# REPORT OF EXAMINATION
# OF THE

# TRUCK INSURANCE EXCHANGE

# AS OF
# DECEMBER 31, 2009

Participating State
and Zone:

California

Filed June 28, 2011

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Los Angeles, California
May 9, 2011

Honorable Joseph Torti, III
Chairman of the NAIC Financial
Condition Subcommittee
Superintendent of Rhode Island Business
Regulation, Division of Insurance
Cranston, Rhode Island

Honorable Linda S. Hall
Secretary, Zone IV – Western
Director of Insurance
Alaska Division of Insurance
Anchorage, Alaska

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

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

TRUCK INSURANCE EXCHANGE

(hereinafter also referred to as the Exchange) at its statutory home office and main administrative office located at 4680 Wilshire Boulevard, Los Angeles, California 90010.

## SCOPE OF EXAMINATION

The previous examination of the Exchange was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Exchange's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2009, as deemed necessary under the circumstances. This examination was conducted concurrently with certain of the Exchange's California subsidiaries and affiliates, namely: Farmers Insurance Exchange, Fire

Insurance Exchange, Mid-Century Insurance Company, Civic Property and Casualty Company, Exact Property and Casualty Company, Neighborhood Spirit Property and Casualty Company, and Farmers Reinsurance Company.

The California Department of Insurance was the lead state in this coordinated examination of the aforementioned companies, six non-California reinsurance pool participant companies, eighteen companies of the 21st Century Insurance and Finance Services (formerly AIG) personal auto group (21st Century), and five companies of the Bristol West Holdings, Inc. (Bristol West) group. The 21st Century group and the Bristol West group are further identified in the Exchange History section of this report.

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

## SUBSEQUENT EVENTS

Truck Underwriters Association (TUA), a subsidiary of Farmers Group, Inc. (FGI) and the Exchange's attorney-in-fact, entered into a settlement agreement on December 12, 2010, regarding a class-action lawsuit identified as Fogel versus TUA, FGI, as attorney-in-fact for Farmers Insurance Exchange (Farmers), Fire Underwriters Association (FUA), as attorney-in-fact for Fire Insurance Exchange (Fire), and Zurich Financial Services Ltd. "Fogel" consists of a class of certain Exchange, Farmers, and Fire policyholders as identified for certain previous policy years. The litigation primarily involves subscription fees (management fees) paid by the policyholders to their respective attorney-in-fact. The total potential settlement amount, if all qualifying policyholders file claims, is $455 million to be paid by FGI, TUA, and FUA. Up to $90 million is additionally established by the settlement agreement for payment to plaintiff's attorneys upon court approval. A number of initiatives at FGI, TUA, and FUA are included in the settlement agreement to further raise standards of customer communication. These include providing welcome packs and additional disclosures to Exchange policyholder-subscribers and providing additional training to its agents and front-line employees regarding the subscription agreement and related procedures.

The three Exchanges are not defendants in the lawsuit but are involved because the plaintiffs in the class-action lawsuit are their policyholders, and because any remaining portion of the settlement amount (the amount not remittable to specific policyholders) will be paid by FGI, TUA and FUA to the Exchanges per this agreement. A final approval hearing for this settlement agreement is set for September 7, 2011.

## EXCHANGE HISTORY

The Exchange was organized in the State of California on February 5, 1935, for the purpose of conducting property and casualty insurance.

A significant portion of the Exchange's reported surplus as regards policyholders at the examination date was composed of surplus notes, issued to non-affiliates, and contribution certificates, issued to affiliates. The following schedule depicts the specific issuances and amounts outstanding at December 31, 2009:

| | Date Issued | Interest Rate | Par Value | Maturity Date |
|---|---|---|---|---|
| 1) | 7/10/1998 | 7.050% | $ 73,077,000 | 7/15/2028 |
| 2) | 7/10/1998 | 7.200% | 21,923,000 | 7/15/2048 |
| 3) | 6/21/2004 | 6.150% | 136,500,000 | 12/31/2013 |
| | Total | | $231,500,000 | |

The aforementioned notes and certificates have restrictions, which require the approval of the California Department of Insurance (CDI) before payment of any interest and principal. Interest can be paid out of earned (unassigned) surplus only. The payments of interest and repayments of principal, occurring during this examination period were made with the approval of the CDI.

Items 1) and 2) are surplus notes, transacted on July 10, 1998, issued to qualified institutional buyers in the open market and administered by JP Morgan Chase Bank.

Item 3) is a new certificate of contribution in the amount of $136,500,000 issued on June 21, 2004, in consideration for the surrender and discharge of three earlier certificates issued on March 7, 2000, November 15, 2001 and December 31, 2001 to Truck Underwriters Association (TUA) in the same total amount, but then assigned by TUA to Zurich Capital Markets, Inc. (ZCM) on January 30, 2004. On July 28, 2004, the certificate was assigned by ZCM to Zurich Investments LLC (ZIL), a Luxembourg company. On January 17, 2008, the certificate was assigned by ZIL to Zurich American Insurance Company.

On December 31, 2009, the Exchange's subsidiary, Foremost Corporation of America (Foremost Corp.), was merged into FCOA, LLC, a non-insurance entity formed in 2009 and owned by the Foremost Insurance Company Grand Rapids, Michigan (Foremost I.C.), with FCOA, LLC as the surviving entity. All outstanding common shares of Foremost Corp. were retired and Foremost I.C. issued new common shares to the Exchange.

Bristol West Holdings, Inc.

On July 3, 2007, Farmers Group, Inc. (FGI) completed the acquisition of Bristol West Holdings, Inc. (BWH), a Delaware corporation, including its two directly-owned insurance company subsidiaries: Security National Insurance Company, a Florida company, and Bristol West Preferred Insurance Company, a Michigan company. Also included in the acquisition were certain insurance services companies and BWH's directly owned insurance holding company: Coast National Holding Company, a California company, and its insurance company subsidiary Coast National Insurance Company (CNIC), also a California company, which in turn owned Bristol West Insurance Company, an Ohio company, and Bristol West Casualty Insurance Company, an Ohio company. Concurrent with the acquisition, FGI sold BWH and its subsidiaries and underlying insurance business to the Exchange, Farmers Insurance Exchange (Farmers), Fire Insurance Exchange (Fire), and Mid-Century Insurance Company (Mid-Century).

BWH, via its insurance subsidiaries, had licenses in 38 states plus the District of Columbia, and operated in 22 states as a provider of liability and physical damage insurance, specializing in non-standard private passenger auto.

FGI paid $713.5 million and assumed $100 million of debt obligations as consideration for the acquisition of BWH. Additional consideration for the transaction included the "commutation of certain existing affiliated reinsurance arrangements" between BWH's insurance subsidiaries, and the execution of a 90% quota share cession agreement between CNIC and Farmers, effective January 1, 2007. That quota share treaty was replaced with a 100% quota share agreement effective July 1, 2008 with CNIC and Farmers.

The acquisition of BWH resulted in changes in the ultimate control of BWH's subsidiary, CNIC. The Exchange and Zurich Financial Services Ltd. (ZFS), a Swiss company and FGI's ultimate parent corporation, filed a joint Form A application pursuant to California Insurance Code (CIC) Section 1215.2. Additionally, Form D applications were filed pursuant to CIC Section 1215.5. The transactions were approved by the CDI on June 28, 2007.

FGI sold BWH and its subsidiaries and underlying insurance business to the Exchange, Farmers, Fire, and Mid-Century for $420 million, which represented an equity value of $370 million plus $50 million of debt assumption. In addition, the Exchange, Farmers, Fire, and Mid-Century incurred transaction fees of $13.8 million. FGI retained certain of BWH's employees, the operational systems, and the management servicing rights. The acquisition was recorded using the statutory purchase method of accounting. The following schedule depicts each exchange/company's share of the costs, fees and goodwill for the acquisition of the BWH insurance business at the time acquired:

| Entity | Cost and Fees | Goodwill | Percentage |
|---|---|---|---|
| | (in millions) | | |
| Farmers Insurance Exchange | $162.7 | $38.2 | 37.50% |
| Truck Insurance Exchange | 38.0 | 8.9 | 8.75% |
| Fire Insurance Exchange | 16.3 | 3.8 | 3.75% |
| Mid-Century Insurance Company | 216.8 | 51.0 | 50.00% |
| Totals | $433.8 | $101.9 | 100.00% |

On September 30, 2008, the following additional transactions were made between the Exchanges:

(1) Farmers purchased an additional 4.5% ownership interest in BWH with 2.5% purchased from Mid-Century for $12.3 million and 2.0% from the Exchange for $9.8 million.

(2) Farmers sold all of its 80% ownership interest in Civic Property and Casualty Company, Exact Property and Casualty Company and Neighborhood Spirit Property and Casualty Company to the Exchange and Fire for $182.9 million.

(3) Farmers sold 5% and 10% of its ownership interest in Mid-Century and Farmers Insurance Company of Oregon for $34.9 million and $43.0 million respectively to the Exchange.

Zurich Small Business Unit - Access Rights Agreement

Pursuant to an access rights agreement, effective June 1, 2008, four affiliated Zurich Small Business Unit companies (American Zurich Insurance Company (Illinois), Assurance Company of American (New York), Maryland Casualty Company (Maryland), and Northern Insurance Company of New York (New York)) sold and transferred all of their rights under certain insurance policies, producer agreements, and legal arrangements to the Exchange. The CDI approved this access rights agreement on June 1, 2008. A related quota share reinsurance treaty between the Exchange and these four insurers was entered into effective and approved the same date as this access rights agreement.

Purchase of AIG personal auto business

On July 1, 2009, FGI completed the acquisition of the American International Group, Inc.'s personal auto group of companies. This included the personal auto business of 21$^{st}$ Century Insurance Group. FGI paid $1.9 billion plus solely assumed $100 million of 21$^{st}$ Century Insurance Group's outstanding debt. Concurrent with the transaction FGI sold the personal auto group of companies and underlying insurance business to the Exchange, Farmers, and Fire for $1.39 billion. FGI retained certain of the personal auto group employees, the operational systems, and the management servicing rights. In addition, the Exchange, Farmers, and Fire incurred transaction fees of $6 million and also contributed $55 million of additional paid-in capital. The CDI approved the transactions on June 26, 2009,

The Exchanges now own, either directly or indirectly, the following insurers: 21$^{st}$ Century Casualty Company, 21$^{st}$ Century Insurance Company , 21$^{st}$ Century Insurance Company of the Southwest, AIG Centennial Insurance Company, AIG Auto Insurance Company of New Jersey, AIG Preferred Insurance Company, AIG Premier Insurance Company, AIG Indemnity Insurance Company, AIG Hawaii Insurance Company, Inc., American Pacific Insurance Company, Inc., AIG Advantage Insurance Company, American International Insurance Company of California, Inc., American International Insurance Company of New Jersey, American International Insurance Company of Delaware, American International Pacific Insurance Company, New Hampshire Indemnity Company, Inc., AIG National Insurance Company, Inc., and American International Insurance Company.

Concurrent to this acquisition a 100% quota share reinsurance agreement was entered into between American International Insurance Company (New York) and the Farmers to be effective July 1, 2009. This 100% quota share agreement was approved by the CDI on June 30, 2009.

The following 21st Century Companies officially changed their names effective April 1, 2010. The name change was filed with and approved by the requisite regulatory authorities.

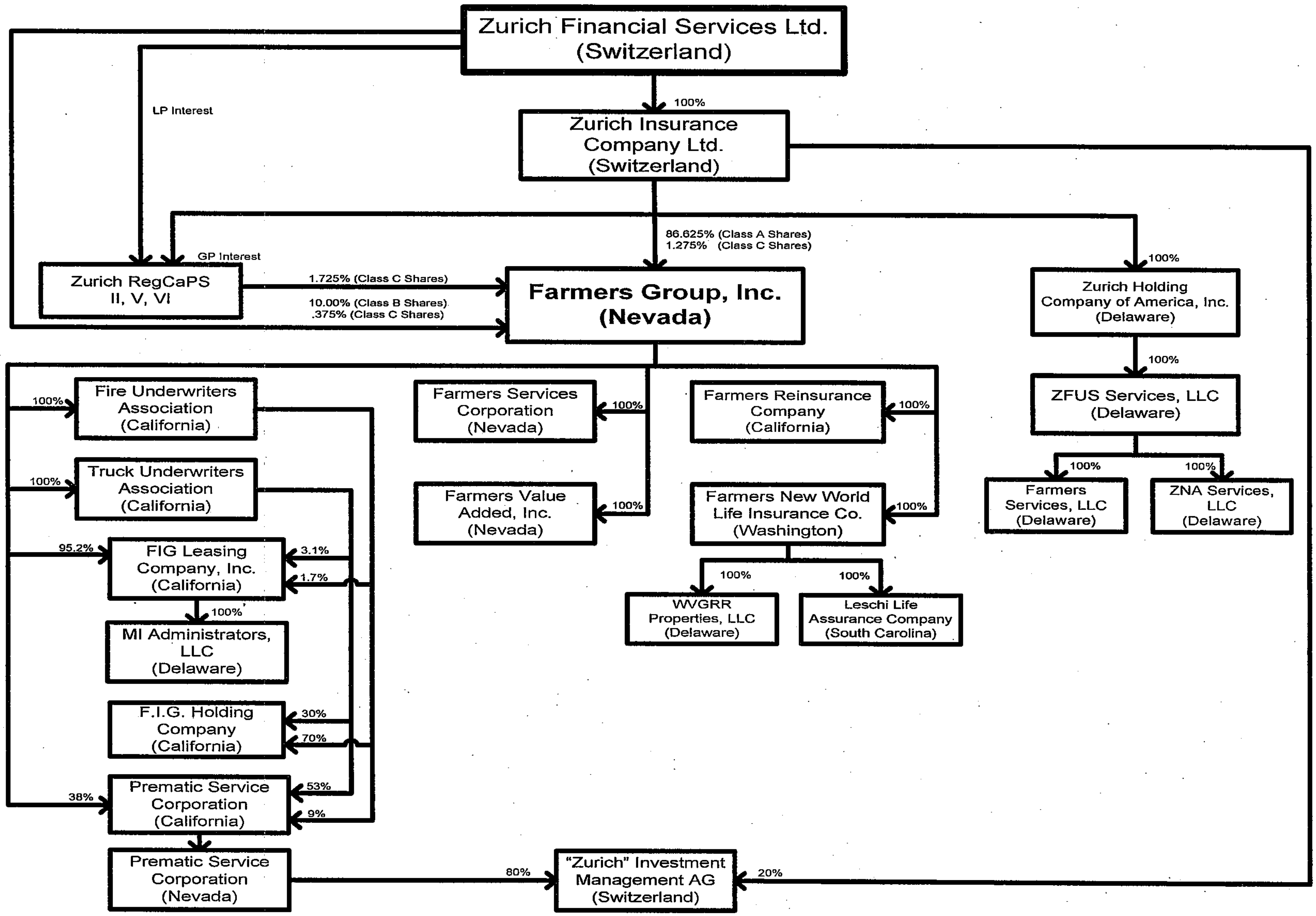
| Current Name | Formerly Doing Business As |
|---|---|
| 21st Century Advantage Insurance Company | AIG Advantage Insurance Company |
| 21st Century Assurance Company | American International Insurance Company of Delaware |
| 21st Century Auto Insurance Company of New Jersey | AIG Auto Insurance Company of New Jersey |
| 21st Century Centennial Insurance Company | AIG Centennial Insurance Company |
| 21st Century Indemnity Insurance Company | AIG Indemnity Insurance Company |
| 21st Century National Insurance Company | AIG National Insurance Company, Inc. |
| 21st Century North America Insurance Company | American International Insurance Company |
| 21st Century Pacific Insurance Company | American International Pacific Insurance Company |
| 21st Century Pinnacle Insurance Company | American International Insurance Company of New Jersey |
| 21st Century Preferred Insurance Company | AIG Preferred Insurance Company |
| 21st Century Premier Insurance Company | AIG Premier Insurance Company |
| 21st Century Security Insurance Company | New Hampshire Indemnity Company, Inc. |
| Farmers Insurance Hawaii, Inc. * | AIG Hawaii Insurance Company, Inc. |

*Effective January 1, 2010

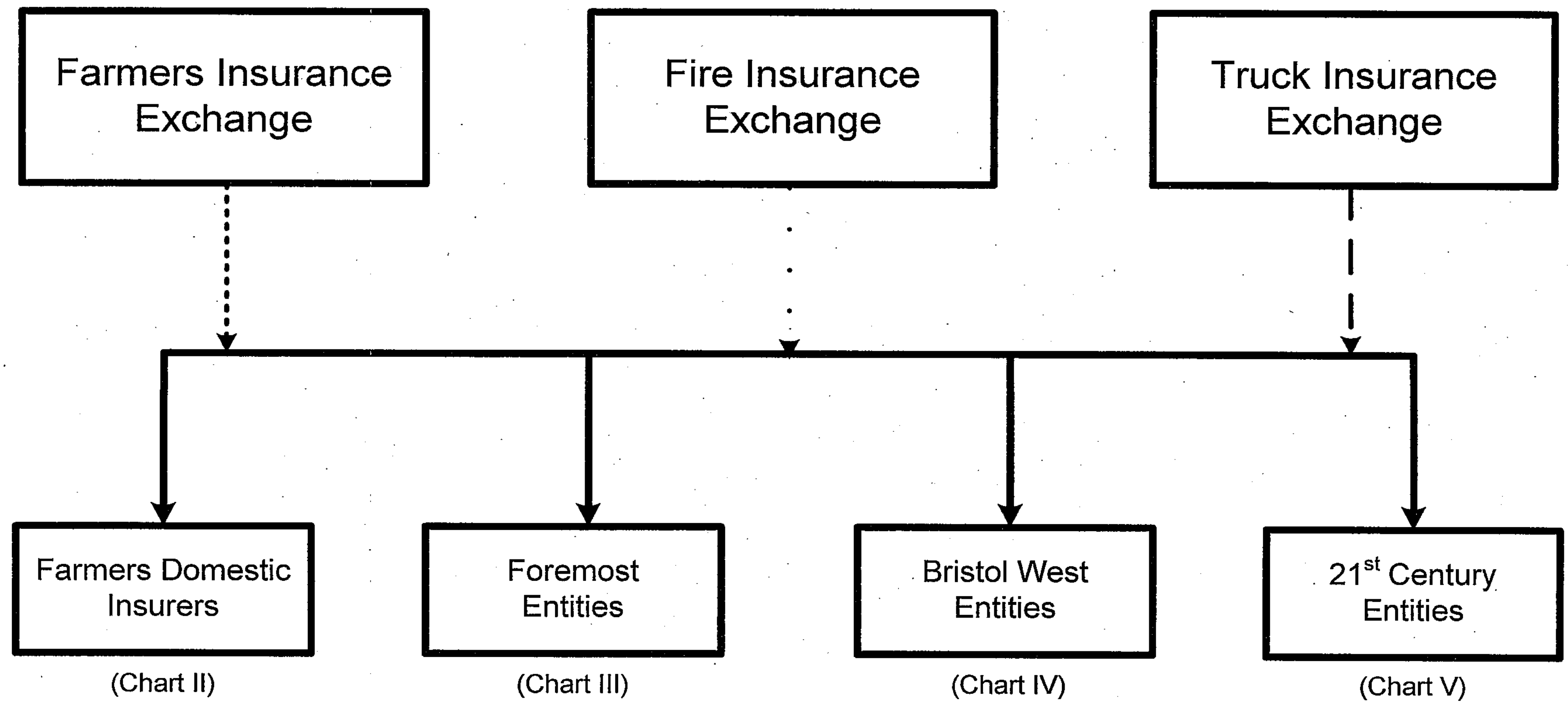
## MANAGEMENT AND CONTROL

The Exchange, a reciprocal insurer organized under California Insurance Code (CIC) Section 1300 et. seq. was controlled by its attorney-in-fact, Truck Underwriters Association (TUA). TUA is a U.S. subsidiary of Zurich Financial Services Ltd. (ZFS), a Swiss holding company. On May 8, 2008, the intermediate-level holding structure was re-organized and FGI, the parent of TUA, became owned 87.9% by Zurich Insurance Company (ZIC), 10.375% by Zurich Group Holdings (ZGH), and 1.725% by three Partnerships (Zurich RegCaPs II, V, VI) having ZIC as the General Partner and ZGH as the Limited Partner. On November 30, 2009, another restructuring occurred, as a result of which FGI became directly owned 87.9% by ZIC, 10.375% by ZFS, and 1.725% by three Partnerships (Zurich RegCaPs II, V, VI). ZFS continues to be the ultimate controlling party.

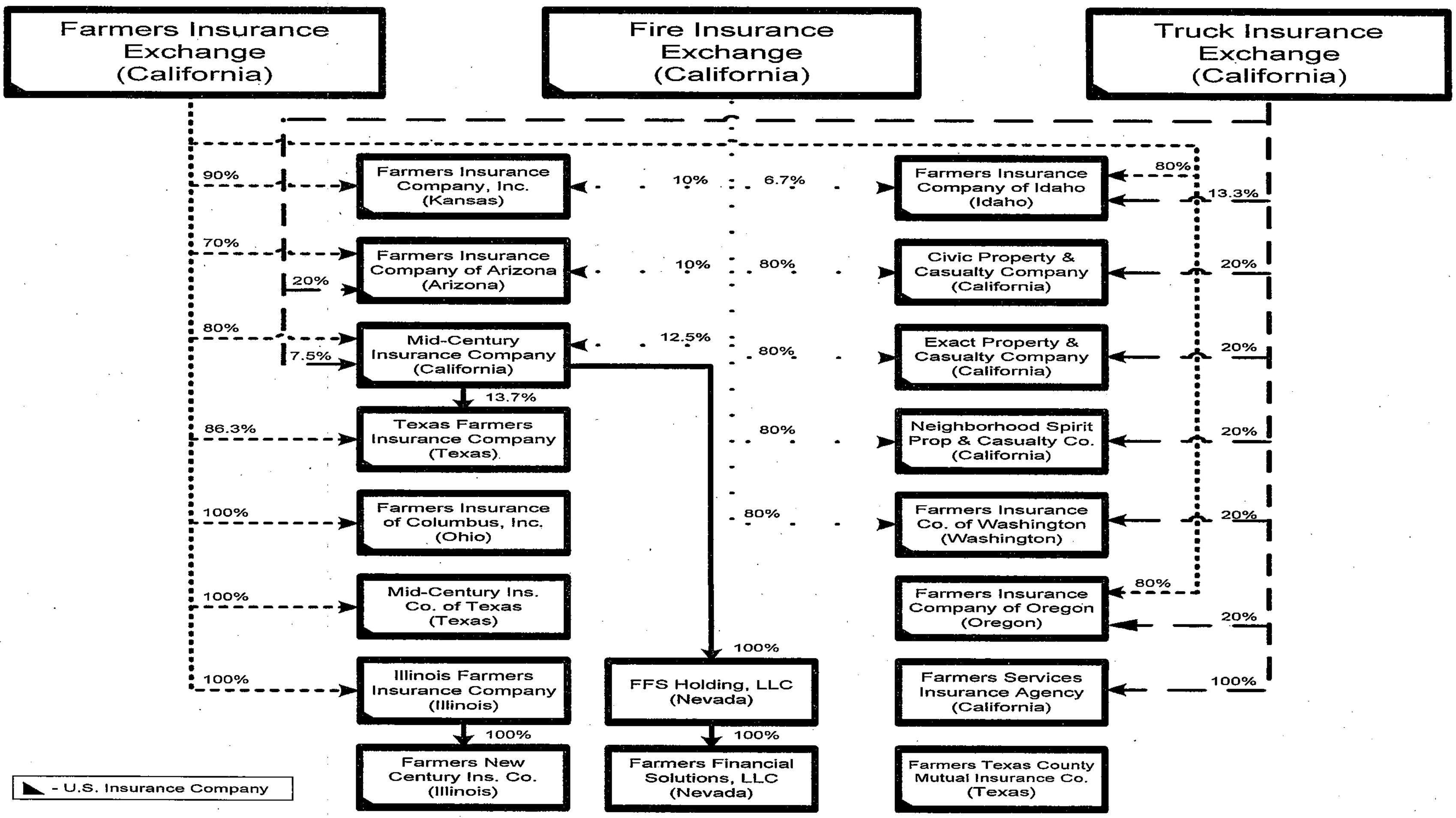
The following abridged organizational chart show the relationships of the attorney-in-fact, TUA, to its ultimate parent ZFS, and of the three Exchanges to their affiliates as of December 31, 2009:


Zurich Financial Services Ltd. (Switzerland)
100%
Zurich Insurance Company Ltd. (Switzerland)
LP Interest
GP Interest
Zurich RegCaPS II, V, VI
1.725% (Class C Shares)
10.00% (Class B Shares)
.375% (Class C Shares)
86.625% (Class A Shares)
1.275% (Class C Shares)
Farmers Group, Inc. (Nevada)
100%
Zurich Holding Company of America, Inc. (Delaware)
100%
ZFUS Services, LLC (Delaware)
100%
Farmers Services, LLC (Delaware)
100%
ZNA Services, LLC (Delaware)
100%
Fire Underwriters Association (California)
100%
Truck Underwriters Association (California)
95.2%
3.1%
1.7%
FIG Leasing Company, Inc. (California)
100%
MI Administrators, LLC (Delaware)
30%
70%
F.I.G. Holding Company (California)
38%
53%
9%
Prematic Service Corporation (California)
Prematic Service Corporation (Nevada)
100%
Farmers Services Corporation (Nevada)
100%
Farmers Value Added, Inc. (Nevada)
100%
Farmers Reinsurance Company (California)
100%
Farmers New World Life Insurance Co. (Washington)
100%
WGRR Properties, LLC (Delaware)
100%
Leschi Life Assurance Company (South Carolina)
80%
20%
"Zurich" Investment Management AG (Switzerland)

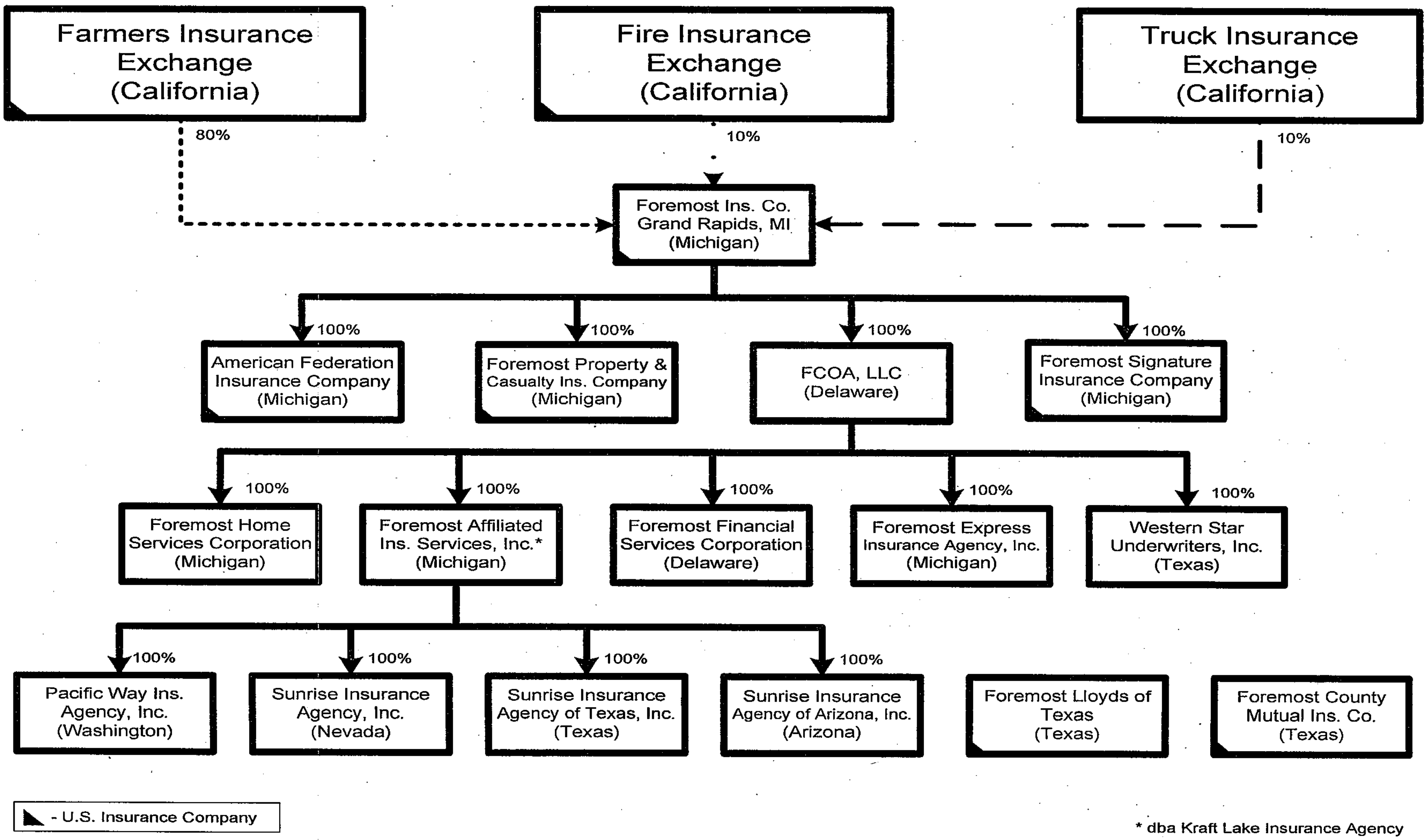
# FARMERS EXCHANGES ORGANIZATION



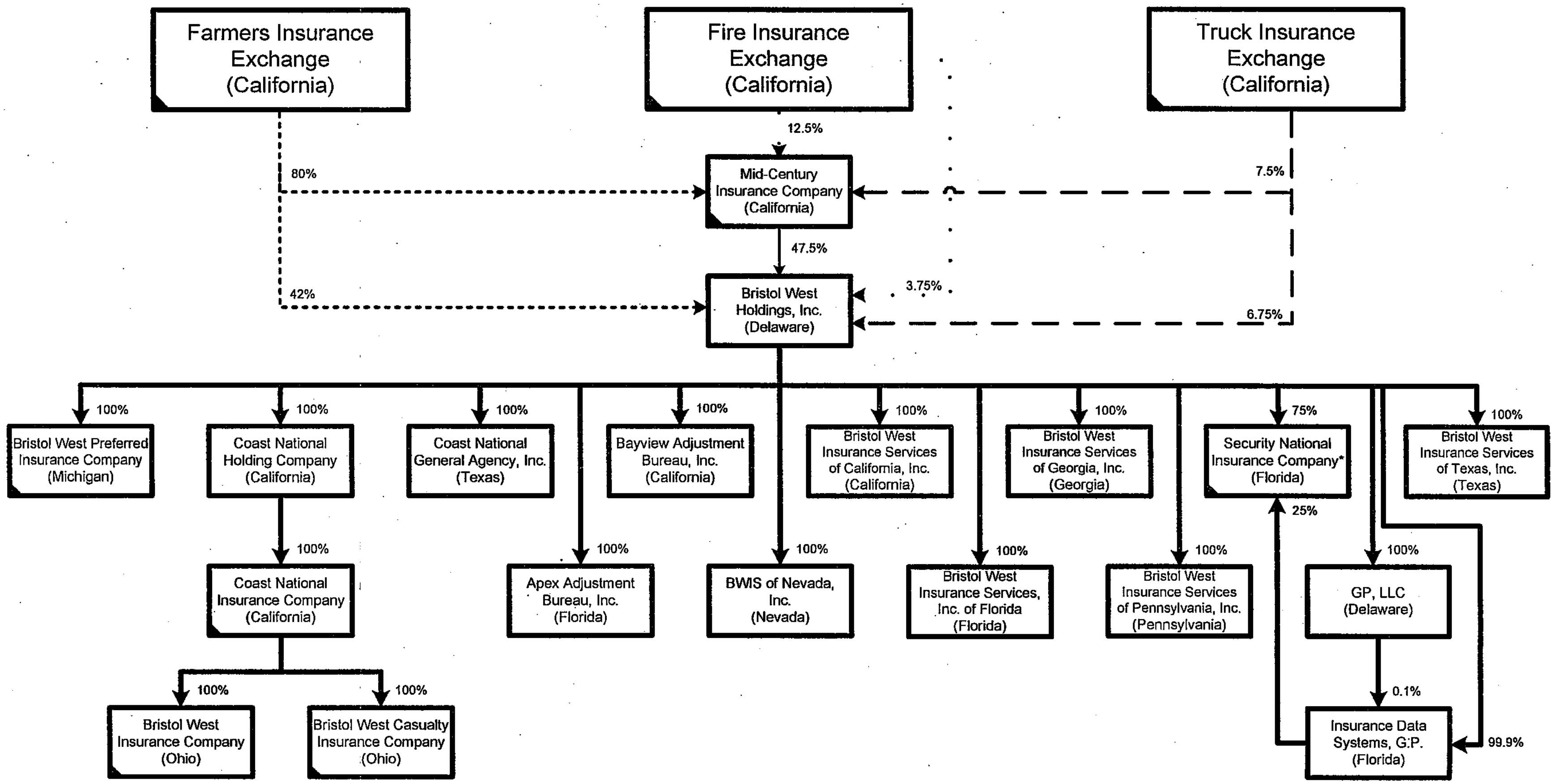
# CHART II: EXCHANGES/FARMERS ENTITIES ORGANIZATION



# CHART III: EXCHANGES/FOREMOST ORGANIZATION



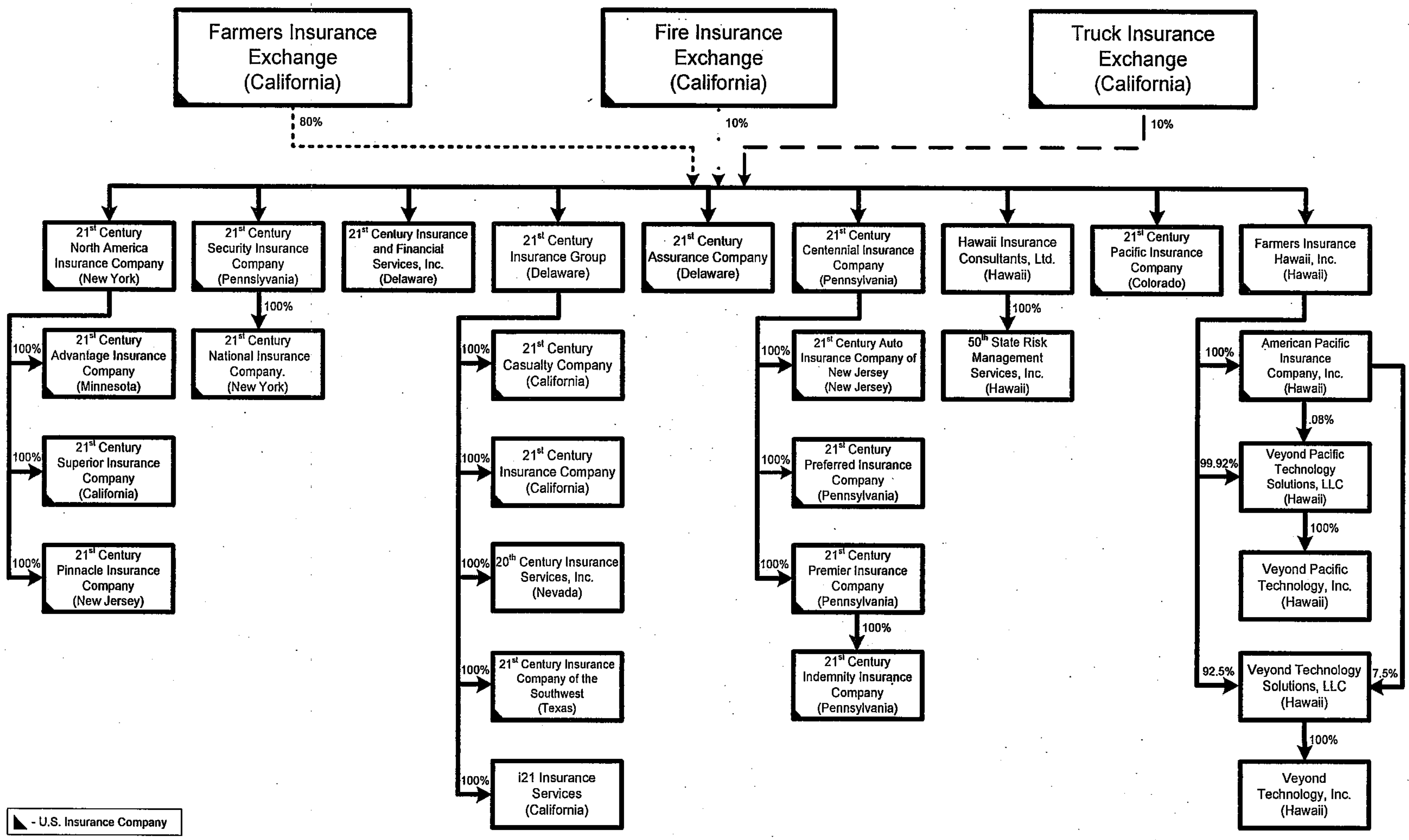
# CHART IV: EXCHANGES/BRISTOL WEST ORGANIZATION




◣ - U.S. Insurance Company

* Shares held by Bristol West Holdings, Inc. are voting shares, while those held by Insurance Data Systems, G.P. are non-voting shares

# CHART V: EXCHANGES/21st CENTURY ORGANIZATION



The Exchange has a Board of Governors of fifteen, elected annually. A listing of the members of the Board of Governors of the Exchange and principal officers of the Exchange and of its attorney-in-fact serving on December 31, 2009 follows:

Board of Governors

| Name and Residence | Principal Business Affiliation |
|---|---|
| Kenneth Wayne Bentley<br>Los Angeles, California | Vice President<br>Public Relations |
| James Earl Blincoe<br>Stockton, California | President<br>Trucking Company |
| Frank Anthony Bonello<br>Edina, Minnesota | Retired |
| Thomas David Brown<br>Clive, Iowa | President<br>Truck Leasing Company |
| Joe David Bryant<br>Oklahoma City, Oklahoma | Owner<br>Ribbon and Medal Company |
| James Junior Devine<br>Carmel, California | Retired |
| Hugh Cromer Dunlap *<br>Quitman, Arizona | Consultant |
| Alan Roy Gildemeister<br>Schaumburg, Illinois | Owner<br>Machine Tool Manufacturing Company |
| Guy Meade Hanson<br>Missoula, Montana | Owner<br>Retail Store |
| Peter David Kaplan<br>Los Angeles, California | Retired |
| Dennis Joseph Lorch<br>Advance, Missouri | Retired |
| Ronald Lee Marrone | Co-Owner |

## Board of Governors

| Name and Residence | Principal Business Affiliation |
|---|---|
| Pittsburgh, Kansas | Family Food Services Corporation |
| Gary Randolph Martin<br>Encinitas, California | President<br>Real Estate Management Company |
| Ottie Joel Wallace<br>Merced, California | President<br>Trucking and Logistics Company |
| Richard Lewis Wells<br>Lake Ozark, Missouri | Retired |

(*) Replaced by Gerald Alden McElroy on March 23, 2010.

## Principal Officers of the Exchange

| Name | Title |
|---|---|
| Ronald Gregory Myhan | Vice President and Treasurer |
| Doren Eugene Hohl | Secretary |

## Principal Officers of the Attorney-in-Fact of the Exchange

| Name | Title |
|---|---|
| F. Robert Woudstra | President and Chief Executive Officer |
| Doren Eugene Hohl | Secretary |
| Frank Joseph Ceglar, Jr. | Vice President |
| Jeffrey John Dailey | Vice President |
| Dan Curtis Dunmoyer * | Vice President |
| Scott Robert Lindquist | Vice President |
| Bryan Francis Murphy | Vice President |
| Mhayse Gokul Samalya | Vice President |
| Mark Bailey Smith | Vice President |

(*) Replaced by Denise Elaine Ruggiero on March 19, 2010.

## Management Agreements

TUA, as the attorney-in-fact, provides operating services (including staffing and occupancy), except claims adjustment services, to the Exchange. These services were provided to the Exchange pursuant to the "subscription agreements" entered into between the Exchange and each individual policyholder of the Exchange. There was no specific management services agreement required between the Exchange and TUA for the aforementioned services provided. CIC Sections 1215.4 and 1215.5 provide for an exemption from reporting for an inter-insurance exchange utilizing the subscription agreements providing that the "form of this agreement was in place prior to 1943 and it was not amended in any way to modify payments, fees, or waivers of fees or otherwise substantially amended after 1943". For 2007, 2008, and 2009, subscription fees forwarded by the Exchange to TUA for such services were $132,766,004, $145,553.878, and $162,692,414, respectively.

The Exchange is responsible for the payment of claims (adjustment function), payment of commissions, and the payment of premium and income taxes.

## Claims Adjustment Services Arrangement

Farmers Insurance Exchange (Farmers) staffs a claims department for the adjustment of its own claims and to adjust certain of its affiliated insurance companies' claims, including the Exchange. The claims adjustment services arrangement in place between Farmers and certain of its affiliates (the pooled companies including the Exchange), with Farmers providing all of their claims adjustment services, was not provided to the examiners in written form during previous examinations. A written agreement has now been provided documenting that the Exchange is a party to a claims adjustment services agreement with Farmers dated August 25, 1964. This agreement was amended and restated effective June 1, 1966.

During 2007, 2008, and 2009, net claims adjustment service fees paid by the Exchange to Farmers as a result of its participation in the intercompany reinsurance agreement were $82,175,000, $82,164,000, and $67,634,000, respectively.

Managed Care Services Agreement

The Exchange is a party to a managed care services agreement, effective October 1, 1998, with Zurich Services Corporation (ZSC), an affiliate. ZSC provides certain bill review and medical management services for the Exchange's workers' compensation claims. It was recommended in the previous examination that the Exchange submit this managed care services agreement to the CDI, pursuant to CIC Section 1215.5, for approval. The submission of the ZSC managed care services agreement was still pending as of the examination date, December 31, 2009. The Exchange and ZSC have, via amendment, terminated the existing agreement (except for case management services) effective July 15, 2010. A replacement managed care services agreement with Corvel Healthcare Corporation (unaffiliated) is currently near completion.

During 2007, 2008, and 2009, service fees paid by the Exchange to ZSC as a result of its participation in the existing managed care services agreement were $2,000,000, $2,000,000, and $2,200,000, respectively.

Tax Sharing Agreement

The Exchange's federal income tax return was consolidated with an affiliate, Farmers Services Insurance Agency. There was a written tax sharing agreement in place, effective May 1, 1995. The tax allocation was based on separate return calculations with current credit for net losses. The Exchange's portion of the federal income taxes paid or recovered via the tax sharing agreement for 2007, 2008, and 2009, was $5,257,000, ($17,774,000), and $4,748,000, respectively.

Investment Management Agreements

Farmers Group Inc.(FGI), acting on behalf of the Exchange, Farmers, Fire Insurance Exchange (Fire), and the subsidiaries of these three Exchanges, entered into an Investment Management Agreement dated July 1, 1998 with its affiliate, Scudder Kemper Investments Inc. (Scudder). In 2002, Scudder was acquired and replaced by Deutsche Asset Management (DeAM), a division of Deutsche Bank, AG. DeAM, a non-affiliate, managed the fixed income and equity asset portfolios of the Exchange, Farmers, Fire, and the subsidiaries. The terms of the agreement have otherwise not been altered.

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 Exchange, Farmers, Fire and the stock subsidiaries' investment portfolios, including Securities Valuation Office reporting. DeAM was given the authority to vote the proxies of the common stock. The terms of the Service Level Agreement were left unchanged except for the replacement of parties.

Securities Lending Agreement

In 1999 the Exchange filed with the CDI a securities lending agreement with its affiliate, Zurich Capital Markets Trust Company (Zurich). In December 2001, the Exchange changed its securities lending agent from Zurich to the Bank of New York Western Trust (BNY), a non-affiliate, as Zurich exited the securities lending business. "Collateral" is defined in the securities lending agreement as government securities and cash. The agreement also stipulated that BNY establish a "custodial custody account" in the name of the Exchange for the purpose of holding collateral and approved investments pertaining to securities lending transactions. The custodian was Wall Street Portfolio Advisors, a division of BNY. The agreement was amended and restated, effective May 24, 2005. The agreements conformed to the securities lending limits specified in CDI Bulletin 82-2.

## TERRITORY AND PLAN OF OPERATION

The Exchange is licensed to transact insurance business in the District of Columbia and the following 49 states:

| | | | | |
|---|---|---|---|---|
| Alabama | Idaho | Michigan | New York | Tennessee |
| Alaska | Illinois | Minnesota | North Carolina | Texas |
| Arizona | Indiana | Mississippi | North Dakota | Utah |
| Arkansas | Iowa | Missouri | Ohio | Vermont |
| California | Kansas | Montana | Oklahoma | Virginia |
| Colorado | Kentucky | Nebraska | Oregon | Washington |
| Connecticut | Louisiana | Nevada | Pennsylvania | West Virginia |
| Florida | Maine | New Hampshire | Rhode Island | Wisconsin |
| Georgia | Maryland | New Jersey | South Carolina | Wyoming |
| Hawaii | Massachusetts | New Mexico | South Dakota | |

Major Lines of Business:

The Exchange principally wrote commercial lines on a direct basis. However, Farmers Insurance Exchange (Farmers), 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 written or assumed by the Exchange from Farmers (the lead pooling Company in a pooling arrangement) were private passenger auto liability, auto physical damage, and homeowners multiple peril. By volume, commercial multiple peril, workers' compensation, and commercial auto writings were the more material commercial lines being written by the Exchange.

In 2009, the Exchange wrote $884.9 million of direct premiums. Of the direct premiums written, $346.1 million (39.1%) was written in California, $98.4 million (11.1%) was written in Texas, $47.1 million (5.3%) was written in New York and $393.2 million (44.5%) was written in the remaining states.

Personal and commercial business was produced for the Farmers property and casualty companies (including the Exchange) by an exclusive agency force of about 15,000 agents and was supported by 28 state executive offices, 7 service centers, and about 270 branch offices responsible for handling claims.

## REINSURANCE

### Intercompany Reinsurance Pooling Agreement

The Exchange, and certain affiliated companies, participate in an intercompany reinsurance pooling agreement. Under this agreement, the affiliated participants ceded all of their business, net of reinsurance, to the Farmers Insurance Exchange (Farmers), the lead company. Farmers then retroceded a share of the business back to certain participants based on percentages prescribed under the pooling agreement. The last amendment to this agreement was approved by the California Department of Insurance (CDI) on January 12, 1999.

The participants in the intercompany reinsurance pooling agreement, and their respective participation percentages as of December 31, 2009, were as follows:

| Pool Participant | Percentage |
|---|---|
| Farmers Insurance Exchange | 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 | 0.75 |
| Total | 100.00 |

Assumed

*Affiliated*

Farmers maintains certain fronting 100% quota share agreements (the so-called "RAS" treaties, which are historically long-standing reinsurance agreements with affiliates initiated between 1950 and 1995) by which all of the property business it writes is ceded "prior to the intercompany pooling" to Fire Insurance Exchange (Fire). Similarly all of Farmer's workers' compensation, medical malpractice, and commercial lines business are ceded to the Exchange via the RAS quota share agreements. Farmers then retrocedes the remaining business to the insurers participating in the intercompany reinsurance pooling agreement according to their respective participation percentages.

Effective June 1, 2008, via quota share agreements the Exchange began assuming 100% of the Zurich Small Business Unit's renewal and new sales of commercial business insurance policies written by the following four insurers: American Zurich Insurance Company (Illinois), Assurance Company of American (New York), Maryland Casualty Company (Maryland), and Northern Insurance Company of New York (New York). The CDI approved these agreements on June 1, 2008.

Ceded

*Affiliated*

Treaties ceding quota share risks to affiliated reinsurers were written with Farmers and certain of its affiliates (including the Exchange) as the cedents and remained in effect at December 31, 2009:

These included an auto physical damage (APD agreement) 100% quota share agreement, effective January 1, 2006, with two participants: the affiliated Zurich Insurance Company (Zurich) and the affiliated Farmers Reinsurance Company (Farmers Re). The premium for this APD agreement was $1 billion annually with Zurich assuming an 80% participation and Farmers Re assuming a 20% participation. The CDI approved this agreement on December 28, 2005. This 2006 APD agreement was renewed with the same terms, effective January 1, 2009, for a three-year term. The CDI approved this latest APD agreement on April 27, 2009.

Farmers is a party to an "all-lines" quota share reinsurance agreement ceding business to Zurich and Farmers Re. The agreement as amended, effective December 31, 2005, ceded a 6% quota share (Zurich 4.8% and Farmers Re 1.2%). The CDI approved this 2005 amendment on December 28, 2005. The agreement was amended, effective December 31, 2007 to decrease the percentage to 5% (Zurich 4% and Farmers Re 1%) and extend the duration to December 31, 2010. The 2007 amendment was approved by the CDI on December 28, 2007. An amendment effective September 30, 2008 increased the percentage to 25%. This 25% all lines quota share agreement was then terminated, effective June 30, 2009, and replaced with a new 37.5% all lines quota share agreement (Zurich 30% and Farmers Re 7.5%). An amendment, effective December 31, 2009, decreased the percentage ceded to 35%. The CDI approved the December 31, 2009, amendment on May 25, 2010.

Ceded

*Non-affiliated*

Treaties ceding risks to non-affiliated reinsurers were written with the Exchange, Farmers, and Fire as the cedents. The following is a summary of the principal non-affiliated ceded excess of loss reinsurance treaties inforce as of December 31, 2009:

| Type of Contract | Reinsurer's Name | Company's Retention | Reinsurer's Maximum Limits |
|---|---|---|---|
| Property Catastrophe Excess of Loss – 1st Layer | Lloyds of London (32.175%)<br>Various reinsurers (59.28%) | $250 million per occurrence | 91.445% of $200 million excess of $250 million retention per occurrence.<br>Coverage for property located in all territory except Florida. |
| Property Catastrophe Excess of Loss – 2nd Layer | Various reinsurers (95%) | $450 million per occurrence | 95% of $550 million excess of $450 million retention per occurrence. |
| Regional Property Catastrophe Excess of Loss | Lloyds of London (20.856%)<br>Various reinsurers (74.144%) | $1 billion per occurrence | 95% of $500 million excess of $1 billion retention per occurrence.<br>Coverage for property located Texas, Louisiana, Arkansas, Oklahoma, and California. |
| Property Catastrophe Excess of Loss – 1st Layer | Flagstone Reinsurance Limited (12%) | $1.5 billion per occurrence | 95% of $300 million in excess of $1.5 billion per occurrence. |

| Type of Contract | Reinsurer's Name | Company's Retention | Reinsurer's Maximum Limits |
|---|---|---|---|
| Texas Only | Partner Reinsurance Company, Ltd. (11%)<br>Various reinsurers (72%) | | Coverage for property located in Texas only. |
| Property Catastrophe Excess of Loss – 2nd Layer Texas Only | Flagstone Reinsurance Limited (12%)<br>Partner Reinsurance Company, Ltd. (11%)<br>Various reinsurers (77%) | $1.8 billion per occurrence | 100% of $200 million in excess $1.8 billion retention per occurrence.<br>Coverage for property located in Texas only. |
| Property Catastrophe Excess of Loss – Southeast region | DaVinci Reinsurance, Ltd. (17%)<br>Renaissance Reinsurance, Ltd (17%)<br>Validus Reinsurance, Ltd. (15%)<br>Lloyd's of London (33.5%)<br>Various reinsurers (17.5%) | $200 million per occurrence. | 100% of $200 million in excess of $200 million retention per occurrence.<br>Coverage for losses from Alabama, Florida, Georgia, North Carolina, and South Carolina. |
| Property Catastrophe Excess of Loss | Lloyds of London (33.5%)<br>Various reinsurers<br>(67.5%) | $20 million per occurrence. | 100% of $80 million in excess of $20 million in any one occurrence.<br>Coverage for Zurich Small Business Solutions' losses from Florida only. |
| Property Catastrophe Umbrella Excess of Loss | Lloyds of London (23.33%)<br>Various reinsurers (76.67%) | $1 billion per occurrence. | 100% of $300 million in excess of $1 billion per occurrence.<br>Coverage for losses from Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Missouri, Oklahoma, Tennessee, and Texas. |
| Property Per Risk Excess of Loss – 1st Layer | Lloyds of London (47%)<br>Various reinsurers (53%) | $3 million per risk | 100% of $7 million in excess of $3 million per risk and $7 million in aggregate losses. |
| Property Per Risk Excess of Loss – 2nd Layer | Lloyds of London (50.9%)<br>Various reinsurers (49.1%) | $10 million per risk | 100% of $40 million in excess of $10 million per risk. |

| Type of Contract | Reinsurer's Name | Company's Retention | Reinsurer's Maximum Limits |
|---|---|---|---|
| Property Per Risk Excess of Loss – 3rd Layer | Lloyds of London (58%)<br>Various reinsurers (42%) | $50 million per risk | 100% of $25 million in excess of $50 million per risk. |
| Casualty / Workers Compensation Catastrophe Excess of Loss – 1st Layer | Lloyds of London (32%)<br>Aspen Insurance UK Limited (20%)<br>Endurance Specialty Ins. Ltd. (25%)<br>Various reinsurers (23%) | $10 million per occurrence | 100% of $15 million in excess of $10 million per occurrence. |
| Casualty / Workers Compensation Catastrophe Excess of Loss – 2nd Layer | Lloyds of London (41%)<br>Endurance Specialty Ins. Ltd. (26%)<br>Various reinsurers (33%) | $25 million per occurrence. | 100% of $25 million in excess of $25 million per occurrence. |
| Casualty / Workers Compensation Catastrophe Excess of Loss – 3rd Layer | Lloyds of London (24.69%)<br>Aspen Insurance UK Limited (18.74%)<br>Endurance Specialty Ins. Ltd. (26.15%)<br>Various reinsurers (30.42%) | $50 million per occurrence. | 100% of $50 million in excess of $50 million per occurrence. |
| Workers Compensation Catastrophe Excess of Loss | Lloyds of London (17%)<br>Montpelier Reinsurance Ltd. (20%)<br>Tokio Millennium Reinsurance Limited (25%)<br>Validus Reinsurance, Ltd. (15%)<br>Various reinsurers (13%) | $50 million per occurrence. | 90% of $50 million in excess of $100 million per occurrence. |
| Marine Yacht Excess of Loss – 1st Layer | Swiss Reinsurance America Corp. (32.5%). | $5 million per occurrence | 100% of $5 million in excess of $5 million per occurrence. |

| Type of Contract | Reinsurer's Name | Company's Retention | Reinsurer's Maximum Limits |
|---|---|---|---|
| | Transatlantic Reinsurance Company (15%)<br><br>Various reinsurers (52.5%) | | |
| Marine Yacht Excess of Loss – 2nd Layer | Swiss Reinsurance America Corp. (32.5%).<br><br>Transatlantic Reinsurance Company (15%)<br><br>Various reinsurers (52.5%) | $10 million per occurrence. | 100% of $10 million in excess of $10 million per occurrence. |
| Marine Yacht Excess of Loss – 3rd Layer | Swiss Reinsurance America Corp. (32.5%).<br><br>Transatlantic Reinsurance Company (15%)<br><br>Various reinsurers (52.5%) | $10 million per occurrence. | 100% of $10 million in excess of $20 million per occurrence. |

As of December 31, 2009, reinsurance recoverables for all ceded reinsurance totaled $4.7 billion, or 880.5% of surplus as regards policyholders. Of the reinsurance recoverables 95.9% were from admitted affiliates, primarily resulting from the pooling arrangement of which Farmers was the lead company.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

| Assets | Ledger and Nonledger Assets | Assets Not Admitted | Net Admitted Assets | Notes |
|---|---|---|---|---|
| Bonds | $ 234,371,648 | $ | $ 234,371,648 | |
| Stocks: | | | | |
| Preferred stocks | 13,200 | | 13,200 | |
| Common stocks | 675,569,678 | | 675,569,678 | |
| Real Estate | | | | |
| Properties occupied by the company | 2,509,458 | | 2,509,458 | |
| Properties held for the production of income | 215,322 | | 215,322 | |
| Properties held for sale | 532,806 | | 532,806 | |
| Cash, cash equivalents and short-term investments | 377,194,975 | | 377,194,975 | |
| Investment income due and accrued | 3,109,904 | | 3,109,904 | |
| Premiums and consideration: | | | | |
| Uncollected premiums and agents balances in the course of collection | 39,933,033 | 7,784,084 | 32,148,950 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 172,453,682 | | 172,453,682 | |
| Accrued retrospective premiums | 294,616 | | 294,616 | |
| Reinsurance: | | | | |
| Amounts recoverable from reinsurers | 130,821,480 | | 130,821,480 | |
| Current federal and foreign income tax recoverable and interest thereon | 3,608,430 | | 3,608,430 | |
| Net deferred tax asset | 29,884,453 | | 29,884,453 | |
| Guaranty funds receivable or on deposit | 2,901,564 | | 2,901,564 | |
| Receivables from parent, subsidiaries and affiliates | 1,986,661 | | 1,986,661 | |
| Aggregate write-ins for other than invested assets | 15,260,770 | 2,652,241 | 12,608,528 | |
| Total assets | $1,690,661,680 | $10,436,325 | $1,680,225,355 | |

Statement of Financial Condition
as of December 31, 2009

(Continued)

Liabilities, Surplus and Other Funds

| | | | |
|---|---|---|---|
| Losses | | $ 450,086,385 | (1) |
| Reinsurance payable on paid losses and loss adjustment expenses | | 112,558,225 | |
| Loss adjustment expenses | | 142,484,374 | (1) |
| Commissions payable, contingent commissions and other similar charges | | 904,792 | |
| Taxes, licenses and fees | | 3,063,621 | |
| Unearned premiums | | 325,868,806 | |
| Advance premium | | 7,606,265 | |
| Dividends declared and unpaid: Policyholders | | 238,434 | |
| Ceded reinsurance premiums payable | | 127,067,539 | |
| Funds held by company under reinsurance treaties | | 1,965,249 | |
| Amounts withheld or retained by company for account of others | | 8,848,907 | |
| Remittances and items not allocated | | 550,497 | |
| Provision for reinsurance | | 15,096,246 | |
| Draft outstanding | | 150,631 | |
| Aggregate write-ins for liabilities | | (56,708,277) | |
| Total liabilities | | 1,139,781,694 | |
| Surplus notes | $ 231,500,000 | | |
| Unassigned funds (surplus) | 308,943,661 | | |
| Surplus as regards policyholders | | 540,443,661 | |
| Total liabilities, surplus and other funds | | $1,680,225,355 | |

Underwriting and Investment Exhibit
for the Year Ended December 31, 2009

Statement of Income

| | | |
|---|---|---|
| Underwriting Income | | |
| Premiums earned | | $ 787,935,537 |
| Deductions: | | |
| Losses incurred | $ 434,586,621 | |
| Loss adjustment expenses incurred | 96,778,939 | |
| Other underwriting expenses incurred | 245,325,588 | |
| Total underwriting deductions | | 776,691,148 |
| Net underwriting gain | | 11,244,389 |
| Investment Income | | |
| Net investment income earned | $ 9,860,070 | |
| Net realized capital gains | 1,548,293 | |
| Net investment gain | | 11,408,363 |
| Other Income | | |
| Net loss from agents' or premium balances charged off | $ (8,020,759) | |
| Finance and service charges not included in premiums | 6,584,843 | |
| Aggregate write-ins for miscellaneous loss | (7,389,141) | |
| Total other loss | | (8,825,057) |
| Net income before dividends to policyholders, before all other federal and foreign income taxes | | 13,827,695 |
| Dividends to policyholders | | 134,993 |
| Federal and foreign income taxes incurred | | (525,130) |
| Net income | | $ 14,217,832 |

Underwriting and Investment Exhibit
for the Year Ended December 31, 2009

(Continued)

Capital and Surplus Account

| | | |
|---|---|---|
| Surplus as regards policyholders, December 31, 2008 | | $428,324,478 |
| Net income | $ 14,217,832 | |
| Change in net unrealized capital gains less capital gains tax | 66,172,620 | |
| Change in net deferred income tax | 316,879 | |
| Change in nonadmitted assets | 28,493,665 | |
| Change in provision for reinsurance | 9,419,208 | |
| Cumulative effect of changes in accounting principles | 497,636 | |
| Aggregate write-ins for losses in surplus | (6,998,657) | |
| Change in surplus as regards policyholders | | 112,119,183 |
| Surplus as regards policyholders, December 31, 2009 | | $540,443,661 |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2009

| | | | |
|---|---|---|---|
| Surplus as regards policyholders, December 31, 2006, per Examination | | | $471,158,636 |
| | Gain in Surplus | Loss in Surplus | |
| Net income | $30,836,040 | $ | |
| Change in net unrealized capital gain | 8,880,159 | | |
| Change in net deferred income tax | | 6,046,941 | |
| Change in nonadmitted assets | 8,663,697 | | |
| Change in provision for reinsurance | 13,518,037 | | |
| Cumulative effect of change in accounting principles | 497,636 | | |
| Aggregate write-ins for gain in surplus | 12,936,397 | | |
| Totals | $75,331,966 | $6,046,941 | |
| Net increase in surplus as regards policyholders for the examination | | | 69,285,025 |
| Surplus as regards policyholders, December 31, 2009, per Examination | | | $540,443,661 |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Exchange was directed by the California Department of Insurance (CDI), under California Insurance Code (CIC) Section 733(g), to retain the American Actuarial Consulting Group, LLC, (AACG) for the purpose of assisting this examination in determining the reasonableness of the Exchange's loss and loss adjustment expense reserves. Because the business of the Farmers property and casualty companies was pooled, it was necessary to review the losses on a group-wide basis. Based on the analysis by AACG and the review of their work by a Casualty Actuary from the CDI, the Exchange's December 31, 2009, reserves for losses and loss adjustment expenses were determined to be reasonably stated and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None

Previous Report of Examination

Management and Control (Page 10): Management of the Exchange is vested in a fifteen member board of governors elected annually. However, the Exchange's Rules and Regulations stated a five to twelve member board of governors. It was recommended that the Exchange revise its number of member board of governors to comply with its Rules and Regulations. The Exchange revised its Rules and Regulations on January 12, 2011, to state a five to fifteen member board of governors and is now in compliance.

Management and Control - Claims Adjustment Services Arrangement (Page 12): The claims adjustment services arrangement in place between the Farmers Insurance Exchange (Farmers) and certain of its affiliates (the pooled companies, including the Exchange), with Farmers providing all of their claims adjustment services was not written. It was recommended that the Exchange and all of the California domiciled affiliates that Farmers is currently providing claims adjustment services to, enter into written claims adjustment services agreements and submit to the California Department of Insurance (CDI) for approval pursuant to California Insurance Code (CIC) Section 1215.5. A written agreement has now been provided documenting that the Exchange is a party to a long-standing claims adjustment services agreement with the Farmers dated August 25, 1964. This agreement was amended and restated effective June 1, 1966.

Management and Control - Managed Care Services Agreement (Page 13): Zurich Service Corporation (ZSC), an affiliate of the Exchange, provided certain bill review and medical management services for Truck's workers' compensation claims. It was recommended that the Exchange submit the managed care services agreement to the CDI for approval pursuant to CIC Section 1215.5. The submission of the ZSC managed care services agreement was still pending as of the examination date, December 31, 2009. The Exchange and ZSC have, via amendment, terminated this agreement (except for case management services) effective July 15, 2010. A replacement managed care services agreement with Corvel Healthcare Corporation (non-affiliated) is currently near completion.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Exchange's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/__________________

Gary W. McMurray, CFE
Examiner-In-Charge
Contract Insurance Examiner
Department of Insurance
State of California