

REPORT OF EXAMINATION
OF THE
MONTEREY INSURANCE COMPANY
AS OF
DECEMBER 31, 2007

Participating State
and Zone:

California

Filed November 19, 2008

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San Francisco, California
September 26, 2008

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Morris Chavez
Secretary, Zone IV-Western
Superintendent of Insurance
New Mexico Insurance Division
Santa Fe, New Mexico

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

MONTEREY INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office, located at 2300 Garden Road, Monterey, California 93940.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2007. The examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The present examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of the assets, and a determination of liabilities as of December 31, 2007, as deemed necessary under

the circumstances. The examination was conducted concurrently with the Company's affiliates, California Capital Insurance Company, Eagle West Insurance Company, and Nevada Capital Insurance Company. These insurers are collectively referred to as the Capital Insurance Group (Group) hereinafter.

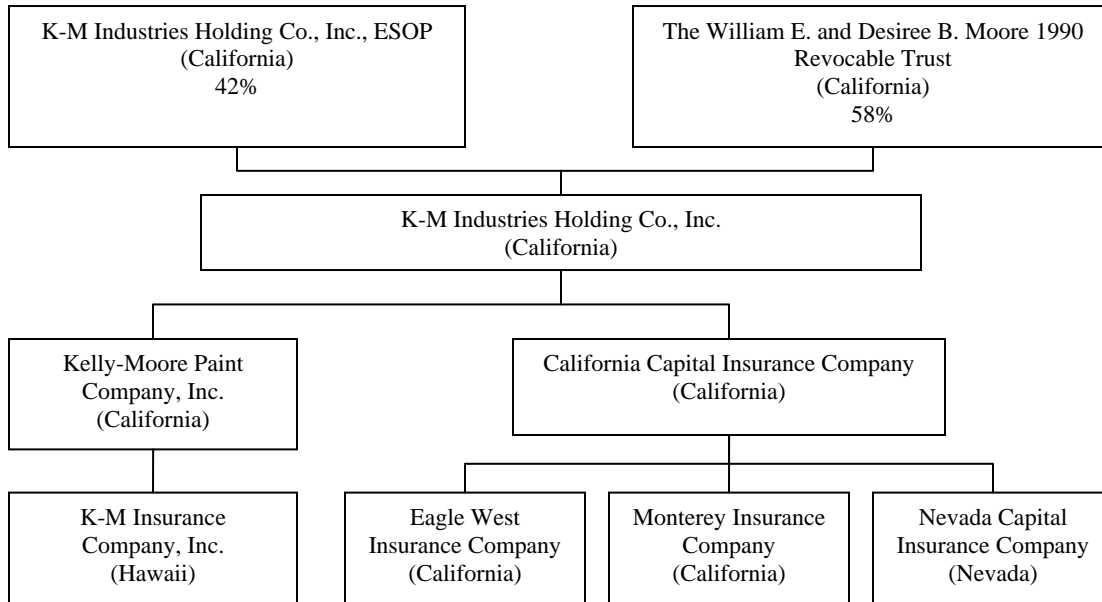
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans;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

COMPANY HISTORY

On October 10, 2004, the Board of Directors approved an amendment to the Company's Articles of Incorporation changing the par value of its common stock from \$100 per share to \$116 per share.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Desiree B. Moore is the ultimate controlling person. The following chart depicts the interrelationship of the companies within the holding company system:



(*) all ownership is 100% unless otherwise noted.

Management of the Company is vested in a five-member board of directors. Following are lists of directors and the principal officers of the Company as of December 31, 2007:

Directors

Name and Residence

Principal Business Affiliation

Peter M. Cazzolla
Reno, Nevada

President and Chief Executive Officer
Capital Insurance Group

Steven W. DeVoe*
San Carlos, California

President
Kelly-Moore Paint Company, Inc.

Christine McCall*
Missoula, Montana

Director
K-M Industries Holding Company, Inc.

Desiree B. Moore
Woodside, California

Chairwoman of the Board
K-M Industries Holding Company, Inc.

William E. Moore II
Escondido, California

Director
K-M Industries Holding Company, Inc.

**These directors were added in 2008.*

Principal Officers

<u>Name</u>	<u>Position</u>
Peter M. Cazzolla	President and Chief Executive Officer
Robert M. Erickson	Secretary, Treasurer and Chief Financial Officer
Thomas H. Scherff	Vice President of Claims
Robert D. Winn	Vice President of Underwriting

Intercompany Agreements

Allocation of Federal Income Taxes Agreement: Effective December 26, 2001, K-M Industries Holding Co., Inc. and the Company and its affiliates, California Capital Insurance Company (CCIC), Eagle West Insurance Company (EWIC), and Nevada Capital Insurance Company (NCIC) entered into a federal income tax allocation agreement. This agreement provides for allocation of the year-end consolidated tax liability among participants in the agreement. The year-end tax liability is computed on a consolidated basis; however, each participant's tax provision is calculated individually. Pursuant to California Insurance Code (CIC) Section 1215.5(b)(4), this agreement was submitted to and approved by the California Department of Insurance (CDI) on March 22, 2002.

Management Agreement: Effective January 1, 2002, the Company entered into a management agreement with CCIC. Under the terms of the agreement, CCIC provides sales, reinsurance, underwriting, claims payments, investment and various other administrative services to the Company and its affiliates based on actual cost. This agreement was submitted to the CDI pursuant to CIC Section 1215.5(b)(4) in 2002 and is pending approval.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2007, the Company was licensed to transact business in Arizona, California, Idaho, Montana, Nevada, Oregon, and Washington.

Direct premiums written during 2007 were \$31.1 million, of which 87% was written in California. Direct premiums written in Arizona and Oregon were 10% and 3%, respectively. The Company's primary lines of business written during 2007 were commercial auto liability (55.5%), commercial multiple peril (23.5%), auto physical damage (8.4%), inland marine (6.9%) and other liability-occurrence (4.2%). The Company also wrote a small amount of fire, allied lines, earthquake, burglary and theft, and boiler and machinery insurance.

Business for the Company is produced entirely by independent agents and brokers. There were approximately 500 agents and brokers appointed by the Company as of the examination date.

The Company operates on a joint basis with its parent, California Capital Insurance Company (CCIC), and its affiliates, Eagle West Insurance Company (EWIC) and Nevada Capital Insurance Company (NCIC), pursuant to an inter-company reinsurance pooling agreement. Each company uses a different marketing approach. CCIC and EWIC write all standard lines of business on a preferred basis. The Company writes direct commercial multiple peril business at deviated rates. NCIC writes policies only in Nevada.

The Company has regional and branch offices in Bakersfield, Camarillo, Campbell, Ferndale, Gold River, Modesto, Orange, San Diego, and Visalia, California, in Reno, Nevada, and in Salem, Oregon. Most branch offices perform both underwriting and claims adjusting functions. The Visalia and Bakersfield branch offices perform only claims adjusting. The San Diego branch office performs only underwriting.

Underwriting for personal lines is performed at the Company's home office in Monterey and the branch office in Reno. Underwriting for the farm business is performed at the Modesto and Salem branches. Commercial lines underwriting is performed at all branches for amounts within the authority of the branch. Larger policies are underwritten at the home office.

On July 25, 2008, the Board of Directors authorized management to execute a Uniform Consent of Service Process to allow the Company to apply to be a nonadmitted or surplus lines carrier in

Nevada. This filing would require the Company to withdraw its Certificate of Authority in Nevada.

REINSURANCE

Pooling Agreement

A revised pooling agreement was approved by the California Department of Insurance effective January 1, 2006. The agreement authorizes California Capital Insurance Company (CCIC) to collect and receive all premiums, to adjust and pay all losses and to reinsure or cancel all contracts and policies for the pool. Under the terms of this agreement, the Company, Eagle West Insurance Company, and Nevada Capital Insurance Company cede 100% of all premiums, losses, loss adjustment expenses and most underwriting expenses to CCIC, which then retrocedes a prorated amount to each company based on the following pooling percentages:

California Capital Insurance Company	61%
Eagle West Insurance Company	16%
Monterey Insurance Company	11%
Nevada Capital Insurance Company	<u>12%</u>
Total	100%

Assumed

The Company did not assume any business during the period under examination other than from the pooling agreement above.

Ceded

The following is a summary of principal reinsurance agreements in effect as of December 31, 2007. All reinsurers are authorized unless indicated otherwise. Reinsurers with less than 5% participation have been accumulated and listed in aggregate.

<u>Type of Contract</u>	<u>Line(s) of Business</u>	<u>Reinsurer(s)</u>	<u>Company's Retention</u>	<u>Reinsurer's Limits</u>	
Mutli-line XOL	1 st Layer	Property and Casualty	Motors Insurance Corporation	Property: \$750,000 per risk	Property: \$250,000 per risk, \$750,000 per occurrence
				Casualty: \$750,000 per occurrence	Casualty: \$250,000 per occurrence
	2 nd Layer	Property and Casualty	Motors Insurance Corporation	Property: \$1 million per risk	Property: \$5 million per risk, \$10 million per occurrence
				Casualty: \$1 million per occurrence	Casualty: \$5 million per occurrence
Catastrophe	1 st Layer	Property	Lloyd's (11.5%) Various (4%) Nonadmitted: AXIS Specialty Ltd (25%) Flagstone Reinsurance Ltd. (7.5%) Max Re Ltd. (7.5%) Validus Reinsurance, Ltd. (8.5%) Amlin Bermuda Ltd. (5%) AXA Re (5%) R+V Versicherung A.G. (10%) Various (11%)	\$10 million per occurrence	95% of \$15 million excess of \$10 million, loss limit of \$30,000,000
	2 nd Layer	Property	Lloyd's (11.5%) Various (4%) Nonadmitted: AXIS Specialty Ltd (25%) Flagstone Reinsurance Ltd. (7.5%) Mapfre Re Compania de Reasegueros, S.A. (5%) Max Re Ltd. (5.5%) Validus Reinsurance, Ltd. (8.5%) Amlin Bermuda Ltd. (5%) AXA Re (5%) R+V Versicherung A.G. (10%) Various (8%)	\$25 million per occurrence	95% of \$25 million excess of \$25 million, loss limit of \$50 million
	3 rd Layer	Property	Lloyd's (11.5%) Various (4%) Nonadmitted: AXIS Specialty Ltd (25%) Flagstone Reinsurance Ltd. (7.5%) Mapfre Re Compania de Reasegueros, S.A. (5%) Max Re Ltd. (5.5%) MS Frontier Reinsurance Ltd. (5%)	\$50 million per occurrence	95% of \$35 million excess of \$50 million, loss limit of \$70 million

<u>Type of Contract</u>	<u>Line(s) of Business</u>	<u>Reinsurer(s)</u>	<u>Company's Retention</u>	<u>Reinsurer's Limits</u>
		Validus Reinsurance, Ltd. (8.5%) Amlin Bermuda Ltd. (5%) AXA Re (5%) R+V Versicherung A.G. (5%) Various (8%)		
Top Layer	Property	Mutual Reinsurance Bureau: Country Mutual Ins. Co. (20%) Employers Mutual Cas. Co. (20%) Kentucky Farm Bureau Mutual Ins. Co. (20%) Motorists Mutual Ins. Co. (20%) Nonadmitted: Auto-Owners Ins. Co. (20%)	\$85 million per occurrence	\$25 million excess of \$85 million, loss limit of \$50 million

ACCOUNTS AND RECORDS

Information Systems Controls

A review was made of the Company's general controls over its information systems. As a result of the review, weaknesses were noted in the area of business continuity planning. The weaknesses noted were presented to the Company along with recommendations to strengthen its controls. It is recommended that the Company evaluate these 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, 2007

Underwriting and Investment Exhibit for the year ended December 31, 2007

Reconciliation of Surplus as Regards Policyholders from December 31, 2003 through December 31, 2007

Statement of Financial Condition
as of December 31, 2007

	<u>Ledger and Non-ledger Assets</u>	<u>Non- Admitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
<u>Assets</u>				
Bonds	\$ 51,704,476	\$	\$ 51,704,476	
Cash and short-term investments	10,087		10,087	
Investment income due & accrued	611,910		611,910	
Premiums and agents' balances in course of collection	1,816,474	168,550	1,647,924	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	2,767,803		2,767,803	
Reinsurance recoverables	4,758		4,758	
Net deferred tax asset	1,822,810	343,420	1,479,390	
Aggregate write-ins for other than invested assets	<u>114,991</u>	<u>57,541</u>	<u>57,450</u>	
Total assets	<u>\$ 58,853,309</u>	<u>\$ 569,511</u>	<u>\$ 58,283,798</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 11,130,783	(1)
Loss adjustment expenses			4,445,099	(1)
Commissions payable, contingent commissions and other similar charges			1,968,728	
Other expenses			706,298	
Taxes, licenses and fees			11,595	
Current federal and foreign income taxes			135,541	
Unearned premiums			14,262,035	
Advanced premiums			132,062	
Ceded reinsurance premiums payable			622,910	
Drafts outstanding			979,548	
Payable to parent, subsidiaries and affiliates			<u>170,755</u>	
Total liabilities			\$ 34,565,354	
Capital common stock		\$ 3,016,000		
Gross paid-in and contributed surplus		24,180		
Unassigned funds		<u>20,678,264</u>		
Surplus as regards policyholders			<u>23,718,444</u>	
Total liabilities, surplus and other funds			<u>\$ 58,283,798</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2007

Statement of Income

Underwriting Income

Premiums earned		\$ 29,615,519
Deductions:		
Losses incurred	\$ 13,206,116	
Loss expenses incurred	3,618,884	
Other underwriting expenses incurred	<u>11,421,540</u>	
Total underwriting deductions		<u>28,246,540</u>
Net underwriting gain		1,368,979

Investment Income

Net investment income earned	\$ 2,770,493	
Net realized capital gains	<u>1,640</u>	
Net investment gain		2,772,133

Other Income

Net loss from agents' balances or premium balances charged off	\$ (9,646)	
Finance and service charges not included in premiums	275,781	
Aggregate write-in for miscellaneous income	<u>41,784</u>	
Total other income		<u>307,919</u>
Net income before federal income taxes		4,449,031
Federal income taxes incurred		<u>1,584,524</u>
Net income		<u>\$ 2,864,507</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2006		\$ 20,864,603
Net income	\$ 2,864,507	
Change in deferred income tax	157,080	
Change in nonadmitted assets	<u>(167,746)</u>	
Change in surplus as regards policyholders for the year		<u>2,853,841</u>
Surplus as regards policyholders, December 31, 2007		<u>\$ 23,718,444</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2003 through December 31, 2007

Surplus as regards policyholders, December 31, 2003, per Examination			\$ 12,073,652
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 11,213,041	\$	
Change in net deferred income tax	807,710		
Change in nonadmitted assets		375,970	
Capital transfer: From surplus	416,000		
Surplus adjustments: Transfer to capital stock		416,000	
Write-ins for gains and losses in surplus	<u>11</u>	<u></u>	
Totals	<u>\$ 12,436,762</u>	<u>\$ 791,970</u>	
Net increase in surplus as regards policyholders			<u>11,644,792</u>
Surplus as regards policyholders, December 31, 2007, per Examination			<u>\$ 23,718,444</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2007 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 – Information Systems Controls (Page 8): It is recommended that the Company evaluate the recommendations from the Information Systems review and make appropriate changes to strengthen its information systems controls.

Prior Report of Examination

Accounts and Records – Information Systems Controls (Page 8): It was recommended that the Company evaluate the recommendations from the Information Systems review and make appropriate changes to strengthen its information system controls. Some recommendations have been implemented.

Comments on Financial Statement Items – Losses and Loss Adjustment Expenses (Page 12): It was recommended the Company comply with Statement of Statutory Accounting Principles No. 65, paragraph 32. The Company has implemented this recommendation.

