

REPORT OF EXAMINATION
OF THE
NEIGHBORHOOD SPIRIT PROPERTY
AND CASUALTY COMPANY
AS OF
DECEMBER 31, 2017



Insurance Commissioner

FILED 6-28-19

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Los Angeles, California
May 16, 2019

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

NEIGHBORHOOD SPIRIT PROPERTY AND CASUALTY COMPANY

(hereinafter also referred to as the Company) at its former administrative office located at 4680 Wilshire Boulevard, Los Angeles, California 91010. The Company's current statutory home office and main administrative office is located at 6301 Owensmouth Avenue, Woodland Hills, California 91367.

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, 2013. This examination covers the period from January 1, 2014 through December 31, 2017.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Company.

This examination was a coordinated examination with California as the lead state of the Farmers Insurance Exchange subgroup of the Farmers Insurance Group. The states of Illinois and Washington participated on the examination, and it was conducted concurrently with the examinations of the following insurance entities in the holding company group:

Group/Company	NAIC CoCode	Domiciled State
FARMERS INSURANCE EXCHANGE GROUP		
Farmers Insurance Company of Arizona	21598	AZ
Farmers Insurance Exchange	21652	CA
Truck Insurance Exchange	21709	CA
Fire Insurance Exchange	21660	CA
Civic Property and Casualty Company	10315	CA
Neighborhood Spirit Property and Casualty Company (the Company)	10317	CA
Exact Property and Casualty Company	10318	CA
Mid-Century Insurance Company	21687	CA
Farmers Insurance Company of Idaho	21601	ID
Farmers New Century Insurance Company	10806	IL
Illinois Farmers Insurance Company	21679	IL
Farmers Insurance Company Inc.	21628	KS
Farmers Insurance of Columbus, Inc.	36889	OH
Farmers Insurance Company of Oregon	21636	OR
Texas Farmers Insurance Company	21695	TX
Farmers Texas County Mutual Insurance Company	24392	TX
Mid Century Insurance Company of Texas	28673	TX
Farmers Insurance Company of Washington	21644	WA

Group/Company	NAIC CoCode	Domiciled State
COAST NATIONAL/BRISTOL WEST GROUP		
Coast National Insurance Company	25089	CA
Security National Insurance Company	33120	FL
Bristol West Preferred Insurance Company	12774	MI
Bristol West Casualty Insurance Company	11034	OH
Bristol West Insurance Company	19658	OH

Group/Company	NAIC CoCode	Domiciled State
FOREMOST GROUP		
Foremost Insurance Company Grand Rapids, Michigan	11185	MI
Foremost Property and Casualty Insurance Company	11800	MI
Foremost Signature Insurance Company	41513	MI
Farmers Specialty Insurance Company	43699	MI
Foremost County Mutual Insurance Company	29254	TX
Foremost Lloyds of Texas	41688	TX

Group/Company	NAIC CoCode	Domiciled State
21ST CENTURY INSURANCE GROUP		
21st Century Casualty Company	36404	CA
21st Century Insurance Company	12963	CA
21st Century Superior Insurance Company	43761	CA
21st Century Pacific Insurance Company	23795	CO
21st Century Assurance Company	44245	DE
American Pacific Insurance Company, Inc.	10805	HI
Farmers Insurance Hawaii, Inc.	28487	HI
21st Century Advantage Insurance Company	25232	MN
21st Century Auto Insurance Company of New Jersey	10184	NJ
21st Century Pinnacle Insurance Company	10710	NJ
21st Century National Insurance Company (a)	36587	NY
21st Century North America Insurance Company	32220	NY
21st Century Centennial Insurance Company	34789	PA
21st Century Indemnity Insurance Company	43974	PA
21st Century Preferred Insurance Company	22225	PA
21st Century Premier Insurance Company	20796	PA
21st Century Security Insurance Company (b)	23833	PA
21st Century Insurance Company of the Southwest	10245	TX

- (a) 21st Century National Insurance Company was sold to Plymouth Rock Assurance Corporation (Plymouth), effective April 1, 2018.
- (b) 21st Century Security Insurance Company (Security) was sold to Plymouth, which assigned its right to acquire Security to High Point Preferred Insurance Company, effective August 1, 2018.

Group/Company	NAIC CoCode	Domiciled State
ZURICH GROUP		
Farmers Reinsurance Company	10873	CA

With the exception of the Farmers Reinsurance Company, which is part of the Zurich Group, all the above companies are part of the Farmers Insurance Group of companies. Although owned by Farmers Group, Inc. (FGI), the attorney-in-fact for the Farmers Insurance Group, the Farmers Reinsurance Company operates as one of the Farmers property and casualty companies.

COMPANY HISTORY

The Company was incorporated on February 17, 1995, under the laws of California. It received its Certificate of Authority from the California Department of Insurance on June 30, 1995 and commenced business on September 1, 1995.

Capitalization

Paid-in capital of \$5 million consists of 100,000 shares of \$50 par value common stock issued and outstanding. The Company has 5,000,000 shares authorized.

MANAGEMENT AND CONTROL

The Company is a subsidiary of Fire Insurance Exchange (80%) and Truck Insurance Exchange (20%). Through its 80% ownership interest, Fire Insurance Exchange is the ultimate controlling person of the Company.

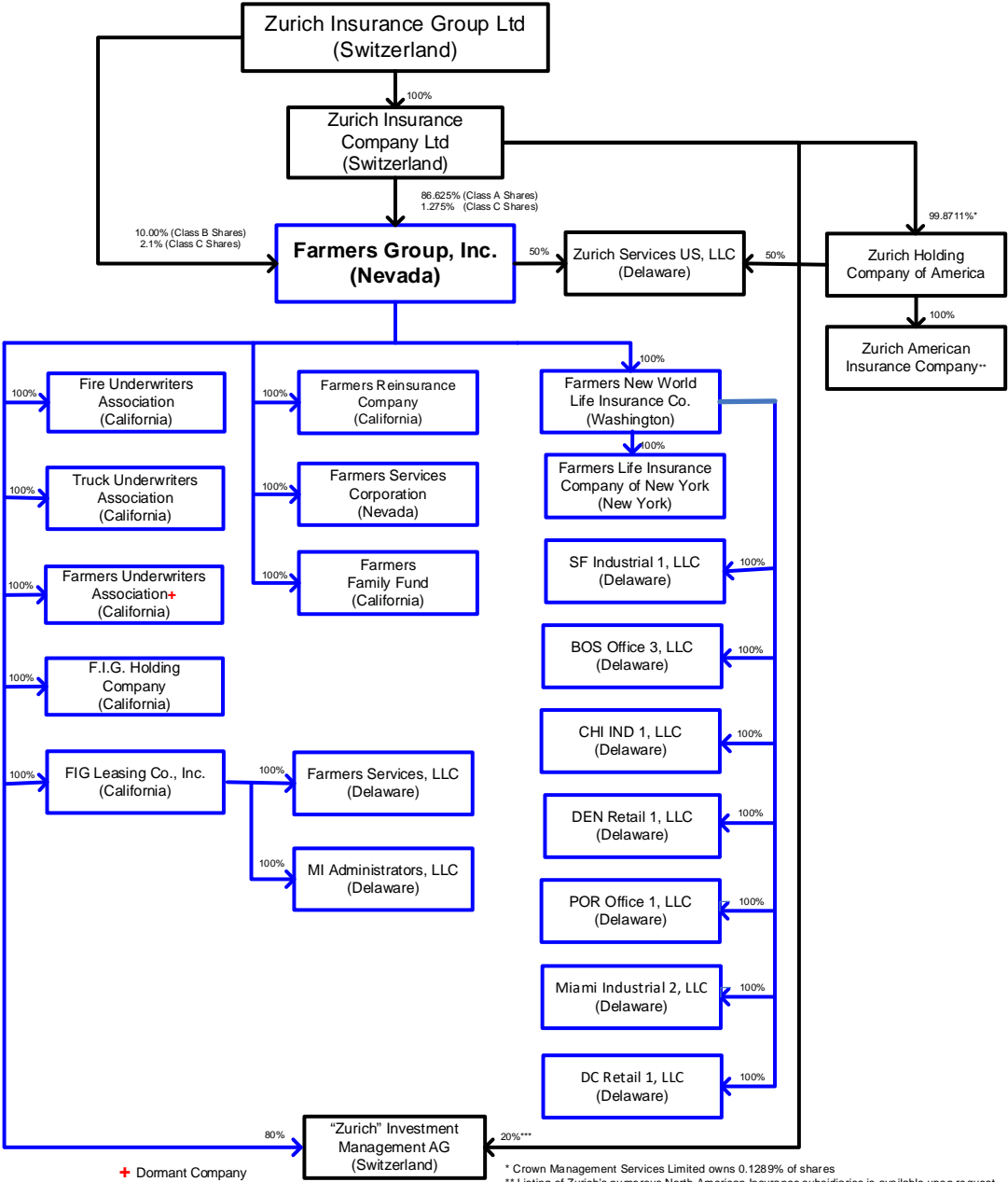
With the approval of the California Department of Insurance (CDI) in December 2013, a unique National Association of Insurance Commissioners (NAIC) Group Code has been assigned to the Farmers Group of companies (previously part of the Zurich NAIC Group Code 0212 and now included in the Farmers Group Code 0069). As such Zurich Insurance Company (ZIC), is no longer named as an Ultimate Controlling Party for the Farmers Group of companies. However, disclosure continues to be provided in the Holding Company Annual Registration Statements regarding the relationship with Zurich Insurance Group Ltd. (ZIG) and transactions involving entities with the ZIC NAIC Group Code 0212.

The Farmers Exchanges (Farmers Insurance Exchange, Fire Insurance Exchange, and Truck Insurance Exchange) and the Company are provided certain non-claims services by the Farmers Exchanges Attorney-In-Fact, Farmers Group, Inc. (FGI). FGI is a U.S.

subsidiary of ZIG, a Swiss holding company. ZIG was formerly known as Zurich Financial Services until it changed its name in 2012.

The following abridged organizational charts show the relationships of FGI to its ultimate parent ZIG, and of the Farmers Exchanges to their subsidiaries and affiliates as of December 31, 2017:

ZURICH ORGANIZATION (NAIC GROUP CODE 0212)



**FARMERS EXCHANGES ORGANIZATION
(NAIC GROUP CODE 0069)**

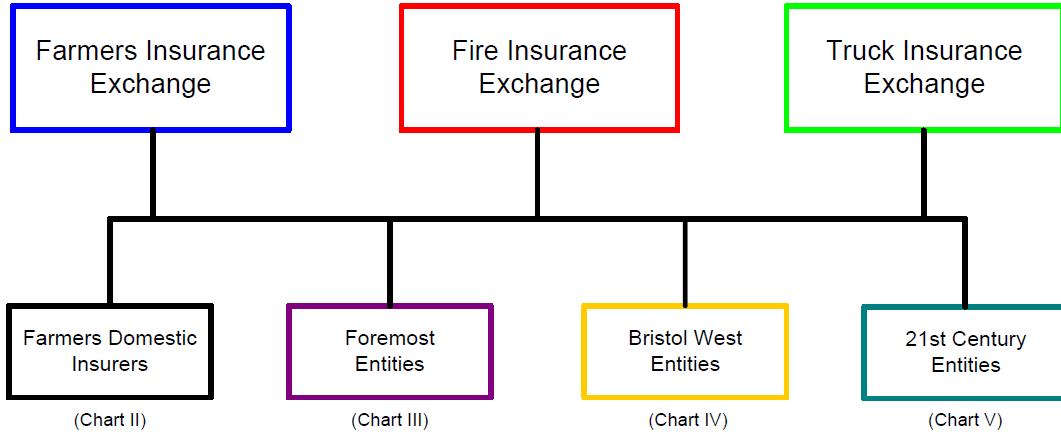


CHART II: EXCHANGES/FARMERS ENTITIES ORGANIZATION

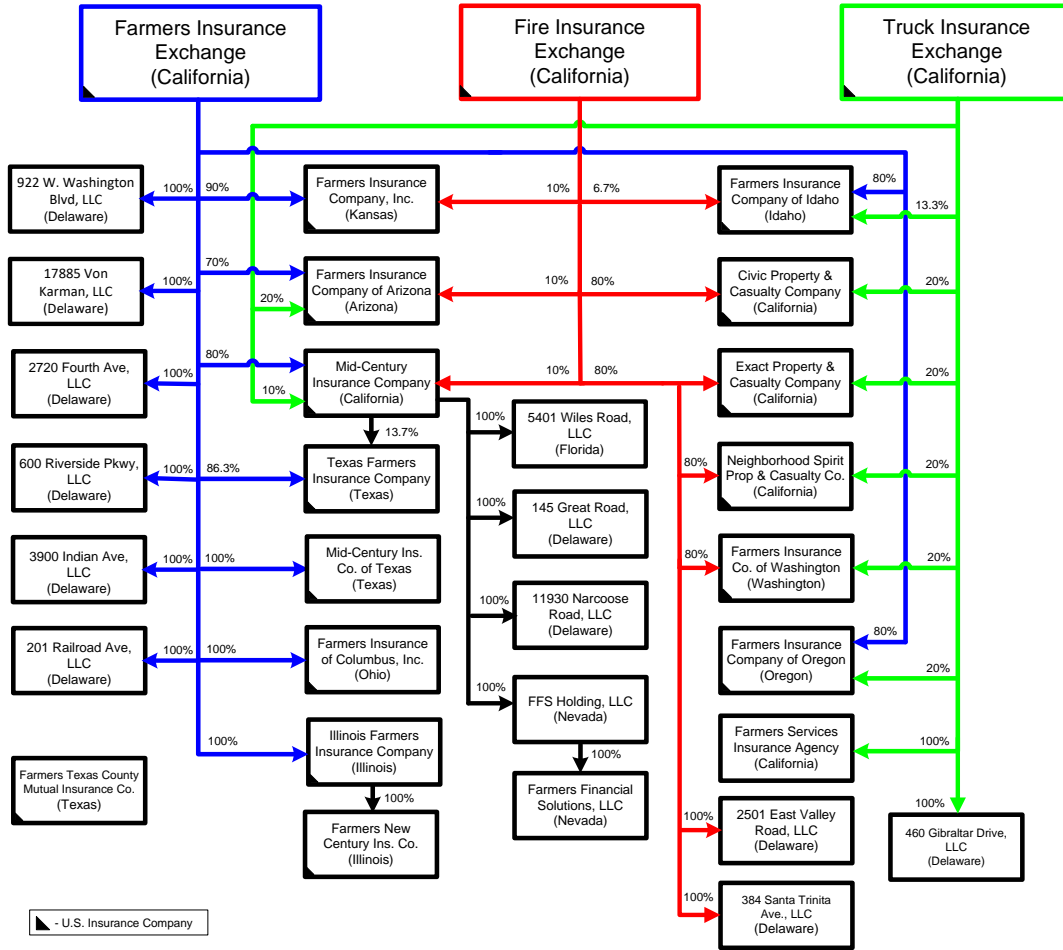


CHART III: EXCHANGES/FOREMOST ORGANIZATION

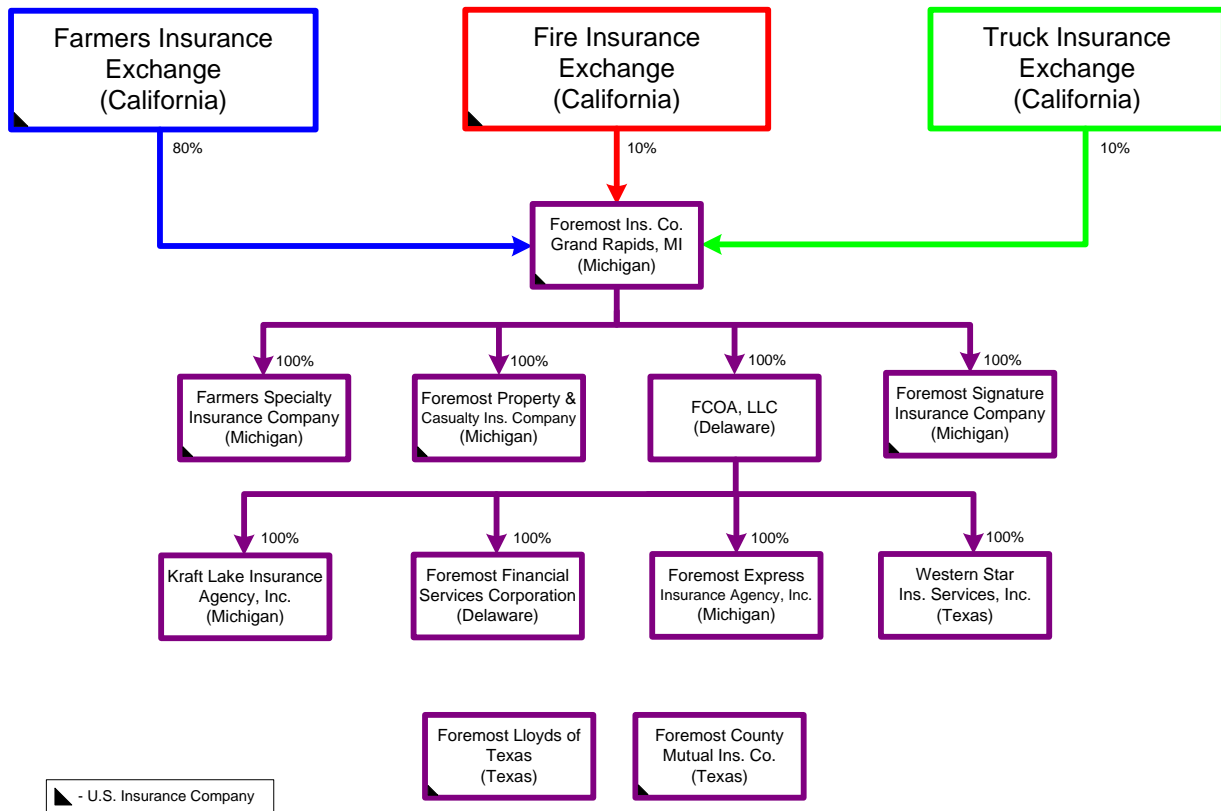


CHART IV: EXCHANGES/BRISTOL WEST ORGANIZATION

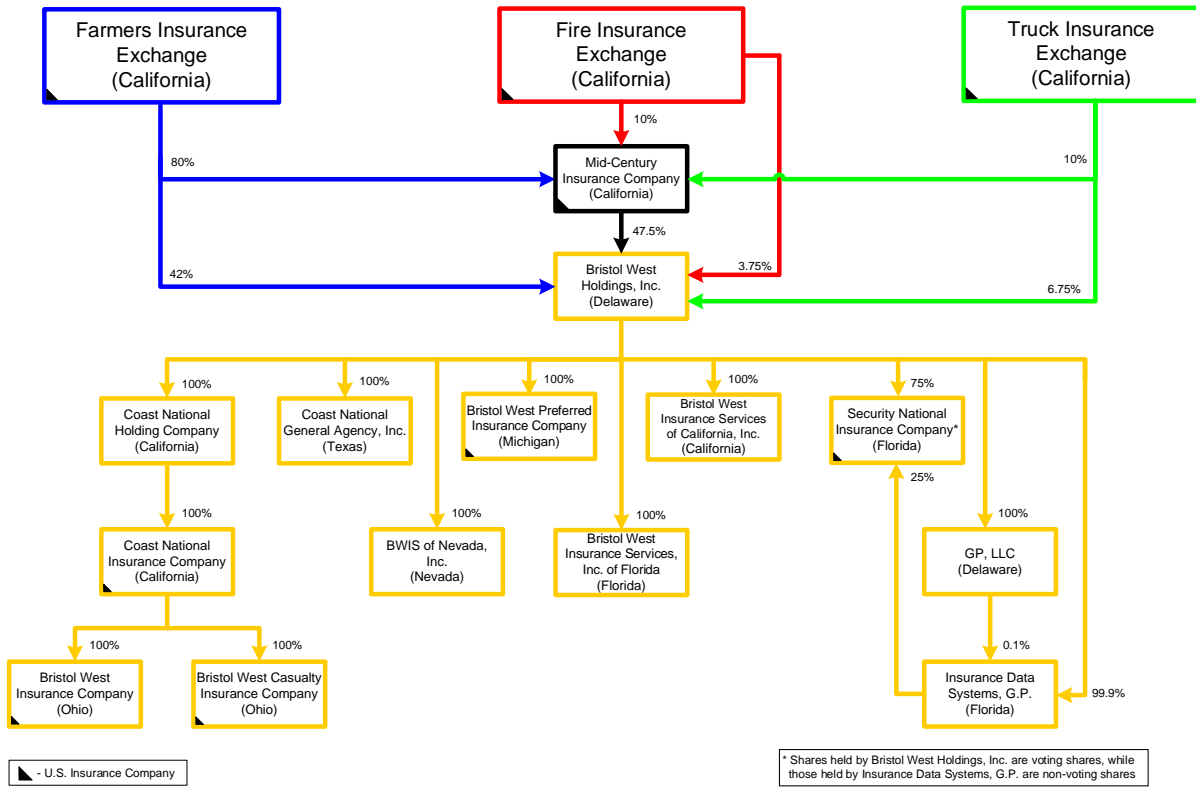
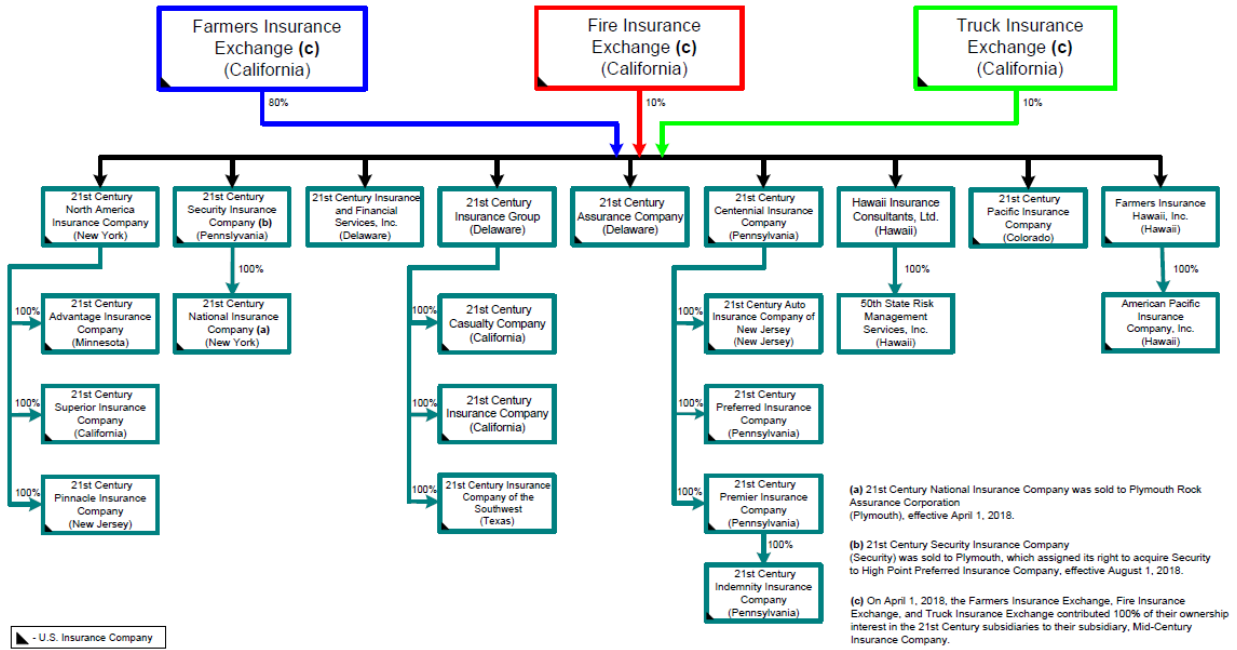


CHART V: EXCHANGES/21st CENTURY ORGANIZATION



Management of the Company is vested in a seven-member board of directors, elected annually. A listing of the members of the board and principal officers serving on December 31, 2017 follows:

Board of Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Gisselle Acevedo (a) New Canaan, Connecticut	Child Therapist The Child and Family Guidance Center
Thomas G. Allen (b) Denver, Colorado	President Intermountain Electric, Inc.
Keith G. Daly (c) Westlake Village, California	Chief Claims Officer Farmers Insurance Exchange
Ronald L. Marrone Pittsburg, Kansas	Co-owner Family Food Services Corporation
Ronald G. Myhan (d) Malibu, California	Chief Financial Officer Farmers Insurance Exchange
Donald E. Rodriguez (e) Long Beach, California	Executive Director Boys and Girls Club
Richard M. Shriver (f) Stevenson Ranch, California	Head of Zone Field Operations Farmers Group, Inc.

- (a) Replaced by Stanley R. Smith, effective June 6, 2018. Replaced by Gary R. Martin, effective March 19, 2019
- (b) Replaced by Julio A. Da Silva, effective March 19, 2019
- (c) Replaced by Frederick H. Kruse, effective June 6, 2018. Replaced by Alan R. Gildemeister, effective March 19, 2019
- (d) Removed, effective June 1, 2019 - not replaced
- (e) Removed, effective June 1, 2019 - not replaced
- (f) Replaced by Keith G. Daly, effective September 18, 2018

Principal Officers

<u>Name</u>	<u>Title</u>
Richard Michael Shriver (a)	President
Maite I. Baur	Vice President
Keith G. Daly (b)	Vice President
Victoria L. McCarthy	Vice President
Ronald G Myhan (c)	Vice President and Treasurer
James L. Nutting	Vice President and Actuary
Doren E. Hohl	Secretary

(a) Replaced by Keith G. Daly, effective September 18, 2018

(b) Replaced by Robert P. Howard, effective June 11, 2018

(c) Replaced by Thomas S. Noh, effective June 1, 2019

Management Agreements

Farmers Group, Inc. (FGI), as the Attorney-In-Fact (AIF) for the Farmers Insurance Exchange (FIE), provides operating services, including staffing and occupancy to FIE. The operating services do not include claims adjustment services, nor do they include the payment of claims, commissions, and the payment of premium and income taxes, all of which are the responsibility of the FIE. These operating services are provided to FIE pursuant to Subscription Agreements entered into between FGI and each of the Farmers Exchange's individual policyholders. There is no specific management services agreement required between FIE and FGI for these services provided. The compensation to the AIF for these services is derived through membership fees and subscription fees under the terms of the Subscription Agreements.

Service Agreements: On July 1, 2015, FIE and its subsidiaries (including the Company) entered into separate Service Agreements (Agreements). In accordance with the terms of the Agreements, FIE provides various services which include policy and premium administration, agents and commissions, including claims adjustment services, accounting and financial reporting services, investment management services, and other administrative services. FIE provides these services at a cost which are allocated in accordance with the methods prescribed in the NAIC Accounting Practices and

Procedures Manual, Statement of Statutory Accounting Principle (SSAP) No. 70. Allocations occur prior to the Intercompany Reinsurance and Pooling Agreement (see the “REINSURANCE” section of this examination report).

The parties acknowledge that FIE shall provide these services either directly or through its attorney-in-fact, agents, representatives or affiliates; however, FIE shall continue to be liable at all times. The parties to the Agreements are:

Bristol West Casualty Insurance Company	Bristol West Insurance Company
Bristol West Preferred Insurance Company	Civic Property and Casualty Company
Coast National Insurance Company	Exact Property and Casualty Company
Farmers Insurance Company of Arizona	Farmers Insurance of Columbus, Inc.
Farmers Insurance Company of Idaho	Farmers Insurance Company of Oregon
Farmers Insurance Company of Washington	Farmers New Century Insurance Company
Farmers New World Life	Foremost Insurance Company, Grand Rapids, Michigan
Illinois Farmers Insurance Company	Mid-Century Insurance Company
Mid-Century Insurance Company of Texas	Neighborhood Spirit Property and Casualty Co.
Security National Insurance Company	Texas Farmers Insurance Company

These Agreements were approved by the California Department of Insurance (CDI) on December 9, 2015.

FIE charges a portion of the compensation it pays FGI to its subsidiaries based on each company’s percentage participation in the Intercompany Reinsurance and Pooling Agreement.

For 2014, 2015, 2016, and 2017, the pooled share of the compensation paid by FIE and its subsidiaries to FGI for its services was as follows (including membership, installment, and policy fees):

<u>Company</u>	<u>Compensation Paid to Farmers Group, Inc. (for Exchange Issued Policies)</u>			
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Farmers Insurance Exchange	\$ 1,431,844,943	\$ 1,414,798,318	\$ 1,371,514,957	\$ 1,370,276,762
Truck Insurance Exchange	214,430,885	211,878,009	205,395,960	205,210,530
Fire Insurance Exchange	207,513,760	205,043,235	198,770,284	198,590,835
Mid-Century Insurance Company	442,696,021	437,425,567	424,043,272	423,660,448
Civic Property and Casualty Company	27,668,501	27,339,098	26,502,704	26,478,778
Exact Property and Casualty Company	27,668,501	27,339,098	26,502,704	26,478,778
Neighborhood Spirit Property and Casualty Company	27,668,501	27,339,098	26,502,704	26,478,778
Subtotals	\$ 2,379,491,112	\$ 2,351,162,423	\$ 2,279,232,585	\$ 2,277,174,909
All Other Subsidiaries	387,359,018	382,747,371	371,037,863	370,702,891
Totals - Compensation Paid	\$ 2,766,850,130	\$ 2,733,909,794	\$ 2,650,270,448	\$ 2,647,877,800
Totals - Membership, Installment, and Policy Fees Paid	\$ 94,726,319	\$ 104,002,073	\$ 104,490,270	\$ 101,774,982

As previously noted, the above amounts paid to FGI by FIE and its subsidiaries do not include the cost of claims adjustment services, nor do they include the payment of claims, commissions, and the payment of premium and income taxes, all of which are the responsibility of FIE and its subsidiaries.

Tax Sharing Agreement: Fire Insurance Exchange (Fire) is the lead party to a Tax Sharing Agreement (Agreement), effective January 1, 2015, with the Company and other affiliated insurers, Civic Property and Casualty Company (Civic), Exact Property and Casualty Company (Exact), and Farmers Insurance Company of Washington (Farmers WA). On August 19, 2015, the CDI approved this Agreement, which amended and superseded the Tax Sharing Agreement effective September 30, 2008, between the Company, Fire, Civic, Exact, and Farmers WA.

Fire is the party primarily responsible for filing and making all tax payments on behalf of the Company and the other parties to the Agreement. Allocation of taxes is based upon separate return calculations with intercompany tax balances payable or receivable being settled in amounts equal to the amounts which would be due to or from federal taxing authorities as if separate returns were filed. Intercompany balances are settled monthly, and the final settlement is made within 30 days after the filing date of the consolidated return.

The Company's portion of the federal income taxes paid or (recovered) under the Agreement for 2014, 2015, 2016, and 2017 was \$8,082,284, \$1,035,026, (\$1,026,149), and (\$94,727), respectively.

Agreements with Non-Affiliates

Third-Party Administrator Agreement: Effective November 1, 2000, a Third-Party Administrator Agreement (Agreement) was entered into by Zurich Services Corporation (ZSC) with the Company, Farmers Insurance Exchange (FIE), Truck Insurance Exchange (Truck), Mid-Century Insurance Company, Exact, and Civic. Under this Agreement, ZSC provides claims administration and risk engineering services which are subject to a reinsurance agreement for equipment breakdown coverage provided by Zurich American Insurance Company.

Investment Management Agreement: FGI, acting on behalf of the Exchanges (Farmers Insurance Exchange, Fire Insurance Exchange, Truck Insurance Exchange, and the subsidiaries of these Exchanges), entered into an Investment Management Agreement with the following third-party advisors to act as the investment manager:

- Deutsche Investment Management Americas, Inc: FGI entered into an Investment Management Agreement dated July 1, 1998 with its affiliate, Scudder Kemper Investments Inc. (Scudder). There have been multiple amendments since then, mostly related to Schedule III, of which the latest is dated April 12, 2011. In 2002, Scudder was acquired and replaced by Deutsche Asset Management (DeAM), and the name changed to Deutsche Investment Management Americas, Inc. (now called DWS Investment Management Americas, Inc. since March 2018) (DWS). DWS, a non-affiliate, manages the fixed income and equity asset portfolios. Fees are based on a sliding scale percentage on the value of the portfolio being managed.
- Clarion Partners, LLC.: FGI entered into an Investment Management Agreement dated October 14, 2014 and amended July 17, 2017 with Clarion Partners, LLC, a non-affiliate, to manage the investment of certain real estate assets.

- Medley SMA Advisors, LLC.: FGI entered into an Investment Management Agreement dated December 14, 2016 with Medley SMA Advisors, LLC, a non-affiliate, to manage the senior loan securities portfolio.
- Prudential Private Investors, L.P.: FGI entered into an Investment Management Agreement dated January 30, 2013, and amended June 9, 2017 with Prudential Private Investors, L.P., a non-affiliate, to manage the private placement securities portfolio.
- Wells Capital Management, Inc.: FGI entered into an Investment Management Agreement, dated March 6, 2015, with Wells Capital Management, Inc., a non-affiliate, to manage the municipal and tax-exempt securities portfolio.

Service Level Agreement: FGI was also a party to the Service Level Agreement dated November 4, 1998 with Scudder, which was replaced in 2002 by DeAM. DeAM, a non-affiliate, provided accounting and reporting services in connection with the Farmers Exchanges and their stock subsidiaries' investment portfolios, including Securities Valuation Office reporting. DeAM was given the authority to vote the proxies of the common stock. The services under this agreement are no longer provided as of 2015.

Related Party Transactions

Revolving Credit Facility Framework Agreement: Effective January 25, 2017, the Farmers Companies, all of whom are affiliate insurers within the Farmers Insurance Holding Company system, became signatories to a Revolving Credit Facility Framework Agreement (Agreement) for the purposes of eliminating the need to maintain large cash balances or unnecessarily liquidating investments during the monthly reinsurance cash settlement process among participating affiliates.

The revolving credit framework allows participating affiliates to make short term loans to each other to cover debt arising from the monthly reinsurance settlement process. The loans, executed on an as-needed basis, mature in ninety (90) days and cannot exceed in the cumulative aggregate three percent (3%) of a borrower's or lenders admitted assets. Loans may be collateralized with a pledge of securities at lender's option, and in any

event, must be collateralized if the loan crosses from one calendar year into the next calendar year such that the loan is secured and perfected as of December 31 of the year the loan was made.

Parties to the Agreement will renegotiate the terms of the Agreement at least once every three (3) years. The Agreement was approved by the CDI on January 18, 2017, pursuant to California Insurance Code Section 1215.5(b)(1)(A) as well as by the regulators of the domiciliary states of the FIE's affiliates outside of California. The parties to the Agreement are:

21st Century Advantage Insurance Company	21st Century Assurance Company
21st Century Casualty Company	21st Century Centennial Insurance Company
21st Century Indemnity Insurance Company	21st Century Insurance Company
21st Century National Insurance Company	21st Century North America Insurance Company
21st Century Pacific Insurance Company	21st Century Pinnacle Insurance Company
21st Century Preferred Insurance Company	21st Century Premier Insurance Company
21st Century Security Insurance Company	American Pacific Insurance Company
Bristol West Casualty Insurance Company	Bristol West Insurance Company
Bristol West Preferred Insurance Company	Civic Property and Casualty Company
Coast National Insurance Company	Exact Property and Casualty Company
Farmers Insurance Company, Inc.	Farmers Insurance Company of Arizona
Farmers Insurance of Columbus, Inc.	Farmers Insurance Company of Idaho
Farmers Insurance Company of Oregon	Farmers Insurance Company of Washington
Farmers Insurance Exchange	Farmers Insurance Hawaii, Inc.
Farmers New Century Insurance Company	Farmers Specialty Insurance Company
Farmers Texas County Mutual	Foremost County Mutual Insurance Company
Foremost Insurance Company Grand Rapids, Michigan	Foremost Lloyds of Texas
Foremost Property & Casualty Insurance Company	Foremost Signature Insurance Company
Fire Insurance Exchange	Illinois Farmers Insurance Company
Mid-Century Insurance Company	Mid-Century Insurance Company of Texas
Neighborhood Spirit Property and Casualty Company	Security National Insurance Company
Texas Farmers Insurance Company	Truck Insurance Exchange

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact insurance business in the states of California, Michigan, Missouri, Ohio, and Pennsylvania.

In 2017, the Company wrote \$19.5 million of direct premiums. Of the direct premiums written, \$18.2 million (93.7%) was written in California, and \$1.3 million (6.2%) was written in Pennsylvania.

The fire (44.2%), allied lines (25.3%), and homeowners multiple perils (23.6%) lines account for 93.1% of the direct writings of the Company. The Company is also a 1% participant in the Intercompany Reinsurance and Pooling Agreement (Pooling Agreement). Farmers Insurance Exchange (FIE) and its pooled subsidiaries and affiliates write most of the property and casualty lines of business with a heavy emphasis on personal lines. The principal lines assumed by the Company from FIE (the lead insurer in the Pooling Agreement) were private passenger automobile liability, homeowners multiple perils, and automobile physical damage.

Business is produced by an independent agency force and is supported by 11,000 claims employees.

LOSS EXPERIENCE

The following schedule reflects the net underwriting and net investment results along with the net income and losses as reported by the Company in its financial statements for the years under examination and through December 31, 2018:

Year	Net Premiums Written	Net Underwriting Gains/(Losses)	Net Investment Gains/(Losses)	Net Income/(Losses)
2014	\$ 140,622,968	\$ (2,100,035)	\$ 17,666,167	\$ 14,976,067
2015	149,306,946	(3,385,236)	6,130,018	3,781,149
2016	147,618,367	(5,540,182)	3,232,722	81,605
2017	141,847,396	(3,470,772)	4,089,936	1,811,359
Sub-totals	\$ 579,395,677	\$ (14,496,225)	\$ 31,118,843	\$ 20,650,180
2018	138,375,378	(1,745,652)	4,582,208	3,366,338
Totals	\$ 717,771,055	\$ (16,241,877)	\$ 35,701,051	\$ 24,016,518

The Company reported net underwriting losses in all years under examination and through December 31, 2018. In aggregate, the Company reported \$16.2 million of net underwriting losses for the five years from 2014 through 2018. Also, as noted, the Company reported net incomes in all of the last five years.

Underwriting performance deteriorated during the intervening years subsequent to the prior examination in 2013 due to several factors, mainly because of the heightened and susceptibility to the industry-wide catastrophe losses that significantly impacted the Company's property lines. Weather and storm-related catastrophe losses added an average of over 6.0 percentage points to the Company's overall combined ratios reported during the years subsequent to the prior examination.

Another factor for the poor underwriting performance experienced in recent years was principally the result of higher severity and frequency in non-catastrophe related activities that impacted the industry as a whole, driven primarily by loss trends in personal lines automobile, which management believes is due to higher vehicle miles traveled, distracted drivers, and an improved economy (newer cars on the road). Lower gas prices and more miles driven have also contributed to higher losses paid, along with adverse loss development in the prior accident years.

Also contributing to increased underwriting losses was the strengthening of reserves on defense and cost containment costs due to relatively higher litigation and attorney costs incurred, as well as higher adjusting and other expenses incurred to indemnify and settle claims.

Lastly, increased other expenses in 2017 partially resulting from the seed money expended to support the expansion of the Farmers brand and products to states in the eastern third of the country, including Florida and South Carolina, as well as increased advertising and other operating costs during 2017.

Net underwriting losses totaled \$1.7 million on December 31, 2018 compared to an underwriting loss of \$3.5 million in 2017, representing an underwriting loss reduction of \$1.8 million between years, primarily due to rate and underwriting actions. Net income also improved by \$1.6 million due to these actions.

As noted above, the Company has maintained its surplus as regards policyholders for the period covered by this examination primarily through net investment gains of \$31.1 million.

REINSURANCE

Intercompany Reinsurance and Pooling Agreement

The Farmers Insurance Exchange (FIE) is the lead insurer in an Intercompany Reinsurance and Pooling Agreement (Pooling Agreement) under which the Company and the insurers listed below pool their risks and obtain a proportional share of profits and/or losses of the pooled business. The Agreement became effective on January 1, 1999. Under the Pooling Agreement, business is allocated among the pool participants as follows:

<u>Pool Participant</u>	<u>Percentage</u>
Farmers Insurance Exchange (FIE)	51.75
Mid-Century Insurance Company	16.00
Truck Insurance Exchange	7.75
Fire Insurance Exchange	7.50
Farmers Insurance Company of Oregon	7.00
Farmers Insurance Company of Washington	2.00
Civic Property and Casualty Company	1.00
Exact Property and Casualty Company	1.00
Neighborhood Spirit Property and Casualty Company	1.00
Texas Farmers Insurance Company	1.00
Farmers Insurance of Columbus, Inc.	1.00
Farmers Insurance Company, Inc.	0.75
Illinois Farmers Insurance Company	0.75
Farmers New Century Insurance Company	0.75
Farmers Insurance Company of Idaho	<u>0.75</u>
Total	<u>100.00</u>

The last amendment to this long-standing Pooling Agreement was approved by the California Department of Insurance (CDI) on January 12, 1999.

Assumed

Other than a participation in the intercompany pool, the Company has no reinsurance assumed.

Ceded - Affiliated

Treaties ceding risks to affiliated reinsurers were written with FIE and all of its subsidiaries and affiliates (including the Company) as the cedents. The following is a summary of the principal affiliated ceded reinsurance treaties in-force as of December 31, 2017.

Automobile Physical Damage Reinsurance Agreement (APD Agreement): A quota share reinsurance agreement, which has been amended over the years, that covers automobile physical damage, was initially entered into on April 1, 2001, between FIE, Farmers

Reinsurance Company (Farmers Re), and Zurich Insurance Company (ZIC). Under the APD Agreement, FIE, on behalf of itself and its pooling participants, cedes up to \$1 billion per year of its automobile physical damage premiums. Through December 31, 2014, the subscribing reinsurers were Farmers Re, with a 10% quota share participation, ZIC, with an 80% quota share participation and Swiss Reinsurance Company Ltd. (Swiss Re), a third-party reinsurer, assuming the remaining 10%. Effective January 1, 2015, Farmers Re reduced its quota share participation to 7.14%, ZIC decreased its participation to 64.29%, and Swiss Re increased its participation to 28.57%. The APD Agreement was not renewed in 2016 and all recoveries and prior year's business in run-off were settled in 2017.

All Lines Quota Share Reinsurance Agreement (ALQS Agreement): Effective December 31, 2002, FIE, on behalf of itself and its pooling participants, began participating in an ALQS Agreement with Farmers Re and ZIC which has been amended over the years. The ALQS Agreement covers all lines after the APD Agreement has been applied. The aggregate participation percentage was originally at 10% in 2002, and through amendments approved by the California Department of Insurance (CDI), the aggregate participation percentage and participants have varied over the years. The following are the amendments during the examination period:

- Effective December 31, 2014, the aggregate participation percentage was decreased by 6% from 20% to 14%. Farmers Re reduced its participation to 1.0% and ZIC to 9.0%. In addition to this change, Swiss Re replaced Swiss Reinsurance America Corporation with a participation percentage of 4.0%. The CDI approved this amendment on March 26, 2015.
- Effective December 31, 2015, the aggregate participation percentage was increased by 6% from 14% to 20%. Farmers Re was removed as a participant and Transatlantic Reinsurance Company (Trans Re), and Ariel Re Bermuda Limited (Ariel Re) were added as participants at 4.0% and 1.0%, respectively. In addition, ZIC and Swiss Re changed their participation to 8% and 7%, respectively. The CDI approved this amendment on May 3, 2016.
- Effective December 31, 2016, the participation percentage was increased by 4% from 20% to 24%. In addition, Hannover Rueck SE (Hannover Re), and Catlin

Reinsurance Switzerland Limited (Catlin Re) were added as new participants at 2% each. The CDI approved this amendment on September 26, 2017.

- Effective December 31, 2017, the participation percentage was increased by 5% from 24% to 29%. In addition, ZIC was removed as a participant, and Farmers Re and Munich Reinsurance America, Inc., were added as 1% and 5% participants, respectively. In addition, Hannover Re and Catlin Re increased their participation to 7% and 4%, respectively. The CDI approved this amendment on March 19, 2018.
- Effective December 31, 2018, Trans Re decreased its participation percentage from 4% to 3.5%, and Catlin Re increased its participation percentage from 4% to 4.5%. The overall participation remains at 29% with all other participating reinsurers' percentages remaining the same. The CDI approval of this amendment is still pending.

There are a series of 100% Equipment Breakdown Quota Share Reinsurance Agreements effective November 1, 2000, under which Zurich American Insurance Company reinsures the Company and certain of its affiliates for specified industry programs.

As of December 31, 2017, reinsurance recoverables totaled \$23.7 million, or 19.9% of surplus as regards policyholders. All of the ceded reinsurance recoverables were attributable to the Pooling Agreement.

Ceded - Non-Affiliated

The Company, along with its parent and affiliates, were also listed as cedents on various catastrophe and other treaties ceding risk on an excess-of-loss basis to non-affiliated reinsurers.

ACCOUNTS AND RECORDS

California Insurance Code (CIC) Section 734 requires that every company or person from whom information is sought, and its officers, directors, employees, and agents, shall provide to the examiners appointed pursuant to this article, timely, convenient, and free

access at all reasonable hours at its offices to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the company being examined. During the course of this examination, the examiners were not provided full access to all of the information requested from the Company. It is recommended that the Company adhere to CIC Section 734 by providing full access to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the companies being examined and implement procedures to ensure future compliance with CIC Section 734.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2017. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements.

Statement of Financial Condition as of December 31, 2017

Underwriting and Investment Exhibit for the Year Ended December 31, 2017

Reconciliation of Surplus as Regards Policyholders
from December 31, 2013 through December 31, 2017

Statement of Financial Condition
as of December 31, 2017

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 235,950,168	\$	\$ 235,950,168	
Cash, cash equivalents and short-term investments	2,742,339		2,742,339	
Other invested assets	1,582,122		1,582,122	
Investment income due and accrued	1,352,329		1,352,329	
Uncollected premiums and agents' balances in course of collection	2,391,163	686,668	1,704,495	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	23,398,522		23,398,522	
Accrued retrospective premiums	11,000		11,000	
Amounts recoverable from reinsurers	837,755		837,755	
Net deferred tax asset	<u>3,999,919</u>	<u>258,266</u>	<u>3,741,653</u>	
(1)				
Total assets	<u>\$ 272,265,317</u>	<u>\$ 944,934</u>	<u>\$ 271,320,383</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 83,864,872	(2)
Reinsurance payable on paid loss and loss adjustment expenses			9,136,622	
Other expenses			174,150	
Unearned premiums			55,173,189	
Advance premiums			1,124,818	
Ceded reinsurance premiums payable			1,069,109	
Amounts withheld or retained by company for account of others			3,730	
Payable to parent, subsidiaries and affiliates			845,973	
Aggregate write-ins for liabilities			<u>721,948</u>	
Total liabilities			152,414,411	
Common capital stock		\$ 5,000,000		
Gross paid in and contributed surplus		60,000,000		
Unassigned funds (surplus)		<u>53,905,972</u>		
Surplus as regards policyholders			<u>118,905,972</u>	
Total liabilities, surplus and other funds			<u>\$ 271,320,383</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2017

Statement of Income

Underwriting Income

Premiums earned		\$ 145,209,275
Deductions:		
Losses incurred	\$ 86,132,120	
Loss adjustment expenses incurred	14,700,099	
Other underwriting expenses incurred	47,867,219	
Aggregate write-ins for underwriting deductions	<u>(19,391)</u>	
Total underwriting deductions		<u>148,680,047</u>
Net underwriting loss		(3,470,772)

Investment Income

Net investment income earned	\$ 4,146,356	
Net realized capital gains	<u>(56,419)</u>	
Net investment gain		4,089,937

Other Income

Net loss from agents' or premium balances charged off	\$ (867,600)	
Finance and service charges not included in premiums	2,087,764	
Aggregate write-ins for miscellaneous income	<u>(94,789)</u>	
Total other income		<u>1,125,375</u>
Net income before dividends to policyholders and before federal income taxes		1,744,540
Dividends to policyholders		6,725
Net income after dividends to policyholders but before federal income taxes		1,737,815
Federal income taxes incurred		<u>(73,544)</u>
Net income		<u>\$ 1,811,359</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2016		\$ 119,733,609
Net income	\$ 1,811,359	
Change in net unrealized capital gains	(441)	
Change in net deferred income tax	(2,857,175)	
Change in nonadmitted assets	213,185	
Aggregate write-ins for gains and losses in surplus	<u>5,435</u>	
Change in surplus as regards policyholders for the year		<u>(827,637)</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 118,905,972</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2013 through December 31, 2017

Surplus as regards policyholders,

<u>Surplus as regards policyholders,</u> December 31, 2013 per Examination			\$ 110,089,554
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 20,650,179	\$	
Change in net unrealized capital gains		8,691,357	
Change in net deferred income tax		3,333,576	
Change in nonadmitted assets	201,441		
Cumulative effect of changes in accounting principles		76,954	
Aggregate write-ins for gains and losses in surplus	<u>66,685</u>	<u></u>	
Total gains and losses	<u>\$ 20,918,305</u>	<u>\$ 12,101,887</u>	
Net increase in surplus as regards policyholders			<u>8,816,418</u>
Surplus as regards policyholders, December 31, 2017, per Examination			<u>\$ 118,905,972</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Net Deferred Tax Asset

The Tax Cuts and Jobs Act (H.R.1) was enacted into law on December 22, 2017. The Company re-valued the deferred tax assets and liabilities from a 35% corporate tax rate to the enacted 21% corporate tax rate at December 31, 2017. The re-valuation resulted in a decrease in net admitted deferred tax assets amounting to \$2.5 million and is reflected as a direct charge to surplus in the appropriate categories in the accompanying financial statements.

(2) Losses and Loss Adjustment Expenses

Since the business of the Company was pooled, it was necessary to review the losses and loss adjustment expenses on a group-wide basis. 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, 2017 were found to be reasonably stated and have been accepted for purposes of this examination.

SUBSEQUENT EVENTS

Catastrophe Losses in 2018

Camp and Woolsey Fires

In November 2018, Camp and Woolsey fires had a major impact on Farmers Insurance Group (Group). The Camp Fire was the deadliest and most destructive fire in California history. The gross loss for the Group from the Camp and Woolsey fires was \$2.1 billion, and a net loss of \$324.8 million was recorded as of December 31, 2018. Under the Intercompany Reinsurance and Pooling Agreement, the Company's participation is 1.0% of the pooled losses. As such, the Company's share of the net loss was \$3.2 million.

All Catastrophe Losses

The gross and net losses for all catastrophes in the 2018 calendar year (including the Camp and Woolsey fires) were \$3.3 billion and \$1.3 billion, respectively. The Company's share of the Group's gross and net catastrophe losses after pooling was \$33.2 million and \$13.2 million, respectively.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records (Page 25): It is recommended that the Company adhere to California Insurance Code (CIC) Section 734 by providing full access to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the companies being examined and implement procedures to ensure future compliance with CIC Section 734.

Previous Report of Examination

Accounts and Records (Page 21): It was recommended that the Company continue to address the recommendations made regarding its information systems controls. The Company continues to address these recommendations.

ACKNOWLEDGMENT

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

Respectfully submitted,

/S/ _____

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Contract Insurance Examiner
Department of Insurance
State of California

/S/ _____

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