REPORT OF EXAMINATION
OF THE
MONTEREY INSURANCE COMPANY
AS OF
DECEMBER 31, 2011

Filed April 12, 2013

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San Francisco, California
March 8, 2013

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of

MONTEREY INSURANCE COMPANY

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

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, 2007. This examination covers the period from January 1, 2008 through December 31, 2011. 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 with participation from the Nevada Division of Insurance and was conducted concurrently with the examination of other insurance entities in the holding company group, including California Capital Insurance Company, Eagle West Insurance Company, and Nevada Capital Insurance Company. Collectively, the insurers in the group are known as the Capital Insurance Group.

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; accounts and records; and statutory deposits.

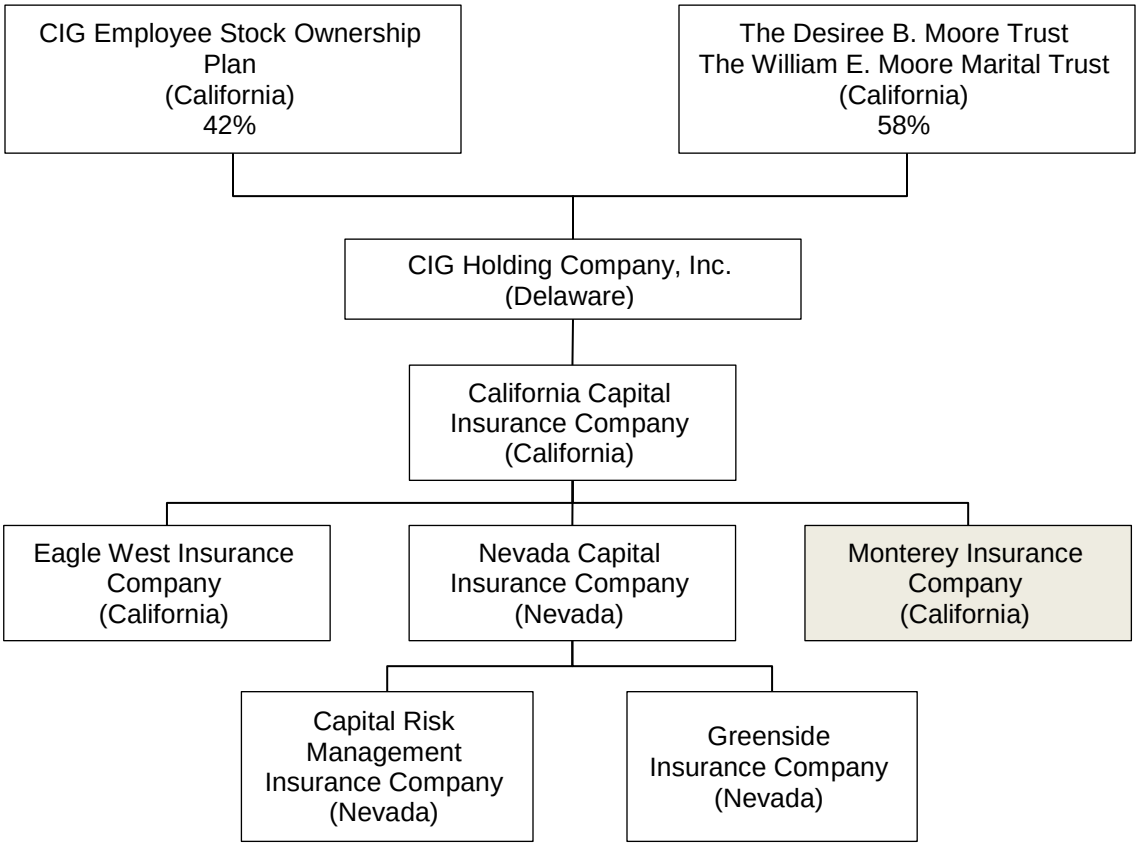
COMPANY HISTORY

Effective December 31, 2011, the Company, California Capital Insurance Company, Eagle West Insurance Company and Nevada Capital Insurance Company (hereinafter collectively referred to as CIG) separated from K-M Industries Holding Company, Inc. (KMIHC). This separation occurred through the creation of a new holding company for CIG, while KMIHC remained as the holding company for the Kelly-Moore Paint Company. The newly created holding company for CIG is CIG Holding Company, Inc. (CIGHCI), a Delaware corporation. An Employee Stock Ownership Plan (ESOP) named CIG Employee Stock Ownership Plan (CIG-ESOP) was also created to move the CIG employees from the K-M Industries Holding Co., Inc., ESOP to an ESOP that supports only the employees of the CIG insurance operations. Subsequent to the reorganization, 42% of the voting securities of CIGHCI are owned by CIG-ESOP. The remaining 58% of CIGHCI is owned by The Desiree B. Moore Revocable Trust and The William E. Moore Marital Trust. There was no change in the ultimate control or ownership of the CIG companies as a result of the reorganization. On November 14, 2011, the California

Department of Insurance granted a Request for Exemption from Filing a Form A pursuant to California Insurance Code Section 1215.2(f) for the above transaction.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which ultimate control is held by The Desiree B. Moore Revocable Trust and The William E. Moore Marital Trust. The Company is a wholly-owned subsidiary of California Capital Insurance Company, which is in turn a wholly owned subsidiary of CIG Holding Company, Inc. The following chart depicts the interrelationship of the companies within the holding company system (all ownership is 100% unless otherwise indicated):



Management and control of the Company is vested in a four-member Board of Directors elected annually. As of December 31, 2011, the members serving on the Board of Directors were as follows:

Directors

Name and Residence	Principal Business Affiliation
Peter Michael Cazzolla Reno, Nevada	President and Chief Executive Officer California Capital Insurance Company
Steven William DeVoe San Carlos, California	President Kelly-Moore Paints, Inc.
Christine Moore McCall Missoula, Montana	Director K-M Industries Holding Company, Inc.
William Edwards Moore II Escondido, California	Director K-M Industries Holding Company, Inc.

The principal officers serving as of December 31, 2011 were as follows:

Officers

Name	Title
Peter Michael Cazzolla	President
Robert Michael Erickson	Secretary, Treasurer, and Vice President of Finance
Walter Montgomery Bennett	Vice President of Underwriting
Thomas Henry Scherff	Vice President of Claims

Intercompany Agreements

Management Agreement: Effective January 1, 2002, the Company entered into a management agreement with California Capital Insurance Company (CCIC). Under the terms of the agreement, CCIC provides sales, reinsurance, underwriting, premium billing and collection, data processing, claims and policy payments, investment, personnel, and other general administrative services to the Company based on actual cost. In November 2009, the agreement was amended to include a settlement provision

at the request of the California Department of Insurance's (CDI) Financial Analysis Division. The amended management agreement was approved by the CDI on December 3, 2009 pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Tax Allocation Agreement: Effective October 1, 2012, a revised tax allocation agreement was entered into between the Company and CCIC. Under the terms of the revised tax allocation agreement, CCIC files a consolidated federal income tax return on behalf of the Company. The tax liability of each participant is calculated on a separate income tax return basis. On November 14, 2012, the revised tax allocation agreement was approved by the CDI. This revised tax allocation agreement replaced the previously approved tax allocation agreement between the Company, its affiliates and K-M Industries Holding Co., Inc., which was terminated after the reorganization.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2011, the Company was licensed to transact business in Arizona, California, Idaho, Montana, New Mexico, Oregon, and Washington. The Company is also authorized as a surplus lines insurer in Nevada.

Direct premiums written during 2011 were $36.7 million, with the majority written in California (87.7%) and Arizona (9.5%). The Company's primary lines of business written during 2011 were commercial auto liability (45.8%), commercial multiple peril (32.6%), auto physical damage (9.8%), and inland marine (7.6%). The Company also wrote a small amount of fire, allied lines, earthquake, other liability-occurrence, burglary and theft, and boiler and machinery insurance, which altogether comprised 4.2% of the direct premiums written during 2011. Business for the Company is produced entirely by independent agents and brokers. There were approximately 680 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 affiliates, Eagle West Insurance Company (MIC) and Nevada

Capital Insurance Company (NCIC), pursuant to an intercompany reinsurance pooling agreement. Each company uses a different marketing approach. The EWIC and CCIC write all standard lines of business on a preferred basis. The Company writes direct commercial multiple peril business at deviated rates. NCIC writes policies on an admitted basis in Nevada and on a surplus lines basis in Arizona, California, Oregon, and Washington.

The Company has regional and branch offices in the following cities in California: Bakersfield, Camarillo, Ferndale, Gold River, Orange, Visalia, and San Diego. There are also offices in Reno, Nevada and 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 and Salem branch offices perform 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 underwriting branch offices for amounts within the authority of the branch. Larger policies are underwritten at the home office.

REINSURANCE

Intercompany Reinsurance Pooling Agreement

On September 17, 2007, a revised pooling agreement was approved by the California Department of Insurance with an effective date of January 1, 2006. The agreement authorizes the 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:

Pool Participant	Participation Percentage
California Capital Insurance Company	61%
Eagle West Insurance Company	16%
Monterey Insurance Company	11%
Nevada Capital Insurance Company	12%
	100%

Affiliated Quota Share Reinsurance Agreement

The insurers in the Capital Insurance Group (CIG) write a small book of business classified as captive business that is 100% reinsured with either one of the following affiliated captive insurance companies: Capital Risk Management Insurance Company (CRMIC) or Greenside Insurance Company (Greenside).

Greenside is a sponsored captive company that was approved by the Nevada Division of Insurance in 2009. The design was for Greenside to be a "Cell Captive" to supplement the Company's Golf Program. Greenside was closed and returned all remaining capital to Nevada Capital Insurance Company during December 2011 due to the lack of sales.

CRMIC is a sponsored captive company that is designed similar to Greenside except it is open to all CIG policyholders. A policyholder may participate in its own risk by buying into CRMIC through the purchase of a Preferred Share which provides it with a "cell." The policy is written on CIG paper and is ceded 100% net of inuring reinsurance to CRMIC. The cell takes its portion of the premium and the associated losses and CRMIC's core assumes the rest. CRMIC operations and administration are handled by Lionheart Insurance Group out of Scottsdale, Arizona. The Company stated that at year-end 2011, CRMIC only had five cells consisting of policyholders who are large commercial clients

with a desire to take on some risk in their insurance. The total premiums assumed by CRMIC during 2011 were $1.2 million.

Both of the above affiliated reinsurance agreements are below the threshold required for prior approval under California Insurance Code Section 1215.5(b)(3).

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 the Company's reinsurance agreements in-force as of December 31, 2011:

Type of Contract	**Line(s) of Business**	**Reinsurer(s) and Participation**	**Company's Retention**	**Reinsurer's Limits**
Multi-line Excess of Loss	Property and Casualty	Maiden Reinsurance Company (100%)	1st Property $1 million each risk, each occurrence 1st Casualty $1 million each risk, each occurrence	1st Property $5 million excess $1 million, maximum occurrence limit of $10 million 1st Casualty $5 million excess of $1 million, maximum occurrence limit of $5 million
Property per Risk Excess of Loss	Property	Munich Reinsurance America, Inc. (100%)	$6 million each risk, each occurrence	$4 million excess of $6 million each risk, maximum loss limit of $8 million each occurrence

Type of Contract	Line(s) of Business	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limits
100% Quota Share	Equipment Breakdown	Factory Mutual Insurance Company (100%)	None	100% quota share, maximum of $50,000 per occurrence
Umbrella Quota Share	Commercial, Personal and Farm Umbrella Liability	Maiden Reinsurance Company (95%)	1st Layer 5% quota share of $1 million 2nd Layer 5% quota share of $9 million excess of $1 million	1st Layer 95% of $1 million 2nd Layer 95% of $9 million excess of $1 million
CAT Excess of Loss	Property	Allied World Assurance Co Ltd. Alterra Bermuda Ltd American Agricultural Ins Co Amlin AG Arch Reinsurance Limited AXIS Specialty Limited Hannover Re (Bermuda), Ltd. Hardy Bermuda Ltd/Lloyds 382 Liberty Synd Paris/Synd 4472 Lloyds Syndicate 0780 (ADV) Lloyds Syndicate 0807 (SDM) Lloyds Syndicate 1301 (BGT) Lloyds Syndicate 2001 (AML) Lloyds Syndicate 2010 (MMX) Mapfre Re, Compania de Reas Montpelier Reinsurance Ltd. MS Frontier Reins Ltd Odyssey America Reinsurance Co Paladin Cat Mgmt/Protective Partner Reinsurance Co Ltd QBE Reinsurance Corporation R+V Versicherung AG SCOR Global P&C Zurich Branch Shelter Mutual Insurance Co *Note: Participation for each reinsurer above varies under each layer.*	1st Layer $10 million per occurrence 2nd Layer $20 million per occurrence 3rd Layer $40 million per occurrence 4th Layer $85 million per occurrence	1st Layer [1] $10 million excess of $10 million per occurrence 2nd Layer [2] $20 million excess of $20 million per occurrence 3rd Layer [3] $45 million excess of $40 million per occurrence 4th Layer [4] $55 million excess of $85 million per occurrence

Type of Contract	Line(s) of Business	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limits
CAT Excess of Loss Top Layer	Property	Country Mutual Insurance Company (20%) Employers Mutual Casualty Company (20%) Farm Bureau Mutual Insurance Company of Michigan (20%) Kentucky Farm Bureau Mutual Insurance Company (20%) Motorists Mutual Insurance Company (20%)	$140 million per occurrence	$40 million excess of $140 million per occurrence
Property Facultative	Property	Munich Reinsurance America, Inc. (100%)	$6 million per risk	For Apartments & Condominiums: $24 million excess of $6 million per risk For Offices: $10 million excess of $6 million per risk For All Other: $10 million excess of $6 million per risk Assumed from State National Insurance Company: $9 million excess of $6 million per risk
Casualty Facultative	Casualty	Maiden Reinsurance Company (100%)	$1,000,000 each occurrence, each policy	$1,000,000 excess of $1,000,000 each occurrence, each policy

Notes:
[1] Only 90% of Layer 1 of the CAT Excess of Loss was placed with reinsurers.
[2] Only 85% of Layer 2 of the CAT Excess of Loss was placed with reinsurers.
[3] Only 85% of Layer 3 of the CAT Excess of Loss was placed with reinsurers.
[4] Only 85% of Layer 4 of the CAT Excess of Loss was placed with reinsurers.

The Multi-line Excess of Loss, Umbrella Quota Share, and CAT Excess of Loss Top Layer reinsurance agreements were determined to be deficient as to form pursuant to California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Article 3, (CCR Title 10) Section 2303.14 because the agreements contain an early termination provision

that is not in compliance with the aforementioned regulations. These reinsurance agreements permit the reinsurer to terminate the agreements upon the entry of an order of rehabilitation, conservation or liquidation against the Company, which is a violation of CCR Title 10 Section 2303.14(b)(1)(A). In addition, the Multi-line Excess of Loss and Umbrella Quota Share agreements only requires the reinsurer to give 30-day notice to exercise termination under the early termination provision whereas CCR Title 10 Section 2303.14(b)(1)(B) requires at least 60-day notice. Furthermore, the CAT Excess of Loss Top Layer does not specify that a signature upon delivery of the early termination notice is required as is mandated in CCR Title 10 Section 2303.14(b)(1)(C). It is recommended that the Company ensure that the early termination provision in its reinsurance agreements complies with CCR Title 10 Section 2303.14(b)(1), paragraphs (A) and (B).

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2011

Underwriting and Investment Exhibit for the Year Ended December 31, 2011

Reconciliation of Surplus as Regards Policyholders from December 31, 2007 through December 31, 2011

Statement of Financial Condition
as of December 31, 2011

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 59,317,240	$	$ 59,317,240	
Cash and short-term investments	3,490,391		3,490,391	
Investment income due & accrued	382,118		382,118	
Uncollected premiums and agents' balances in course of collection	2,090,750	201,368	1,889,382	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	3,784,632		3,784,632	
Amount recoverable from reinsurers	201,168		201,168	
Current federal and foreign income tax recoverable and interest thereon	151,818		151,818	
Net deferred tax asset	2,555,410	808,390	1,747,020	
Aggregate write-ins for other than invested assets	140,251	84,709	55,542	
Total assets	$ 72,113,778	$ 1,094,467	$ 71,019,311	
Liabilities, Surplus and Other Funds				
Losses			$ 15,630,697	(1)
Loss adjustment expenses			5,712,025	(1)
Commissions payable, contingent commissions and other similar charges			1,201,878	
Other expenses			522,979	
Taxes, licenses and fees			266,964	
Unearned premiums			16,705,651	
Advance premiums			157,912	
Ceded reinsurance premiums payable			320,329	
Drafts outstanding			259,132	
Payable to parent, subsidiaries and affiliates			673,781	
Total liabilities			41,451,348	
Common capital stock		$ 3,016,000		
Gross paid-in and contributed surplus		24,180		
Unassigned funds (surplus)		26,527,783		
Surplus as regards policyholders			29,567,963	
Total liabilities, surplus and other funds			$ 71,019,311	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2011

Statement of Income

Underwriting Income		
Premiums earned		$ 33,508,309
Deductions:		
Losses incurred	$ 18,650,885	
Loss expenses incurred	4,907,601	
Other underwriting expenses incurred	12,127,913	
Total underwriting deductions		35,686,399
Net underwriting loss		(2,178,090)
Investment Income		
Net investment income earned	$ 1,780,251	
Net realized capital gain	7,630	
Net investment gain		1,787,881
Other Income		
Net loss from agents' or premium balances charged off	$ (35,415)	
Finance and service charges not included in premiums	305,761	
Aggregate write-in for miscellaneous income	(58,037)	
Total other income		212,309
Net income before federal and foreign income taxes incurred		(177,900)
Federal and foreign income taxes incurred		(835)
Net loss		$ (177,065)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2010		$ 29,591,905
Net income	$ (177,065)	
Change in net deferred income tax	(56,144)	
Change in nonadmitted assets	209,267	
Change in surplus as regards policyholders for the year		(23,942)
Surplus as regards policyholders, December 31, 2011		$ 29,567,963

Reconciliation of Surplus as Regards Policyholders
from December 31, 2007 through December 31, 2011

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2007, per Examination			$ 23,718,444
Net income	$ 5,663,819	$	
Change in net deferred income tax	710,656		
Change in nonadmitted assets		524,956	
Total gains and losses	$ 6,374,475	$ 524,956	
Net increase in surplus as regards policyholders			5,849,519
Surplus as regards policyholders, December 31, 2011, per Examination			$ 29,567,963

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance reviewed the Actuarial Report as of December 31, 2011 prepared by the Company's independent actuary and concurred with the conclusion that the reserves as of December 31, 2011 are reasonable.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Reinsurance – Ceded (Page 8): It is recommended that the Company ensure that the early termination provision in its reinsurance agreements comply with California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.14(b)(1), paragraphs (A) and (B).

Previous 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 systems controls. No significant information systems control deficiencies were observed during the current 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,

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Ber Vang, CFE, AES, CISA
Examiner-In-Charge
Senior Insurance Examiner (Supervisor)
Department of Insurance
State of California