REPORT OF EXAMINATION
OF THE
MERCURY CASUALTY COMPANY
AS OF
DECEMBER 31, 2013

Filed April 13, 2015
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</table>
Honorable Dave Jones  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

MERCURY CASUALTY COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 4484 Wilshire Boulevard, Los Angeles, California, 90010. The Company's statutory home office and main administrative office is located at 555 West Imperial Highway, Brea, California 92821.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2010. This examination covers the period from January 1, 2011, through December 31, 2013. The examination was conducted in accordance with the National Association of Insurance Commissioners Financial Condition Examiners Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.
The examination was a coordinated examination and was conducted concurrently with the Florida Department of Financial Services, Georgia Office of Insurance and Safety Fire Commission, and Illinois and Texas Departments of Insurance. The affiliated California domiciled insurance entities reviewed as part of this examination include Mercury Insurance Company, California Automobile Insurance Company, and California General Underwriters Insurance Company, Inc.; the Florida domiciled entities Mercury Insurance Company of Florida and Mercury Indemnity Company of America; the Georgia domiciled entities Mercury Insurance Company of Georgia and Mercury Indemnity Company of Georgia; the Illinois domiciled entities Mercury Insurance Company of Illinois and Mercury National Insurance Company; and the Texas domiciled entities Mercury County Mutual Insurance Company and American Mercury Lloyds Insurance 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: corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; and statutory deposits.

**SUBSEQUENT EVENTS**

The Company is subject to a $20,000,000 collateralized term loan. On October 4, 2011, the Company refinanced its Bank of America $18,000,000 loan that was scheduled to mature on March 1, 2013, with a Union Bank $20,000,000 loan that was scheduled to mature on January 2, 2015. During 2014, the Company extended the maturity date of the loan from January 2, 2015 to December 3, 2017.

The Company is also subject to a $120,000,000 collateralized term loan with Bank of America. Effective August 4, 2011, the maturity date of the loan was extended from January 12, 2012 to January 2, 2015. On July 31, 2013, the Company extended the maturity date of the loan from January 2, 2015 to July 31, 2016. During 2014, the
Company extended the maturity date of the loan from July 31, 2016 to December 3, 2017.

In March 2006, the California Department of Insurance (CDI) issued an Amended Notice of Non-Compliance (NNC) to an NNC originally issued in February 2004, alleging that Mercury General Corporation (MGC) and its subsidiaries charged rates in violation of Proposition 103. On February 3, 2012, an Administrative Law Judge (ALJ) submitted a proposed decision that dismissed the CDI’s allegations that MGC used unlawful rates and recommended it be adopted as the decision of the Insurance Commissioner. In March 2012, the Commissioner rejected the ALJ’s proposed decision. MGC challenged the Commissioner’s rejection of the decision in the Los Angeles Superior Court. The ALJ held an evidentiary hearing on the noncompliance portion of the 2004 NNC during April 2013. Administrative Law Judge Michael A. Scarlett, of the Office of Administrative Hearings of the State of California's Department of General Services, submitted his proposed decision on December 8, 2014, finding there were at least 180,000 transactions in which auto policyholders were charged fees that had not been approved by the CDI and recommended the Commissioner impose a fine in the amount of $27,593,562. Pursuant to the provisions of California Insurance Code Section 1858.2, California Government Code Section 11517, and California Code of Regulations, Title 10 Section 2614.24, the California Insurance Commissioner adopted the proposed decision and ordered MGC to pay a fine in the amount of $27,593,562.

COMPANY HISTORY

The Company was incorporated in California on January 6, 1961, and commenced operations in 1962. The Company is a wholly-owned subsidiary of Mercury General Corporation (MGC) and the immediate parent company of Mercury Insurance Company and California General Underwriters Insurance Company, Inc., California domiciled insurance companies; and Mercury Insurance Services, LLC, a California management services company. The Company is also the sole member of AIS Management, LLC, a
licensed insurance agent. Membership interest in AISM was acquired on January 1, 2009.

Dividends Paid to Parent

The Company paid extraordinary dividends to its parent, MGC, in the amount of $270,000,000 during the calendar year 2011. Approval for the payment of the extraordinary dividends was granted by the California Department of Insurance on December 16, 2010 and were reported as declared and unpaid within the December 31, 2010 Annual Statement.

Ordinary cash dividends paid by the Company to its parent, MGC, totaled $145,000,000 and $120,000,000 for 2012 and 2013, respectively.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Mercury General Corporation (MGC), a publicly traded insurance holding company. The controlling stockholders, George Joseph and Gloria Joseph, own 34.3% and 16.7%, respectively, of MGC's stock with the remaining 49.0% held by public shareholders. The following abridged organizational chart depicts the Company's interrelationship within the holding company system at December 31, 2013 (all ownership is 100% unless otherwise noted):
The nine members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2013:
<table>
<thead>
<tr>
<th>Name and Location</th>
<th>Principal Business Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bruce A. Bunner</td>
<td>Retired President</td>
</tr>
<tr>
<td>Fernandina Beach, Florida</td>
<td>Financial Structures, Ltd.</td>
</tr>
<tr>
<td>Michael D. Curtius</td>
<td>Executive Consultant</td>
</tr>
<tr>
<td>Carlsbad, California</td>
<td>Mercury General Corporation</td>
</tr>
<tr>
<td>Christopher W. Graves (*)</td>
<td>Vice President and Chief Investment Officer</td>
</tr>
<tr>
<td>Palos Verdes Peninsula, California</td>
<td>Mercury General Corporation</td>
</tr>
<tr>
<td>Richard E. Grayson</td>
<td>Retired Senior Vice President</td>
</tr>
<tr>
<td>Murrieta, California</td>
<td>Union Bank</td>
</tr>
<tr>
<td>George Joseph</td>
<td>Chairman of the Board</td>
</tr>
<tr>
<td>Los Angeles, California</td>
<td>Mercury General Corporation</td>
</tr>
<tr>
<td>Martha E. Marcon</td>
<td>Retired Partner</td>
</tr>
<tr>
<td>Glendale, California</td>
<td>KPMG, LLP</td>
</tr>
<tr>
<td>Donald P. Newell</td>
<td>Retired Partner</td>
</tr>
<tr>
<td>Pinehurst, North Carolina</td>
<td>Law Firm of Latham &amp; Watkins, LLP</td>
</tr>
<tr>
<td>Donald R. Spuehler</td>
<td>Retired Partner</td>
</tr>
<tr>
<td>Los Angeles, California</td>
<td>Law Firm of O’Melveny &amp; Meyers, LLP</td>
</tr>
<tr>
<td>Gabriel Tirador</td>
<td>President and Chief Executive Officer</td>
</tr>
<tr>
<td>Tustin, California</td>
<td>Mercury General Corporation</td>
</tr>
</tbody>
</table>

(*) On April 27, 2012, Mr. Christopher W. Graves replaced Mr. Nathan Bessin who resigned from the Board of Directors on December 31, 2011. There were no other changes on the Board of Directors during the examination period.
Principal Officers

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gabriel Tirador</td>
<td>President and Chief Executive Officer</td>
</tr>
<tr>
<td>Theodore R. Stalick</td>
<td>Senior Vice President, Chief Financial Officer, and Treasurer</td>
</tr>
<tr>
<td>Judith A. Walters</td>
<td>Secretary</td>
</tr>
<tr>
<td>Christopher W. Graves</td>
<td>Vice President and Chief Investment Officer</td>
</tr>
</tbody>
</table>

Management Agreements

Management Agreement: Since January 1, 2001, the Company has been party to a Management Agreement with its subsidiary, Mercury Insurance Services, LLC (MIS). Approval of the Agreement was granted by the California Department of Insurance (CDI) on January 1, 2001. Under the terms of this Agreement, MIS performs underwriting and loss adjustment services for the Mercury General Corporation (MGC) group of companies. The management fee is based on actual incurred expenses. The underwriting portion of the management fee is allocated between the Company and its affiliates based upon their proportionate share of direct premiums written. The fee for allocated loss adjustment expenses is based on actual payments by MIS for claims on policies issued by the Company. The unallocated loss adjustment expenses portion of the management fee is allocated between the Company and its affiliates based upon their proportionate share of net losses incurred. The Agreement was amended, effective October 1, 2013, authorizing MIS to pay certain expense items that were previously reserved to the insurers, including agent commissions and audit fees. The amendment also added a 60-day due date for the payment of management fees, in order to comply with Statement of Statutory Accounting Principle No. 96. Notice of approval was provided on September 25, 2013. The Company incurred management fees of $139,523,787, $135,904,672, and $102,902,510 during the years 2011, 2012, and 2013, respectively.
Service Agreement: Since January 17, 2005, the Company has been party to a Service Agreement with Mercury Insurance Company (MIC) and California Automobile Insurance Company (CAIC). Under the terms of this Agreement, the Company collects all premiums and pays claims, commissions, and return premiums on behalf of MIC and CAIC. The Company does not charge for these services as there are no additional incurred costs for the provider. Approval of the Agreement was granted by the CDI on January 11, 2005.

Service Agreement: Since April 1, 2011, the Company has been party to a Service Agreement with American Mercury Insurance Company (AMIC). Under the terms of this Agreement, AMIC collects premiums and pays losses and agent commissions on behalf of the Company on business written in the Commonwealth of Virginia. The Agreement was effective April 1, 2011, for a one-year term. The Agreement was submitted to and approved by the CDI. On March 28, 2012, AMIC and the Company renewed the agreement, effective April 1, 2012, for another one-year term. The new Agreement contained terms allowing for renewal without separate approval from the CDI. The revised Agreement was submitted to and approved by the CDI. On June 7, 2013, the Agreement was renewed, effective as of April 1, 2013. No fees were paid during the examination period under this agreement.

Tax Allocation Agreement: Since January 1, 1983, the Company and various affiliates have been parties to a Tax Allocation Agreement with the ultimate parent, MGC. Under the terms of this Agreement, the tax liability of the Company and its affiliates are computed as if each entity filed a separate stand-alone return with current credit for net losses incurred by the insurance subsidiaries to the extent it can be used in the current consolidated return. Taxes paid by the Company totaled $5,168,389, $(6,247,062), and $9,608,572 for the years 2011, 2012, and 2013, respectively. The Agreement was not subject to prior approval by the CDI due to the effective date of the Agreement.

Furniture and Equipment Rental Agreement: Since January 1, 1993, the Company has provided the use of furniture and equipment to affiliates MIC and CAIC. Rental charges
Furniture and Equipment Rental Agreement: Since January 1, 2002, the Company has provided the use of furniture and equipment to affiliates Mercury Insurance Company of Florida and Mercury Indemnity Company of America. Rental charges are predicated upon the depreciation of the assets utilized. Combined rental income received by the Company from the above referenced affiliates totaled $1,281,250 for the year 2011. No rents were received pursuant to this Furniture and Equipment Rental Agreement in 2012 and 2013, and the Agreement was terminated, effective August 1, 2013. Notice of termination was provided to the CDI in the 2012 Form B Filing Amendment No. 2, filed August 14, 2013.

Furniture and Equipment Rental Agreement: The Company entered into a Furniture and Equipment Rental Agreement with MIS, on June 3, 2010. Effective December 31, 2009, this agreement provides for payment of all facilities and equipment rental by MIS, on behalf of its affiliates, to the Company, while authorizing MIS to receive rents from the affiliates that are utilizing the facilities and equipment. Rental charges are predicated upon the depreciation of the assets utilized. Rental income received by the Company totaled $14,135,793, $24,728,953, and $30,432,117 for the years 2011, 2012, and 2013, respectively.
TERRITORY AND PLAN OF OPERATION

As of December 31, 2013, the Company was licensed to write various property and casualty coverages in Arizona, California, Florida, Nevada, New York, Texas, Virginia, and Washington.

During 2013, the Company wrote $454,714,809 of direct premiums; 62.4% of the writings pertained to homeowners multiple peril, 10.7% pertained to commercial multiple peril, and 10.4% pertained to private passenger automobile liability, and the remainder consisted of other various property and casualty coverages. In May 2012, the Company began transitioning its California private passenger automobile business to its affiliate, California Automobile Insurance Company. The Company wrote $276,496,746 and $129,105,814 of California private passenger automobile business in 2011 and 2012, respectively. The Company also began writing equipment breakdown coverage in the second quarter of 2011 and entered into a quota share reinsurance agreement whereby the Company cedes 100% of the business to Hartford Steam Boiler Inspection and Insurance Company. Of the total direct premiums written, $353,838,721 (77.8%) was written in California. Business is distributed and marketed through a network appointed independent agents. Branch offices are maintained in various locations throughout California including Anaheim, Brea, Camarillo, Folsom, Gilroy, Los Angeles, Rancho Cucamonga, San Diego, and Valencia.

REINSURANCE

Assumed

Assumed reinsurance is limited to business ceded to the Company from various affiliates. The following schedule depicts the Company’s assumed reinsurance contracts in-force as of December 31, 2013:
<table>
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<tr>
<th>Type of Reinsurance</th>
<th>Lines of Business</th>
<th>Affiliate Cedant*</th>
<th>Ceding Company Retention</th>
<th>Reinsurer’s Maximum Limits</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% Quota Share</td>
<td>Private Passenger Automobile Liability &amp; Physical Damage and Commercial Automobile Liability written in Florida and Pennsylvania</td>
<td>MICFL</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100% Quota Share</td>
<td>Private Passenger Automobile Liability &amp; Physical Damage written in Florida</td>
<td>MIDA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100% Quota Share</td>
<td>Private Passenger Automobile Liability &amp; Physical Damage &amp; Homeowners Multiple Peril written in New Jersey</td>
<td>MIDA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100% Quota Share</td>
<td>Private Passenger Automobile Liability &amp; Physical Damage written in Michigan</td>
<td>MNIC</td>
<td></td>
<td></td>
</tr>
<tr>
<td>100% Quota Share</td>
<td>All Lines</td>
<td>MICGA MIDGA MICIL</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aggregate Catastrophe</td>
<td>Homeowners Multiple Peril &amp; Automobile Physical Damage written in Oklahoma, Texas, and Florida</td>
<td>AMIC</td>
<td>$5,000,000</td>
<td>95% of $35 million in excess of coverage provided by the Florida Hurricane Catastrophe Fund</td>
</tr>
</tbody>
</table>

*Mercury Insurance Company of Florida (MICFL); Mercury Indemnity Company of America (MIDA); Mercury National Insurance Company (MNIC); Mercury Insurance Company of Georgia (MICGA); Mercury Indemnity Company of Georgia (MIDGA); Mercury Insurance Company of Illinois (MICIL); American Mercury Insurance Company (AMIC)

**Ceded**

Since July 1, 1999, the Company has been party to a 100% quota share agreement under which the Company cedes to its subsidiary California General Underwriters Insurance Company Inc. (CGU), the fleet automobile policy written by the Company, which covers substantially all vehicles owned by affiliated entities within the Mercury General Group.
During the second quarter of 2011, the Company began writing equipment breakdown coverage and entered into a quota share reinsurance agreement whereby the Company cedes 100% of the business to Hartford Steam Boiler Inspection and Insurance Company.

Aside from various in place excess of loss facultative arrangements covering individual commercial and personal property risks, the remainder of the Company’s reinsurance program is limited to a 100% quota share agreement with an authorized reinsurer that covers commercial umbrella business and provides coverage up to $5,000,000 per occurrence.

The Company, its subsidiary, Mercury Insurance Company, and affiliates California Automobile Insurance Company, and American Mercury Insurance Company, entered into a Catastrophe Reinsurance Treaty (“Treaty”) effective July 1, 2013, through June 30, 2014. The Treaty provides for $100,000,000 coverage on a per occurrence basis after covered catastrophe losses exceed a $100,000,000 retention limit. The Treaty provides coverage for property and automobile physical damage and excludes losses from earthquake, fire following earthquake, and Florida automobile physical damage. The annual premium of $4,250,000 is allocated among the companies based upon their exposure.

ACCOUNTS AND RECORDS

During the course of the examination, a review was made of the Company’s general controls over its information systems. As a result of this review, several findings were noted in controls over logical security. These findings were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.
FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2013

Underwriting and Investment Exhibit for the Year Ended December 31, 2013

Reconciliation of Surplus as Regards Policyholders from December 31, 2010 through December 31, 2013
## Statement of Financial Condition
### as of December 31, 2013

<table>
<thead>
<tr>
<th>Assets</th>
<th>Ledger and Nonledger Assets</th>
<th>Assets Not Admitted</th>
<th>Net Admitted Assets</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>875,559,376</td>
<td>875,559,376</td>
<td>(1)</td>
<td></td>
</tr>
<tr>
<td>Preferred stocks</td>
<td>8,672,791</td>
<td>8,672,791</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stocks</td>
<td>736,194,243</td>
<td>736,194,243</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real estate: Properties occupied by the Company</td>
<td>101,299,235</td>
<td>101,299,235</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and short-term investments</td>
<td>117,161,369</td>
<td>117,161,369</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other invested assets</td>
<td>82,056,830</td>
<td>1,124,870</td>
<td>80,931,960</td>
<td></td>
</tr>
<tr>
<td>Investment income due and accrued</td>
<td>13,257,028</td>
<td>400,633</td>
<td>20,061,555</td>
<td></td>
</tr>
<tr>
<td>Premiums, agents’ balances in course of collection</td>
<td>20,462,188</td>
<td>400,633</td>
<td>20,061,555</td>
<td></td>
</tr>
<tr>
<td>Premiums, agents’ balances and installments booked but deferred and not yet due (including $0 earned but unbilled premiums)</td>
<td>30,457,622</td>
<td>30,457,622</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amounts recoverable from reinsurers</td>
<td>61,377</td>
<td>61,377</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current federal and foreign income tax recoverable</td>
<td>3,791,769</td>
<td>3,791,769</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net deferred tax asset</td>
<td>33,873,045</td>
<td>33,873,045</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electronic data processing equipment and software</td>
<td>47,596,485</td>
<td>39,676,866</td>
<td>7,919,619</td>
<td></td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>4,841,279</td>
<td>4,841,279</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables from parent, subsidiaries and affiliates</td>
<td>52,103</td>
<td>52,103</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health care and other amounts receivable</td>
<td>5,293,441</td>
<td>5,293,441</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aggregate write-ins for other than invested assets</td>
<td>7,399,993</td>
<td>478,137</td>
<td>6,921,856</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>$ 2,088,030,174</td>
<td>$ 46,521,785</td>
<td>$ 2,041,508,389</td>
<td></td>
</tr>
</tbody>
</table>

### Liabilities, Surplus and Other Funds

<table>
<thead>
<tr>
<th>Liabilities, Surplus and Other Funds</th>
<th>Assets</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Losses and loss adjustment expenses</td>
<td>$ 397,024,554</td>
<td>(2)</td>
</tr>
<tr>
<td>Reinsurance payable on paid losses and loss adjustment expenses</td>
<td>22,187,272</td>
<td></td>
</tr>
<tr>
<td>Commissions payable, contingent commissions and other similar charges</td>
<td>8,421,294</td>
<td></td>
</tr>
<tr>
<td>Other expenses</td>
<td>751,076</td>
<td></td>
</tr>
<tr>
<td>Taxes, licenses and fees</td>
<td>394,427</td>
<td>(3)</td>
</tr>
<tr>
<td>Borrowed money and interest thereon</td>
<td>140,003,760</td>
<td></td>
</tr>
<tr>
<td>Unearned premiums</td>
<td>291,358,543</td>
<td></td>
</tr>
<tr>
<td>Advance premiums</td>
<td>10,653,060</td>
<td></td>
</tr>
<tr>
<td>Ceded reinsurance premiums payable</td>
<td>1,266,475</td>
<td></td>
</tr>
<tr>
<td>Remittances and items not allocated</td>
<td>341,057</td>
<td></td>
</tr>
<tr>
<td>Provision for reinsurance</td>
<td>375,000</td>
<td></td>
</tr>
<tr>
<td>Payable to parent, subsidiaries and affiliates</td>
<td>13,604,566</td>
<td></td>
</tr>
<tr>
<td>Aggregate write-ins for liabilities</td>
<td>3,816,791</td>
<td></td>
</tr>
</tbody>
</table>

| Total liabilities                    | 890,197,875 |       |
| Common capital stock                 | $ 10,000,000 |       |
| Gross paid-in and contributed surplus | 100,774,124 |       |
| Unassigned funds (surplus)           | 1,040,536,390 |       |
| Surplus as regards policyholders     | 1,151,310,514 |       |

| Total liabilities, surplus and other funds | $ 2,041,508,389 |       |
Underwriting and Investment Exhibit
for the Year Ended December 31, 2013

Statement of Income

Underwriting Income

Premiums earned $ 738,903,946

Deductions:

- Losses and loss expenses incurred $ 513,050,294
- Other underwriting expenses incurred 204,981,653
- Aggregate write-ins for underwriting deductions (12,956)

Total underwriting deductions 718,018,991

Net underwriting gain 20,884,955

Investment Income

Net investment income earned 142,167,567
Net realized capital gain 64,894,546

Net investment gain 207,062,113

Other Income

- Net loss from agents’ or premium balances charged off (amount recovered $288,646 amount charged off $1,740,825) (1,452,179)
- Finance and service charges not included in premiums 7,869,764
- Aggregate write-ins for miscellaneous income 1,064,134

Total other income 7,481,719

Net income before federal and foreign income taxes 235,428,787
Federal and foreign income taxes incurred 9,276,594

Net income $ 226,152,193

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2012 $1,065,510,131

Net income $ 226,152,193
Change in net unrealized capital losses (20,758,203)
Change in net deferred income tax (23,914,646)
Change in nonadmitted assets 24,696,039
Change in provision for reinsurance (375,000)
Dividends to stockholders (120,000,000)

Change in surplus as regards policyholders for the year 85,800,383

Surplus as regards policyholders, December 31, 2013 $1,151,310,514
## Reconciliation of Surplus as Regards Policyholders
### from December 31, 2010 through December 31, 2013

<table>
<thead>
<tr>
<th>Description</th>
<th>Gain in Surplus</th>
<th>Loss in Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income</td>
<td>$492,195,741</td>
<td>$67,502,843</td>
</tr>
<tr>
<td>Change in net unrealized capital losses</td>
<td>55,814,890</td>
<td>375,000</td>
</tr>
<tr>
<td>Change in nonadmitted assets</td>
<td></td>
<td>265,000,000</td>
</tr>
<tr>
<td>Total gains and losses</td>
<td>$548,010,631</td>
<td>$372,664,744</td>
</tr>
</tbody>
</table>

Net increase in surplus as regards policyholders: **$175,345,887**

Surplus as regards policyholders,
December 31, 2013, per Examination: **$1,151,310,514**
COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The Company acquired all of the membership interest of AIS Management, LLC, on January 1, 2009. The transaction was funded via a $120,000,000 collateralized term loan with Bank of America.

The Company is also subject to an additional $20,000,000 collateralized term loan with Union Bank.

For both loans, the Company is required to maintain collateral with a third party custodian. Assets in such security deposit are required to be maintained in a fair value amount at least equal to the outstanding principal. At December 31, 2013, funds having an admitted value of $165,243,855 and a fair value of $165,687,008 were on deposit with the lenders.

(2) Losses and Loss Adjustment Expenses

Based upon a review conducted by a Casualty Actuary from the California Department of Insurance (CDI), the Company's reserves for losses and loss adjustment expenses as of December 31, 2013, were found to be reasonably stated.

(3) Taxes, Licenses, and Fees

California Insurance Code (CIC), Section 1872.8(a) states, in part, that each insurer doing business in the state of California must pay an annual Vehicle Fraud Assessment Fee for each vehicle insured under an insurance policy it issues in California. The fee provides funding for the increased investigation and prosecution of fraudulent automobile insurance claims and automobile theft in the state of California.

During the course of this examination, it was found that the Company inadvertently failed to include commercial and personal property trailers, mobile equipment, and
motor homes in the vehicle count when calculating the Vehicle Fraud Assessment Fees. Additional quarterly calculation errors were also noted. The total amount of vehicle fraud assessment fees determined to be due as a result of these errors during the period from January 1, 2011, through September 30, 2014, is $19,992, plus additional late charges assessed based on CIC Section 12995, and is summarized by year as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Fee/Vehicle</th>
<th>Vehicle Count</th>
<th>Amount Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>$0.45</td>
<td>15,168</td>
<td>$6,826</td>
</tr>
<tr>
<td>2012</td>
<td>$0.45</td>
<td>15,302</td>
<td>6,886</td>
</tr>
<tr>
<td>2013</td>
<td>$0.45</td>
<td>8,394</td>
<td>3,777</td>
</tr>
<tr>
<td>9/30/2014</td>
<td>$0.45</td>
<td>5,563</td>
<td>2,503</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>44,427</strong></td>
<td><strong>$19,992</strong></td>
</tr>
</tbody>
</table>

The Company and the CDI are in the process of settling the assessment fee and the additional late charges. Since the amount was deemed not material, no adjustment was made to the Company’s financial statements. The Company advised that it has implemented procedures to assure future compliance with the requirement of CIC Section 1872.8(a).

**SUMMARY OF COMMENTS AND RECOMMENDATIONS**

**Current Report of Examination**

Accounts and Records (Page 12): As the result of the review of the Company’s information systems controls, recommendations for improving these controls were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

**Previous Report of Examination**

There were no comments or recommendations in the previous Report of Examination.
ACKNOWLEDGMENT

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

Respectfully submitted,

/S/
Bradley R. Hazelwood, CFE, CPA
Examiner-In-Charge
Contractor Insurance Examiner
Department of Insurance
State of California