

REPORT OF EXAMINATION  
OF THE  
WORKMEN'S AUTO INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2017

Filed on June 17, 2019

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Los Angeles, California  
May 17, 2019

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**WORKMEN'S AUTO INSURANCE COMPANY**

(hereinafter also referred to as the Company) at the primary location of its books and records, 4484 Wilshire Boulevard, Los Angeles, California, 90010. The Company's statutory home office and main administrative office is located at 3060 Saturn Street, Brea, California 92821.

**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, 2012. This examination covers the period from January 1, 2013, 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. The examination also included identifying and evaluating significant risks that could cause the Company'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 includes 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 an adjustment was identified during the course of the examination, the impact of such adjustment would 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.

The examination was a coordinated examination of the Mercury Insurance Group with California as the lead state, and conducted concurrently with the Florida, Georgia, Illinois, Oklahoma, and Texas Departments of Insurance. The insurance entities reviewed as part of this examination are identified below by state of domicile:

<u>Company</u>	<u>State</u>
California Automobile Insurance Company	California
California General Underwriters Insurance Company, Inc.	California
Mercury Casualty Company	California
Mercury Insurance Company	California
Workmen's Auto Insurance Company	California
Mercury Indemnity Company of America	Florida
Mercury Insurance Company of Florida	Florida
Mercury Indemnity Company of Georgia	Georgia
Mercury Insurance Company of Georgia	Georgia
Mercury Insurance Company of Illinois	Illinois
Mercury National Insurance Company	Illinois
American Mercury Insurance Company	Oklahoma

Mercury County Mutual Insurance Company  
American Mercury Lloyds Insurance Company

Texas  
Texas

### COMPANY HISTORY

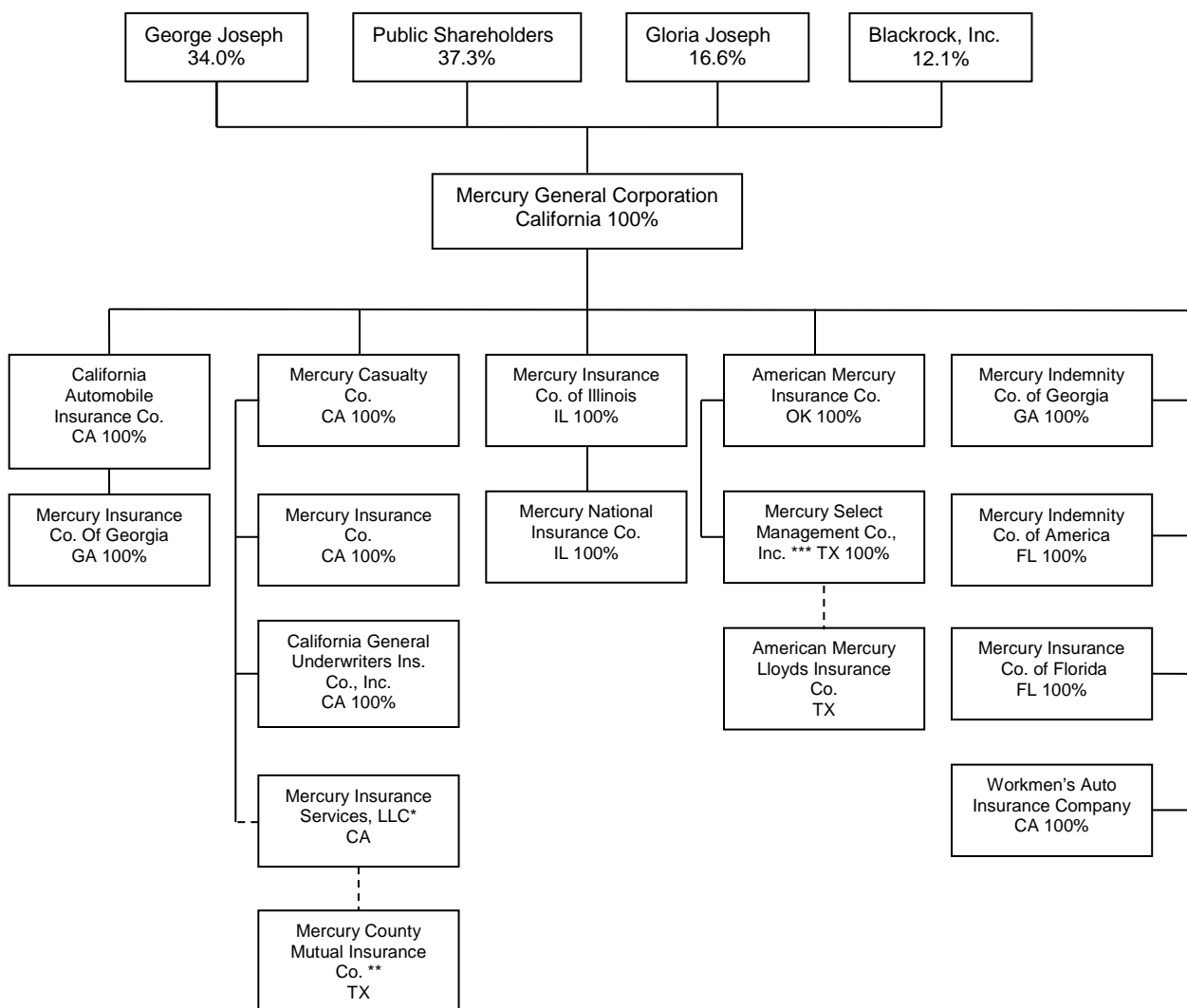
The Company was incorporated in the state of California on August 1, 1949 and commenced operations on December 10, 1949. Prior to January 2, 2015, the Company was a wholly-owned subsidiary of Workmen's Holding Company (WHC), a California corporation. Pursuant to an October 22, 2014 Stock Purchase Agreement, Mercury General Corporation (MGC) purchased all issued and outstanding shares of the Company on January 2, 2015. The acquisition was approved by the California Department of Insurance on December 18, 2014. MGC paid \$8,000,000 in cash for the Company's shares.

### Capital Contributions

During 2013 and 2014, the Company received capital contributions from its former parent, WHC, totaling \$3,550,000 and \$2,600,000, respectively. In accordance with the requirements for MGC to obtain regulatory approval to purchase all issued and outstanding shares of the Company, the Company received a \$15,000,000 capital contribution during 2015 that was recorded in the Company's financial statements as an admitted asset, receivable from MGC, at December 31, 2014. On May 1, 2015, the Company received an additional \$5,000,000 capital contribution from MGC.

### MANAGEMENT AND CONTROL

Mercury General Corporation (MGC) is a publicly traded insurance holding company. The controlling stockholders, George Joseph and Gloria Joseph, own 34.0% and 16.6%, respectively, of MGC's stock with the remaining 49.4% held by public shareholders and Blackrock, Inc. The following organizational chart depicts the Company's relationship within the holding company system:



\* Mercury Insurance Services, LLC, is controlled by its sole and managing member, Mercury Casualty Company, through a management agreement.

\*\* Mercury County Mutual Insurance Company is managed and controlled by Mercury Insurance Services, LLC, through a management agreement.

\*\*\* Mercury Select Management Company, Inc. is Attorney-in-fact for American Mercury Lloyds Insurance Company, a Texas Lloyds Plan Insurer.

The four members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2017:

## Director

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Norris W. Clark Granada Hills, California	Financial and Regulatory Specialist Locke Lord LLP
Don E. Franzen Pacific Palisades, California	Attorney Funsten and Franzen
Jeffrey M. Schroeder Yorba Linda, California	President and Treasurer Workmen's Auto Insurance Company
Gabriel Tirador Tustin, California	President and Chief Executive Officer Mercury General Corporation

## Principal Officers

<u>Name</u>	<u>Title</u>
Jeffrey M. Schroeder *	President and Treasurer
Joseph B. Miler	Secretary
Lisa M. Campbell	Vice President

\* Jeffrey Schroeder was replaced by William Hebert, effective May 6, 2019.

## Management Agreements

Service Agreement: Effective January 2, 2015, the Company entered into a services agreement with Mercury Insurance Services, LLC (MIS). Approval of the agreement was granted by the California Department of Insurance (CDI) on February 23, 2015. Under the terms of the agreement, the Company agreed to reimburse MIS for services provided to include all direct and directly allocable expenses determined to be attributable to the Company. Compensation for providing services is based on actual cost with no profit factor. The Company incurred service fees of \$1,383,607, \$4,016,458, and \$4,613,691 during the years 2015, 2016, and 2017, respectively. Service fees received under the

Company's prior ownership for 2013 and 2014 were \$240,882 and \$245,785, respectively.

Tax Allocation Agreement: Since January 1, 1983, MGC and various affiliates have been parties to a consolidated federal income tax allocation agreement. On July 29, 2015, the agreement was amended to add the Company and to delete three dissolved entities: Concord Insurance Services, Inc., Mercury Group, Inc., and American Mercury MGA, Inc. The amendment was effective as of January 2, 2015. The amendment also included several technical provisions required by the CDI, which did not alter or affect existing practices. The amendment was approved by the CDI on June 5, 2015. Under the terms of this agreement, the tax liability of the Company and its affiliates are computed as if each entity filed a separate stand-alone return, with current credit for net losses incurred by the insurance subsidiaries to the extent it can be used in the current consolidated return. Taxes paid or recovered by the Company totaled \$(2,221,652), \$(556,854), and \$716,150 for the years 2015, 2016, and 2017, respectively. Taxes recovered under the Company's prior ownership for 2013 and 2014 were \$20,254 and \$1,600, respectively.

#### TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Company was licensed to write various property and casualty coverages in California and Nevada. During 2017, the Company wrote non-standard private passenger automobile insurance solely in California. Direct premiums totaled \$29.2 million; 61% of the writings pertained to private passenger automobile liability and 39% pertained to automobile physical damage. The Company's business is distributed and marketed through a network independent agents and brokers.

#### REINSURANCE

##### Assumed

The Company did not assume reinsurance during the period covered by this examination.



## Ceded

As of December 31, 2017, the Company and all other insurance companies under the ownership, control or management of Mercury General Corporation were party to a Catastrophe Reinsurance Treaty (Treaty) consisting of two reinsurance agreements and four layers of coverage. The agreements were effective from July 1, 2017 through June 30, 2018 and provided for \$205 million coverage on a per occurrence basis after covered catastrophe losses exceed a \$10 million retention limit for all insurance companies combined. The Treaty specifically excluded coverage for any Florida business and for California earthquake losses on fixed property policies, such as homeowners, but did cover losses from fires following an earthquake. Subsequently, the Company entered into agreements effective from July 1, 2018 through June 30, 2019 under the same terms as the prior year.

## ACCOUNTS AND RECORDS

### Automobile Assessment File

California Code of Regulations 10 (CCR) § 2698.62(d) states in order to verify the number of vehicles for which an assessment is due and has been paid under this section, each insurer shall maintain a file known as the Automobile Assessment File. The Automobile Assessment File shall contain the vehicle identification, policy number and transaction date for every vehicle for which a policy of insurance was in force for each quarter or any part thereof. For group insurers, the information shall be maintained on an individual company basis. The data shall be kept in a computer format that allows for the insurer to place each calendar year quarter data on a computer media format in a format specified by the Commissioner. The data in the file shall be kept for a minimum of five years after each calendar year quarter. During the course of this examination, it was found the Company did not maintain an automobile assessment file as required by 10 CCR § 2698.62(d).

It is recommended the Company maintain an automobile assessment file in accordance with 10 CCR § 2698.62(d). The Company advised that it has implemented procedures to assure future compliance with the requirements of 10 CCR § 2698.62(d).

### 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. No adjustments were made to the statutory financial statements filed by the Company.

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, 2012 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	\$ 29,844,539	\$	\$ 29,844,539	
Common stocks	6,660,205		6,660,205	
Cash and short-term investments	2,129,981		2,129,981	
Investment income due and accrued	321,649		321,649	
Premiums and agents' balances in course of collection	146,306		146,306	
Premiums, agents' balances and installments booked but deferred and not yet due (including \$0 earned but unbilled premiums)	8,257,069		8,257,069	
Amounts recoverable from reinsurers	1,201		1,201	
Net deferred tax asset	819,483		819,483	
Electronic data processing equipment and software	2,904	2,904	0	
Aggregate write-ins for other-than-invested assets	<u>49,308</u>	<u>49,308</u>	<u>0</u>	
 Total assets	 <u>\$ 48,232,645</u>	 <u>\$ 52,212</u>	 <u>\$ 48,180,433</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 10,638,535	(1)
Loss adjustment expenses			2,710,124	(1)
Commissions payable, contingent commissions and other similar charges			270,296	
Other expenses			530,344	
Taxes, licenses and fees			425,774	
Current federal and foreign income taxes			217,285	
Unearned premiums			10,375,391	
Advance premiums			66,503	
Provision for reinsurance			6,000	
Payable to parent, subsidiaries and affiliates			363,483	
Aggregate write-ins for liabilities			<u>103,864</u>	
 Total liabilities			 25,707,599	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		55,359,316		
Unassigned funds (surplus)		<u>(35,486,482)</u>		
 Surplus as regards policyholders			 <u>22,472,834</u>	
 Total liabilities, surplus and other funds			 <u>\$ 48,180,433</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ 29,071,832
Deductions:		
Losses and loss expenses incurred	\$ 19,969,305	
Other underwriting expenses incurred	<u>9,107,412</u>	
Total underwriting deductions		<u>29,076,717</u>
Net underwriting loss		(4,885)

Investment Income

Net investment income earned	\$ 786,419	
Net realized capital gains	<u>13,211</u>	
Net investment gain		799,630

Other Income

Net loss from agents' or premium balances charged off (amount recovered \$42,030 amount charged off \$661,004)	\$ (618,974)	
Finance and service charges not included in premiums	2,786,704	
Aggregate write-ins for miscellaneous income	<u>16</u>	
Total other income		<u>2,167,746</u>
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		2,962,491
Federal and foreign income taxes incurred		<u>593,673</u>
Net income		<u>\$ 2,368,818</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2016		\$ 18,628,707
Net income	\$ 2,368,818	
Change in net unrealized capital gains	638,674	
Change in net deferred income tax	864,546	
Change in nonadmitted assets	(21,911)	
Change in provision for reinsurance	<u>(6,000)</u>	
Change in surplus as regards policyholders for the year		<u>3,844,127</u>
Surplus as regards policyholders, December 31, 2017		<u>\$ 22,472,834</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2012 through December 31, 2017

Surplus as regards policyholders, December 31, 2012 per Company			\$ 10,227,862
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net loss		\$ 15,784,819	
Change in unrealized capital gains	\$ 534,431		
Change in net deferred income tax	1,163,750		
Change in nonadmitted assets	186,178		
Provision for reinsurance		4,568	
Surplus adjustments: Paid-in	<u>26,150,000</u>		
Total gains and losses	<u>\$ 28,034,359</u>	<u>\$ 15,789,387</u>	
Net increase in surplus as regards policyholders			<u>12,244,972</u>
Surplus as regards policyholders, December 31, 2017, per Examination			<u>\$ 22,472,834</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

Based on an analysis by a Senior Casualty Actuary from 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 the purpose of this examination.

### SUBSEQUENT EVENTS

Two major catastrophe events occurred in the fourth quarter of 2018, the Camp Fire in Northern California and the Woolsey Fire in Southern California, which caused approximately \$206 million and \$43 million, respectively, in losses to the Mercury Insurance Group (Group), before reinsurance benefits. The combined loss to the Group from these two events, net of reinsurance benefits, totaled approximately \$37 million as follows: \$20 million for the Group's initial reinsurance retention for the two catastrophe events (\$10 million for each event); approximately \$11 million Group retention from the first layer of reinstated reinsurance limit previously used up; and approximately \$6 million Group retention on the Camp Fire losses in excess of \$200 million. The Group recorded a total of approximately \$18 million in ceded reinstatement premiums written and \$5 million in ceded reinstatement premiums earned in 2018 for reinstatement of the reinsurance benefits used under the Treaty related to these two catastrophe events.

The Group incurred a total of approximately \$21 million in losses, before reinsurance benefits, resulting from a wildfire, known as the Carr Fire, that occurred in Shasta County of Northern California in the third quarter of 2018. The loss to the Group, net of reinsurance benefits, was \$10 million, which is the Group's retention on the catastrophe event. The Group recorded approximately \$3 million in ceded reinstatement premiums written and \$1 million in ceded reinstatement premiums earned in 2018 for reinstatement of the reinsurance benefits used under the Treaty related to this catastrophe event.

As a result of reinsurance benefits used for the catastrophes described above under the Treaty ending June 30, 2019, the Group has exhausted the reinstated limit on the first layer of the Treaty, and a second reinstatement is not available under the current terms of the Treaty. Should there be another major catastrophe event within the Treaty period ending June 30, 2019, the Group would retain the first \$10 million of losses, retain the following \$30 million of losses reflecting that the reinstated first layer limit has been used up, and have available approximately \$57 million in reinsurance coverage for losses above \$40 million up to \$100 million, 100% reinsurance coverage for losses above \$100 million up to \$200 million and 5% reinsurance coverage for losses above \$200 million up to \$500 million.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records - Automobile Assessment File (Page 8): It is recommended the Company maintain an auto assessment file in compliance California Code of Regulations 10 CCR § 2698.62(d).

### Previous Report of Examination

Accounts and Records – Unclaimed Property (Page 13): It was recommended that the Company escheat policy related unclaimed personal property to the California State Controller’s Office and implement procedures to ensure future compliance with CAC, Title 2 – Subchapter 8. It is further recommended that the Company implement an escheat policy that adheres to the regulations of the other applicable states. The Company has complied with the recommendations.

Accounts and Records – Information System Controls (Page 13): The Company should evaluate the recommendations from the information systems controls review and make appropriate changes to strengthen its controls over its information systems. The

Company has implemented changes to strengthen its controls over information systems.

Comment on Financial Statement Items – Advance Premium (Page 20): It was recommended that the Company properly report advance premiums and premiums receivable in accordance with SSAP No. 53. The Company has complied with this 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,

/S/

Bradley R. Hazelwood, CFE, CPA  
Examiner-In-Charge  
Contract Examiner  
Department of Insurance  
State of California

/S/

Edward Aros, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California