dividends declared and unpaid: policyholders			72,200,000	
Ceded reinsurance premiums payable			63,336,889	
Funds held by company under reinsurance treaties			47,036	
Amounts withheld or retained by company for account of others			8,756,285	
Remittances and items not allocated			738,281	
Payable to parent, subsidiaries and affiliates			23,566,529	
Payable for securities			15,250,086	
Aggregate write-ins for liabilities			<u>4,326,945</u>	
Total liabilities			2,207,250,924	
Unassigned funds (surplus)		<u>\$ 3,691,031,110</u>		
Surplus as regards policyholders			<u>3,691,031,110</u>	
Total liabilities, surplus and other funds			<u>\$5,898,282,034</u>	

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

Statement of Income

Underwriting Income

Premiums earned	\$ 2,367,555,452
Deductions:	
Losses incurred	\$ 1,225,129,038
Loss adjustment expenses incurred	236,441,866
Other underwriting expenses incurred	<u>564,647,373</u>
Total underwriting deductions	<u>2,026,218,277</u>
Net underwriting gain	341,337,175

Investment Income

Net investment income earned	\$ 187,172,311
Net realized capital gains	<u>35,174,944</u>
Net investment gain	222,347,255

Other Income

Net loss from agents' balances charged off	\$ (4,386,639)
Finance and service charges not included in premiums	52,584,297
Aggregate write-ins for miscellaneous income	<u>(10,085)</u>
Total other income	<u>48,187,573</u>

Net income before dividends to policyholders and before federal income taxes	611,872,003
Dividends to policyholders	143,483,658
Federal income taxes incurred	<u>121,678,126</u>
Net income	<u>\$ 346,710,219</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008	\$ 3,162,039,970
Net income	\$ 346,710,219
Change in net unrealized capital gains	182,447,921
Change in net deferred income tax	(15,376,000)
Change in nonadmitted assets	6,542,138
Change in provision for reinsurance	263,536
Cumulative effect of changes in accounting principles	<u>8,403,326</u>
Change in surplus as regards policyholders for the year	<u>528,991,140</u>
Surplus as regards policyholders, December 31, 2009	<u>\$ 3,691,031,110</u>

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

Surplus as regards policyholders, December 31, 2006, per Examination			\$3,110,420,575
	Gain in Surplus	Loss in Surplus	
Net income	\$ 659,591,426	\$	
Net unrealized capital losses		104,657,689	
Change in net deferred income tax		14,884,000	
Change in nonadmitted assets		18,902,950	
Cumulative effect of changes in accounting principles	8,403,326		
Aggregate write-ins for gains in surplus	51,060,422		
Totals	<u>\$ 719,055,174</u>	<u>\$ 138,444,639</u>	
Net increase in surplus as regards policyholders			<u>580,610,535</u>
Surplus as regards policyholders, December 31, 2009, per Examination			<u>\$3,691,031,110</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the Exchange's loss and loss adjustment expense reserves as of December 31, 2009 and determined they were be reasonably stated.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Aggregate Write-ins for Other than Invested Assets and Aggregate Write-ins for Liabilities (Page 17): It was recommended that the Exchange comply with the guidance for reporting a correction of an accounting error in accordance with Statements of Statutory Accounting Principles No.3 relating to its incorrect accounting of the Automobile Club of Southern California's post-retirement benefit obligations. The Exchange has complied with this recommendation.

ACKNOWLEDGEMENT

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

Respectfully submitted,

/S/

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