REPORT OF EXAMINATION

OF THE

STERLING CASUALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

Filed December 21, 2011

TABLE OF CONTENTS

Los Angeles, California
October 27, 2011

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

STERLING CASUALTY INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office located at 600 City Parkway West, Suite 800, Orange, California 92868.

SCOPE OF EXAMINATION

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, 2010. 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.

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; statutory deposits; and sales and advertising.

SUBSEQUENT EVENTS

Effective May 1, 2011, the Company entered into an Automobile Quota Share Reinsurance Agreement with Maiden Reinsurance Company (MRC), an accredited reinsurer. Under the terms of the quota share reinsurance agreement, the Company will cede 50% of its new and renewal business, exclusive of policy fees, inforce on or after the effective date written for private passenger automobile liability to MRC. MRC's maximum liability under the agreement shall not exceed $25,000 per policy per occurrence.

Effective May 1, 2011, the Company also entered into an Automobile Excess of Loss Reinsurance Agreement with MRC. Under the terms of the excess of loss reinsurance agreement, the Company shall retain the first $50,000 of ultimate net loss per occurrence. MRC's maximum liability shall not exceed $450,000 of ultimate net loss per occurrence.

COMPANY HISTORY

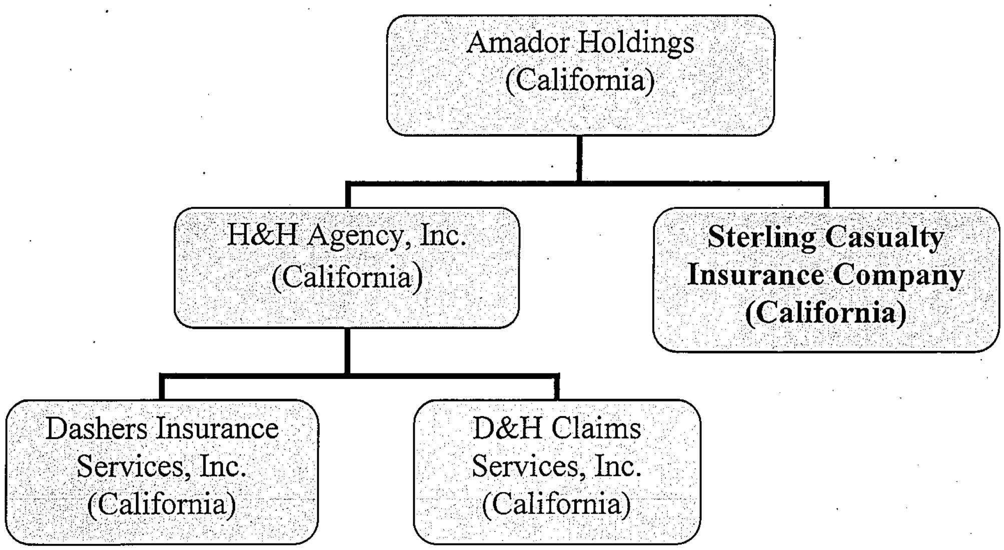
The Company commenced business in California on November 17, 2006 after the acquisition by Amador Holdings (Amador) of Sterling Casualty Insurance Company (Old Sterling). On November 21, 2006, Old Sterling merged into Amador's inactive wholly-owned property and casualty insurance subsidiary, National Automobile and Casualty Insurance Company (NACIC) with NACIC as the surviving entity.

On December 29, 2006, NACIC changed its name to Sterling Casualty Insurance Company. The Company was also assigned a new National Association of Insurance Commissioners' company code (12878).

Under the terms of the acquisition of Old Sterling, Amador also acquired a surplus note issued by Old Sterling in the amount of $1.4 million. The surplus note was originally issued to a related party of the prior owner of Old Sterling. Payment of interest on the surplus note requires the approval of the California Department of Insurance (CDI). Interest on the surplus note cannot be recorded as a liability until the CDI has given approval for payment of interest. Interest payments are also subject to certain minimum unassigned surplus thresholds before repayment can be considered. No interest payments have been made.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system and is wholly-owned by Amador Holdings. The following organizational chart depicts the inter-relationship of the Company within the holding company system: (All ownership is 100%)



Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2010 follows:

Directors

Name and Residence	Principal Business Affiliation
Kenneth D. DeGiorgio Long Beach, California	Senior Vice President, General Counsel The First American Corporation
Roopal P. Shah Granite Bay, California	Chairman Amador Holdings
Michael P. Weinstein Mission Viejo, California	President and Chief Executive Officer Sterling Casualty Insurance Company

Principal Officers

Name	Title
Michael P. Weinstein	President and Chief Executive Officer
Roopal P. Shah	Secretary
David P. Padgham	Chief Financial Officer and Treasurer
Helen L. Hayden	General Counsel
Brian K. Jewell	Vice President, Operations
Joseph Baffoni	Vice President, Claims

Affiliated Management Agreements

Program Management Agreement: On October 6, 2009, the Company entered into a Program Management Agreement (PMA) with H&H Agency, Inc. (H&H), which replaced the prior intercompany management service agreement effective under the operations of Sterling Casualty Insurance Company (Old Sterling). Under the terms of the PMA, the Company appointed H&H as its legal representative and lawful attorney to act on the Company's behalf. H&H performs all administrative functions and services with respect to the operations of the company, including: personnel, management, facilities, accounting, books and record maintenance, premium collection, underwriting, claims handling, reinsurance assistance, marketing assistance, and information technology systems. The Company compensates H&H for the cost of services based on the terms of the Cost Sharing Agreement summarized below. The Company paid H&H $14.4 million in 2009 and $11 million in 2010 for the services provided. Effective July 1, 2011, the terms of the PMA were modified such that the Company will now reimburse H&H a commission of 22.5% of all policy premiums and 97.5 % of all policy related fees excluding fraud fees.

Cost Sharing Agreement: On October 6, 2009, the Company entered into a Cost Sharing Agreement (CSA) with its Parent, Amador Holdings, and affiliates, H&H, Dashers Insurance Services, Inc. (Dashers) and D&H Claims Services, Inc. (D&H). Under the terms of the agreement, each party is responsible for its identifiable direct charges. All other expenses related to the operations of the Company under the terms of the PMA will be allocated based on the actual cost of the services provided to the Company. The amounts paid in 2009 and 2010 are included in the amounts summarized above for the PMA. Effective July 1, 2011, the terms of the CSA were modified to recognize the revisions of the PMA and the creation of the Claim Administration Agreement (CAA) summarized below. Any costs exchanges between affiliates pursuant to the CSA are based on the actual cost of the services provided.

Claim Administration Agreement: The Company entered into a CAA with D&H, effective July 1, 2011. Under the terms of the CAA, D&H shall provide all claim related administration services required by the Company. All costs incurred by D&H on behalf of the Company will be reimbursed based on actual cost.

The prior report of examination recommended that the Company replace or amend its intercompany agreements and submit them to the California Department of Insurance (CDI) for approval in accordance with the requirements of California Insurance Code (CIC) Section 1215.5(b)(4). The Company submitted the above agreements during the examination period and the CDI requested modifications to the agreements which are now currently under review by the CDI.

Consolidated Federal Income Tax Liability Allocation Agreement: The Company entered into a Consolidated Federal Income Tax Liability Allocation Agreement (Tax Agreement) with Amador and other affiliates on November 17, 2006. Under the terms of the agreement, the method of allocation among the companies is subject to Internal Revenue Service Regulation and approval by the board of directors. Allocation is based upon separate return calculations with current credit for net losses. Federal income tax payables and receivables are required to be settled within thirty days subsequent to the filing of the consolidated return. As of December 31, 2010, the Company had only filed its 2008 federal income tax return. The Company filed its 2009 federal income tax return subsequent to the examination date. The Company is expected to amend its 2008 return to reflect the increase of net tax losses and file its 2010 return within the 4th quarter of 2011. The 2008 and 2009 federal income tax returns indicated that the Company is entitled to future tax credits due to pre- and post- acquisition net operating losses.

The prior report of examination recommended that the Company amend or replace the Tax Agreement to reflect the change of ownership resulting from acquisition and submit it to the CDI for approval in accordance with CIC Section 1215.5(b)(4). The Company elected not to update the Tax Agreement until all past due tax returns had been filed. It is again recommended that the Company amend or replace the Tax Agreement and submit it to the CDI for approval to comply with CIC Section 1215.5(b)(4).

Unaffiliated Service Agreements

Multi-State Insurance Services, Inc. (Multi-State) Agency Agreement: Effective December 1, 2001, Old Sterling entered into an agency agreement with Multi-State. Under the terms of the agreement, Multi-State had the authority to accept applications and to issue policies on behalf of Old Sterling. As compensation, Multi-State receives a commission and a portion of policy fees and billing fees, and all filing fees. This agreement is currently inforce for renewal business only.

Freedom National Insurance Services, Inc. (Freedom) Agency Agreement: Effective August 1, 2001, Old Sterling entered into an agency agreement with Freedom. Under the terms of the agreement, Freedom had the authority to accept applications and to issue policies on behalf of Old Sterling. As compensation, Freedom received a commission and all policy fees. A profit commission was available to Freedom if the most current accident year combined loss and loss adjustment expense ratio is below 65% as of the end of the first quarter following the accident year. The agreement was terminated on January 1, 2009.

The Company utilized a third party administrator, Freedom National Adjustment Bureau, Inc. (Freedom National), to pay claims. Under the terms of an agreement effective August 1, 2001, between Freedom National and Old Sterling, Freedom National had the authority to pay any claims on policies it produced and were issued by Old Sterling. As compensation, Freedom National was paid a percentage of the monthly premiums collected. This agreement was terminated on January 1, 2009.

Robert Moreno Insurance Services (RMIS) Program Management Agreement: Effective June 1, 2010, the Company entered into a Program Management Agreement with RMIS, a proprietorship. Under the terms of the agreement, RMIS has the authority to accept applications, issue policies, and collect premium dues on behalf of the Company. As compensation, RMIS receives a commission and a portion of the fees collected.

SCJ Insurance Services, Inc. (SCJ) Program Management Agreement: Effective September 1, 2010, the Company entered into a Program Management Agreement with SCJ. Under the terms of the agreement, SCJ has the authority to accept applications and to issue policies on behalf of the Company. As compensation, SCJ receives a commission and a portion of the fees collected.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2010, the Company is authorized to write private passenger automobile liability and physical damage coverage solely in California. Underwriting activities are targeted exclusively toward insuring non-standard risks. In 2010, the Company wrote $22.7 million of direct premiums. The majority of the Company's business is produced by an affiliated general agent, H&H Agency, Inc. (H&H).

The Company's second quarter written premium increased from $11.2 million in 2010 to $14.1 million in 2011, an increase of approximately 26%, primarily due to the new distribution channels offered through the program management agreements.

LOSS EXPERIENCE

The Company reported operating and net losses in all years under examination except for 2008 as follows:

Year	Net Operating Gain or (Loss)	Net Income Or (Loss)
2008	$ (1,710,639)	$ 449,691
2009	(1,906,228)	(1,634,358)
2010	(1,197,653)	(478,392)
2011 (*)	351,981	769,427

*Through second quarter of 2011

The losses sustained by the Company were primarily due to a decrease in premiums written and above average expense ratio. The Company's surplus has decreased by approximately $1.2 million as a result of the net losses for the years under examination. However, the Company has experienced improvement on both operating and net income in the quarters subsequent to the examination date.

REINSURANCE

The Company had no reinsurance during the examination period.

ACCOUNTS AND RECORDS

Information Systems

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of the review, certain recommendations were made addressing concerns in areas such as segregation of duties, disaster recovery, and business continuity planning.

It is recommended that the Company evaluate the recommendations and make appropriate changes to strengthen its information system controls.

Claim Count

The cumulative counts of claims outstanding and closed reported by the Company in its Annual Statement were determined to be inaccurate. It is recommended that the Company establish and implement procedures to ensure the accuracy of the claim count information in accordance with the National Association of Insurance Commissioners Annual Statement Instructions. It is also recommended that the Company maintain adequate documentation to support claim count information. The claim count documentation should be prepared in sufficient detail as to allow for a full and complete audit trail from the Company's Annual Statements to individual records.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2010

Underwriting and Investment Exhibit for the Year Ended December 31, 2010

Reconciliation of Surplus as Regards Policyholders from December 31, 2007 through December 31, 2010

Statement of Financial Condition
as of December 31, 2010

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 9,357,377	$	$ 9,357,377	
Real Estate: Properties held for the production of income	3,921,958		3,921,958	
Cash and short-term investments	701,775		701,775	
Investment income due and accrued	89,072		89,072	
Premiums and Consideration:				
Uncollected premiums and agents' balances in course of collection	2,945,888	1,502,521	1,443,367	(1)
Deferred premiums, agents' balances and installments booked but deferred and not yet due	6,142,935		6,142,935	
Current federal and foreign income tax recoverable and interest thereon	39,436	39,436		
Net deferred tax asset	2,394,380	1,695,306	699,074	
Electronic data processing equipment and software	22,331		22,331	
Furniture and equipment	56,033	56,033		
Receivable from parent, subsidiaries and affiliates	140,776	71,540	69,236	
Aggregate write-ins for other than invested assets	42,177	42,177		
Total assets	$ 25,854,138	$ 3,407,013	$ 22,447,125	

Liabilities, Surplus and Other Funds			Notes
Losses and loss adjustment expenses		$ 7,109,187	(2)
Other expenses		506,220	(2)
Taxes, licenses and fees		96,022	
Unearned premiums		8,151,227	
Payable to parent, subsidiaries and affiliates		40,698	
Aggregate write-ins for liabilities		99,195	
Total liabilities		16,002,549	
Common capital stock	$ 3,000,000		
Surplus notes	1,400,000		
Gross paid in and contributed surplus	2,300,000		
Unassigned funds (surplus)	(255,424)		
Surplus as regards policyholders		6,444,576	
Total liabilities, surplus and other funds		$ 22,447,125	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2010

Statement of Income

Underwriting Income		
Premiums earned		$ 21,533,382
Deductions:		
Losses and loss expenses incurred	$ 15,082,645	
Other underwriting expenses incurred	7,648,390	
Total underwriting deductions		22,731,035
Net underwriting loss		(1,197,653)
Investment Income		
Net investment income earned	$ 94,243	
Net realized capital gain	204	
Net investment gain		94,447
Other Income		
Net loss from agents' or premium balances charged	$ (89,827)	
Finance and service charges not included in premiums	54,562	
Aggregate write-ins for miscellaneous income	660,079	
Total other income		624,814
Net loss		$ (478,392)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2009		$ 7,451,686
Net loss	$ (478,392)	
Change in net deferred income tax	(392,116)	
Change in nonadmitted assets	(136,602)	
Change in surplus as regards policyholders for the year		(1,007,110)
Surplus as regards policyholders, December 31, 2010		$ 6,444,576

Reconciliation of Surplus as Regards Policyholders from December 31, 2007 through December 31, 2010

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2007 per Examination			$ 7,616,924
Net loss	$	$ 1,663,058	
Change in net deferred income tax		1,344,413	
Change in nonadmitted assets	1,835,123		
Total gains and losses	$ 1,835,123	$ 3,007,471	
Net decrease in surplus as regards policyholders			(1,172,348)
Surplus as regards policyholders, December 31, 2010, per Examination			$ 6,444,576

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Premiums and agents' balances in course of collection

It was noted that the Company does not produce an aging report for its uncollected premiums and agents' balance. It is recommended that the Company establish procedures to identify amounts over ninety days by producing an aging report to comply with the requirements of Statement of Statutory Accounting Principles No. 6, paragraph 9.

(2) Losses and Loss Adjustment Expenses

The December 31, 2010 loss and loss adjustment expense reserves were evaluated by a Casualty Actuary from the California Department of Insurance. Based on the analysis performed, the Company's reserves for losses and loss adjustment expenses were deemed reasonable.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Affiliated Management Agreements – Consolidated Federal Income Tax Liability Allocation Agreement (Page 4): It is again recommended that the Company amend or replace the Tax Agreement and submit it to the California Department of Insurance (CDI) for approval to comply with California Insurance Code (CIC) Section 1215.5(b)(4).

Accords and Records – Information Systems (Page 8): It is recommended that the Company should evaluate the recommendations and make appropriate changes to strengthen its information system controls.

Accords and Records – Claim Counts (Page 9): It is recommended that the Company establish and implement procedures to ensure the accuracy of the claim count information reported in the Annual

Statement in accordance with the National Association of Insurance Commissioners Annual Statement Instructions. It is also recommended that the Company maintain adequate documentation to support claim count information. The claim count documentation should be prepared in sufficient detail as to allow for a full and complete audit trail from the Company's Annual Statements to individual records.

Previous Report of Examination

Management and Control – Affiliated Management Agreements (Page 5): It was recommended that the Company amend or replace its Amended and Restated Management Agreement with H&H Agency, Inc. (H&H) and submit it to the CDI for approval in accordance with the requirements of CIC Section 1215.5(b)(4). The Company submitted the above agreements during the examination period and they are currently under review by the CDI.

Management and Control – Affiliated Management Agreements (Page 6): It was recommended that the Company amend or replace its Consolidated Federal Income Tax Liability Allocation Agreement and submit it to the CDI for approval in accordance with CIC Section 1215.5(b)(4). The Company has not complied with this recommendation.

Taxes, Licenses, and Fees (Page 14): It was recommended that the Company retain all the necessary documentation to support its vehicle counts. In addition, it was recommended that the Company review this detail documentation and determine if it reported an accurate vehicle count in the past. If the vehicle count is determined to be inaccurate, the Company should re-file any applicable reports. The Company has complied with these recommendations.

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/_________________

Vivien Fan, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California