REPORT OF EXAMINATION

OF THE

SUTTER INSURANCE COMPANY

AS OF

DECEMBER 31, 2011

Filed: May 22, 2013

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San Francisco, California
May 16, 2013

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of

SUTTER INSURANCE COMPANY

(hereinafter referred to as the Company) at its home office located at 1301 Redwood Way, Petaluma, California 94954.

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.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; and statutory deposits.

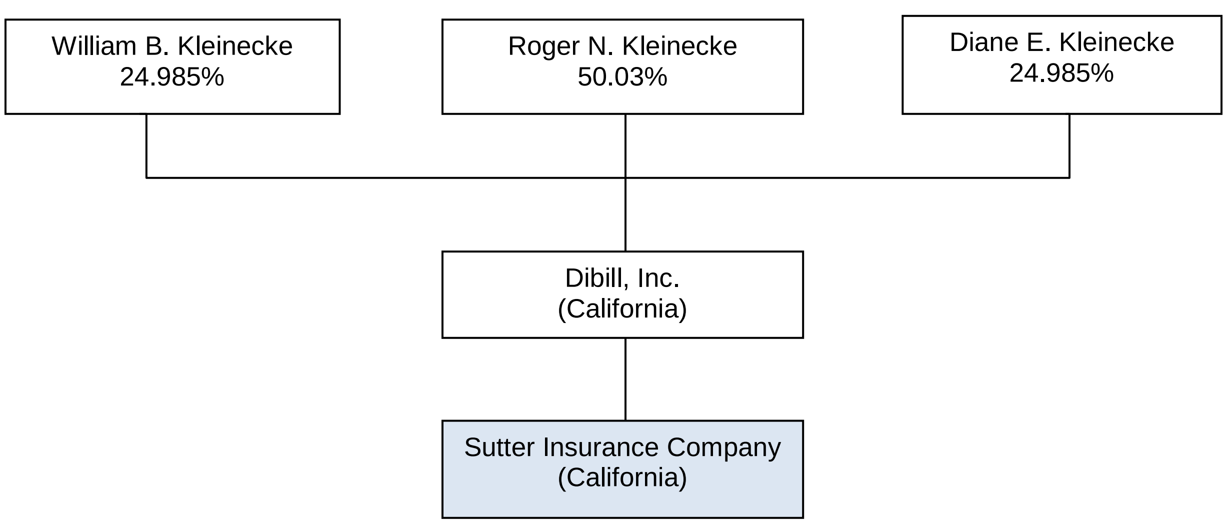
COMPANY HISTORY

During the examination period, the Company paid ordinary cash dividends of $4.3 million and $1.5 million to its parent, Dibill, Inc. in 2008 and 2009, respectively.

MANAGEMENT AND CONTROL

The Company is a wholly owned subsidiary of Dibill, Inc. which in turn is owned and controlled by members of the Kleinecke family as follows: Roger N. Kleinecke (50.03%), William B. Kleinecke (24.985%) and Diane E. Kleinecke (24.985%). The ultimate controlling person is Roger N. Kleinecke.

The following organizational chart depicts the Company's relationship within the holding company system at December 31, 2011 (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 at December 31, 2011 follows:

Board of Directors

Name and Residence	Principal Business Affiliation
Roger N. Kleinecke Santa Rosa, California	President Sutter Insurance Company
William B. Kleinecke Novato, California	Vice President of Underwriting Sutter Insurance Company
Diane E. Kleinecke Santa Rosa, California	Secretary and Treasurer Sutter Insurance Company

Officers

Name	Title
Roger N. Kleinecke (*)	President
William B. Kleinecke (*)	Vice President of Underwriting
Diane E. Kleinecke	Secretary and Treasurer
George W. Lindh	Vice President of Claims

The following changes in management occurred subsequent to the examination date:

(*) On January 1, 2013 Roger N. Kleinecke retired as President and was replaced by William B. Kleinecke. William B. Kleinecke fills both roles as President and Vice President of Underwriting as there is no plan to hire new officers.

Intercompany Agreements

Tax Allocation Agreement: Effective January 5, 1999, the Company, Anza Insurance Company (Anza) and its parent, Dilbill, Inc., entered into a federal income tax allocation agreement. This agreement provides for allocation of year-end consolidated tax liability among the participants to the agreement. The year-end tax liability is computed on a consolidated basis; however, each participant's tax provision is calculated individually. This agreement was submitted to and approved by the California Department of Insurance (CDI) on March 25, 1999, pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

In 2000, Anza was sold and ceased being an affiliate and participant to the tax allocation agreement. The tax allocation agreement has not been amended to remove Anza as a party to this agreement. It is recommended that the Company amend its tax sharing agreement to remove Anza as a party and file the agreement with the CDI pursuant to CIC Section 1215.5(b)(4).

TERRITORY AND PLAN OF OPERATION

As of December 31, 2011, the Company is licensed to transact property and casualty insurance in the states of California, Nevada, Oregon, and Washington.

Direct premiums written during 2011 totaled $19.1 million and were written in California (77.7%), Nevada (3.1%), Oregon (4.6%), and Washington (14.6%). The Company's primary lines of business written during 2011 were commercial auto liability (41.5%) and warranty (32.3%). The Company also wrote fire, allied lines, homeowners multiple peril, inland marine, earthquake, other liability - occurrence, and auto physical damage which altogether comprised 26.2% of the direct premiums written in 2011. Business for the Company is produced entirely by independent agents with the exception of vehicle service contract (warranty) and guaranteed auto protection or guaranteed asset protection (other liability - occurrence) business produced by a managing general agent, PRCO Inc. of Lafayette, California. There were approximately 35 agents appointed by the Company as of the examination date.

REINSURANCE

Assumed

The Company assumes minor amounts of reinsurance through mandatory pools in California. As of the examination date, reinsurance assumed was only $29,502.

Ceded

The following is a summary of principal reinsurance agreements in-force as of December 31, 2011 which covers all lines of business except the vehicle service contract and guaranteed auto protection or guaranteed asset protection product lines (all reinsurers are authorized):

Type of Contract	Line(s) of Business	Reinsurer(s) and Participation	Company's Retention	Reinsurer's Limits
Part 1A: Multi-Line Excess of Loss	Property	QBE Reinsurance Corporation (50%) SCOR Reinsurance Company (50%)	$300,000 per risk	$800,000 excess of $300,000 per risk, subject to a limit of $1.6 million per occurrence
Part 1B: Multi-line Excess of Loss	Casualty	QBE Reinsurance Corporation (50%) SCOR Reinsurance Company (50%)	$300,000 per occurrence	$800,000 excess of $300,000 per occurrence
Part II: Catastrophe Excess of Loss	Property	Liberty Mutual Insurance Company (35%) SCOR Reinsurance Company (65%)	$500,000 per occurrence	$1 million excess of $500,000 per occurrence
Part III: Clash Excess of Loss	Casualty	QBE Reinsurance Corporation (60%)	$1.1 million plus 40% of $1 million excess of $1.1 million per occurrence	60% of $1 million excess of $1.1 million per occurrence

ACCOUNTS AND RECORDS

Managing General Agent Act

California Insurance Code (CIC) Section 769.84(c) requires that an insurer conduct an onsite review of the underwriting and claims processing operations of its managing general agent (MGA) at least semi-annually. The Company and its MGA, PRCO, Inc., have agreed-upon procedures to conduct semiannual onsite reviews of the MGA to evaluate the premiums and claims cycles. The reviews are conducted by an independent certified public accounting firm. It was observed that the focus of the agreed-upon procedures between the Company and its MGA is primarily financial in nature and do not address the underwriting and claims practices of the MGA, such as the MGA's compliance with the Company's underwriting guidelines (i.e., rating, risk selection, etc.) and compliance with the Company's claims guidelines (i.e., ensuring compliance with state fair claims practices regulation). It is recommended that the Company ensure that the onsite reviews it performs on its MGA include a review of the MGA's underwriting and claims practices in accordance with CIC Section 769.84(c).

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	$ 39,176,384	$	$ 39,176,384	
Cash and short-term investments	529,422		529,422	
Investment income due & accrued	389,667		389,667	
Uncollected premiums and agents' balances in course of collection	762,783	22,379	740,404	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	2,511,449		2,511,449	
Amount recoverable from reinsurers	613,369		613,369	
Current federal and foreign income tax recoverable and interest thereon	62,847		62,847	
Net deferred tax asset	1,714,402	531,700	1,182,702	
Aggregate write-ins for other than invested assets	47,184		47,184	
Total assets	$ 45,807,507	$ 554,079	$ 45,253,428	

Liabilities, Surplus and Other Funds				
Losses			$ 8,801,755	(1)
Loss adjustment expenses			1,522,385	(1)
Other expenses			110,947	
Taxes, licenses and fees (excluding federal and foreign income taxes)			0	(2)
Unearned premiums			13,155,596	
Ceded reinsurance premiums payable			871	
Drafts outstanding			11,163	
Total liabilities			23,602,717	
Common capital stock		$ 3,000,000		
Gross paid-in and contributed surplus		2,800,000		
Unassigned funds (surplus)		15,850,711		
Surplus as regards policyholders			21,650,711	
Total liabilities, surplus and other funds			$ 45,253,428	

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

Statement of Income

Underwriting Income		
Premiums earned		$ 17,699,024
Deductions:		
Losses incurred	$ 11,350,000	
Loss expenses incurred	1,595,792	
Other underwriting expenses incurred	5,523,851	
Total underwriting deductions		18,469,643
Net underwriting loss		(770,619)
Investment Income		
Net investment income earned	$ 1,329,238	
Net realized capital gain	233,485	
Net investment gain		1,562,723
Other Income		
Finance and service charges not included in premiums	$ 306,070	
Total other income		306,070
Net income before federal and foreign income taxes incurred		1,098,174
Federal and foreign income taxes incurred		145,427
Net income		$ 952,747

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2010		$ 20,379,916
Net income	$ 952,747	
Change in net deferred income tax	551,076	
Change in nonadmitted assets	(233,028)	
Change in surplus as regards policyholders for the year		1,270,795
Surplus as regards policyholders, December 31, 2011		$ 21,650,711

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			$ 24,239,339
Net income	$ 3,314,641	$	
Change in net deferred income tax	76,587		
Change in nonadmitted assets		179,856	
Dividends to stockholders		5,800,000	
Total gains and losses	$ 3,391,228	$ 5,979,856	
Net decrease in surplus as regards policyholders			(2,588,628)
Surplus as regards policyholders, December 31, 2011, per Examination			$ 21,650,711

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 independent actuary's conclusion that the Company's loss and loss adjustment expense reserves as of December 31, 2011 are reasonable and have been accepted for purposes of this examination.

(2) Taxes, Licenses and Fees

California Insurance Code (CIC) Section 1872.8(a) states, in part, that each insurer doing business in California must pay an annual Vehicle Fraud Assessment Fee for each vehicle insured under an insurance policy it issued in California. The fee provides funding for the increased investigation and prosecution of fraudulent automobile insurance claims and automobile theft in the State of California. During the course of the examination, it was noted that the Company's vehicle counts were understated because of a delay in receiving policy information from an agent. The Company did not true-up the vehicle count; as a result, the vehicle fraud assessment fee paid by the Company was understated. The Company was not in compliance with CIC Section 1872.8(a) as it did not pay an assessment on all vehicles as defined in the California Code of Regulations, Title 10, Section 2698.61(r). It is recommended the Company implement procedures to ensure its vehicle count is accurate and comply with CIC Section 1872.8(a).

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Intercompany Agreements – (Page 3): It is recommended that the Company amend its tax sharing agreement to remove Anza Insurance Company as a party and file the agreement with the California Department of Insurance pursuant to California Insurance Code Section 1215.5(b)(4).

Accounts and Records – Managing General Agent Act (Page 6): It is recommended that the Company ensure that the onsite reviews it performs on its managing general agents (MGA) include a review of the MGA's underwriting and claims practices in accordance with CIC Section 769.84(c).

Comments on Financial Statement items – Taxes, Licenses and Fees (Page 10): It is recommended the Company implement procedures to ensure its vehicle count is accurate and comply with CIC Section 1872.8(a).

Previous Report of Examination

Reinsurance - Ceded (Page 5): It was recommended that the Company revise its reinsurance agreements to comply with California regulations. The Company is now in compliance.

Accounts and Records – Information Systems Controls (Page 6): It was recommended that the Company review the recommendations from the Information Systems review and make appropriate changes to strengthen its information systems controls. The Company has complied with the recommendation.

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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Li S. Lim, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California