

REPORT OF EXAMINATION
OF THE
COAST NATIONAL INSURANCE COMPANY
AS OF
DECEMBER 31, 2009

Participating State
and Zone:

California

Filed May 25, 2011

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Los Angeles, California
March 25, 2011

Honorable Joseph Torti, III
Chairman of the NAIC Financial
Condition Subcommittee
Superintendent of 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

COAST NATIONAL INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 5701 Stirling Road, Davie, Florida 33314. The Company's statutory home office is located at 333 S. Anita Drive, Suite 150, Orange, California 92868.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. The examination included a review of the Company'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.

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: 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.

COMPANY HISTORY

On March 1, 2007, Bristol West Holdings, Inc. (BRW), the Company's then ultimate parent, entered into a merger agreement with Farmers Group, Inc. (FGI), a Nevada corporation, under which FGI acquired 100% of the common stock of BRW for \$713.5 million. FGI also assumed \$100 million of debt obligations which were repaid immediately after closing.

Subsequent to the acquisition, on July 3, 2007, FGI sold the underlying insurance business, including the Company, for \$420 million to Farmers Insurance Exchange, Truck Insurance Exchange, and Fire Insurance Exchange, the current ultimate parents.

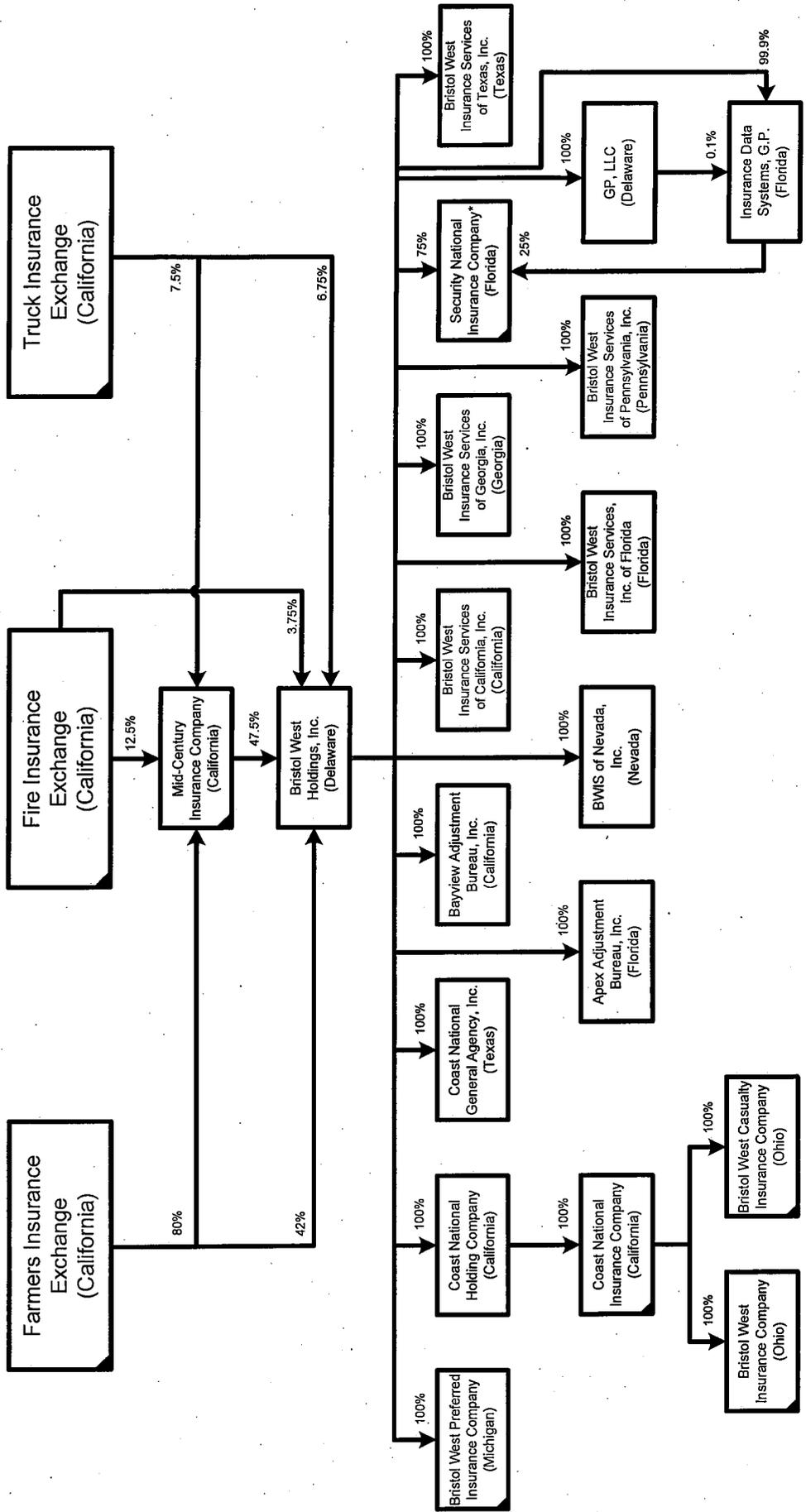
All outstanding capital stock of the Company is owned by Coast National Holding Company (CN Holding), whose stock, in turn, is wholly-owned by Bristol West Holdings, Inc. There are 500,000 shares authorized of which 20,000 shares are issued and outstanding. The Company amended its Articles of Incorporation to increase the par value of the common stock from \$60 per share to \$150 per share, and filed the amendment with the California Secretary of State on September 6, 2007.

In 2006, BRW contributed \$15 million to the Company as a surplus contribution. On December 31, 2007, the Company paid an ordinary dividend in the amount of \$30.5 million to its parent, CN

Holding. On February 18, 2008, the Company also declared an ordinary dividend in the amount of \$10 million to its parent and distributed the cash dividend on March 5, 2008.

MANAGEMENT AND CONTROL

The following organizational chart, which shows the relationships of the Company with its ultimate parents along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



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

* All outstanding voting shares are owned by Bristol West Holdings.

▲ - U.S. Insurance Company

(*) all ownership is 100% unless otherwise noted

Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2009 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Jeffrey J. Dailey Los Angeles, California	President - Personal Insurance Farmers Group, Inc.
Ronald G. Myhan Laguna Beach, California	Executive Vice President - Finance Farmers Insurance Exchange
Robert D. Sadler Parkland, Florida	President Bristol West Holdings, Inc.
Edward J. Steinman Parkland, Florida	Chief Financial Officer Bristol West Holdings, Inc.
Frank R. Woudstra Caledonia, Michigan	Chief Executive Officer Farmers Group, Inc.

Principal Officers

<u>Name</u>	<u>Title</u>
Robert D. Sadler	President
Edward J. Steinman	Vice President and Treasurer
Gregory J. Hammond	Secretary
Maria E. Aguilera	Vice President and Assistant Treasurer
Jeffrey J. Dailey	Vice President
Dan C. Dunmoyer	Vice President
Scott R. Lindquist	Vice President
Bryan F. Murphy	Vice President
Ronald G. Myhan	Vice President
James L. Nutting	Vice President
Mhayse G. Samalya	Vice President
Audrey E. Sylvan	Vice President
Frank R. Woudstra	Vice President

Management Agreements

Services Agreement: The Company entered into the Services Agreement with its parent, Farmers Insurance Exchange (FIE), effective September 2, 2009. Under the terms of this agreement, FIE administers policy management, claims adjusting services, accounting and financial reporting services, investment management services, and statutory filings. Compensation is based on actual expenses incurred except for investment management. For investment management services, the Company agrees to pay FIE an annual charge equal to 0.125% of the average net invested assets computed at the beginning of the year and at the end of the year. The costs incurred by the Company under this agreement are ceded to FIE per the 100% quota share reinsurance agreement, thus FIE ultimately bears the cost of these services. The agreement was approved by the California Department of Insurance (CDI) in September 2009.

General Agency Agreements: Prior to July 3, 2007, the Company's business was produced by two affiliated general agents, Bristol West Insurance Services of California, Inc. and BWIS of Nevada, Inc. These general agents accepted applications and performed other administrative functions. As compensation for their services, the affiliated general agents received a commission based on net direct premiums written and fees. Effective July 3, 2007, the affiliated general agents no longer perform the administrative services described above and no longer receive the commission for these services. The policy management and underwriting services are now provided to the Company by FIE in accordance with the Services Agreement entered into on September 3, 2009 by the Company and FIE (see above Services Agreement). The affiliated general agents have contracts with the independent producers that produce the Company's business and pay commissions to the independent producers pursuant to these contracts. The Company reimburses the affiliated general agents for the commission payments to the independent producers. The Company failed to amend the contract terms of the general agency agreements to reflect the current responsibilities with its affiliated general agents. It is recommended that the Company amend the contract terms to reflect the current responsibilities with its affiliated general agents and file the agreements with the CDI pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Claims Services Agreement: Upon approval from the CDI in June 1998, the Company entered into a claims services agreement with its affiliate, Bayview Adjustment Bureau, Inc. (BABI). Under the terms of this agreement, BABI administers all aspects of the Company's claims operations, which include adjusting and settling claims. Compensation is based on actual unallocated loss adjustment expenses incurred that are distributed to the Company based on allocation percentages calculated by the corporate actuary. The allocation amounts to the Company were \$26.5 million, \$24.2 million and \$26.3 million in 2009, 2008 and 2007, respectively.

Tax Sharing Agreement: The Company entered into a tax sharing agreement with FIE, effective July 3, 2007. In accordance with the tax-sharing agreement, any tax liability or benefit will be computed on a separate return basis, as if each member filed their returns separately. Intercompany tax balances are settled monthly and the final settlement is made within 30 days after the filing date of the consolidated return. The agreement was approved by the CDI in January 2008.

CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter that fact in the board minutes. A review of the board minutes disclosed that the officially filed report was not presented to the board for review. It is recommended that the Company implement procedures to ensure future compliance with CIC Section 735.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company was licensed to transact multiple lines of property and casualty insurance in the states of Arizona, California, Georgia, Mississippi, Nevada, Oregon, Pennsylvania, Tennessee, and Washington. The majority of premiums are written in the following

five states: California, \$189.7 million (60.4%); Arizona, \$44.0 million (14.0%); Oregon, \$21.9 million (7.0%); Nevada, \$16.1 million (5.1%); and Washington, \$15.1 million (4.8%).

The Company specializes in nonstandard private passenger automobile liability and physical damage coverage. The Company wrote a total of \$314 million of direct premiums in 2009.

REINSURANCE

Assumed

On July 3, 2007, the Company terminated and commuted its assumed quota share reinsurance agreements with affiliated companies (Security National Insurance Company, Bristol West Insurance Company, Bristol West Casualty Insurance Company, and Bristol West Preferred Insurance Company), on a cut-off basis effective January 1, 2007.

Ceded

On July 3, 2007, the Company entered into a quota share reinsurance agreement with Farmers Insurance Exchange (FIE), effective January 1, 2007. Under the terms of agreement, the Company agreed to cede 90% of its net business as well as 90% of its net unearned premium reserves as of January 1, 2007. The agreement was terminated on June 30, 2008 and is on a run-off basis.

On July 1, 2008, the Company entered into a separate quota share reinsurance agreement with FIE, wherein the Company agreed to cede 100% of its net business as well as 100% of its net unearned premium reserves as of July 1, 2008.

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, 2005 through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 323,966,620	\$	\$ 323,966,620	
Stocks:				
Common stocks	49,610,433		49,610,433	
Cash and short-term investments	38,335,252		38,335,252	
Investment income due and accrued	3,448,991		3,448,991	
Premiums and considerations:				
Uncollected premiums and agents' balances in course of collection	6,347,915		6,347,915	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	127,476,475		127,476,475	
Amount recoverable from reinsurers	38,062,240		38,062,240	
Net deferred tax asset	2,354,579	2,354,579		
Receivable from parent, subsidiaries and affiliates	610,656		610,656	
Aggregate write-ins for other than invested assets	<u>16,645</u>	<u>15,026</u>	<u>1,619</u>	
 Total assets	 <u>\$ 590,229,806</u>	 <u>\$ 2,369,605</u>	 <u>\$ 587,860,201</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 1,126,034	(1)
Reinsurance payable on paid losses and loss adjustment expenses			3,834,549	
Loss adjustment expenses			808,091	(1)
Commissions payable, contingent commissions and other similar charges			5,631,510	
Other expenses			703,237	
Taxes, licenses and fees			1,343,857	
Current federal and foreign income taxes			2,767,308	
Net deferred tax liability			72,712	
Advance premiums			810,293	
Ceded reinsurance premiums payable (net of ceding commissions)			189,160,509	
Funds held by company under reinsurance treaties			1,619	
Payable to parent, subsidiaries and affiliates			9,278,260	
Aggregate write-ins for liabilities			<u>5,312,870</u>	
 Total liabilities			 220,850,849	
 Common capital stock		\$ 3,000,000		
Gross paid-in and contributed surplus		226,278,921		
Unassigned funds (surplus)		<u>137,730,431</u>		
 Surplus as regards policyholders			 <u>367,009,352</u>	
 Total liabilities, surplus and other funds			 <u>\$ 587,860,201</u>	

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

Statement of Income

Underwriting Income

Deductions:

Losses incurred	\$ 292,481
Loss adjustment expenses incurred	(122,074)
Other underwriting expenses incurred	<u>135,672</u>

Total underwriting deductions \$ 306,079

Net underwriting loss (306,079)

Investment Income

Net investment income earned	\$ 15,596,110
Net realized capital losses	<u>(285,501)</u>

Net investment gain 15,310,609

Other Income

Net loss from agents' balances charged off	\$ (7,539,150)
Finance and service charges not included in premiums	21,936,513
Aggregate write-ins for miscellaneous losses	<u>(14,214,867)</u>

Total other income 182,496

Net income before federal income taxes 15,187,026

Federal income taxes incurred 3,677,142

Net income \$ 11,509,884

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2008 \$ 355,052,562

Net income	\$ 11,509,884
Change in net unrealized capital gains	1,061,102
Change in net deferred income tax	(90,743)
Change in nonadmitted assets	(588,777)
Change in provision for reinsurance	<u>65,324</u>

Change in surplus as regards policyholders 11,956,790

Surplus as regards policyholders, December 31, 2009 \$ 367,009,352

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2009

Surplus as regards policyholders, December 31, 2005, per Examination			\$ 288,173,366
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 121,756,609	\$	
Change in net unrealized capital gains	870,596		
Change in net deferred income tax		16,122,595	
Change in nonadmitted assets		2,168,624	
Surplus – Paid In	15,000,000		
Dividends to stockholders	<u> </u>	<u>40,500,000</u>	
Totals	<u>\$ 137,627,205</u>	<u>\$ 58,791,219</u>	
Net increase in surplus as regards policyholders			<u>78,835,986</u>
Surplus as regards policyholders, December 31, 2009, per Examination			<u>\$ 367,009,352</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company was directed by the California Department of Insurance (CDI), under California Insurance Code (CIC) Section 733, to retain American Actuarial Consulting Group, LLC (AACG) for the purpose of assessing the reasonableness of the Company's loss and loss adjustment expense reserves. Based on the analysis by AACG and the review of their work by a Casualty Actuary from the CDI, the Company's combined reserves for losses and loss adjustment expenses as of December 31, 2009 were determined to be reasonably stated and have been accepted for purposes of this examination report.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – General Agency Agreements (Page 6): It is recommended that the Company amend the contract terms to reflect the current responsibilities with its affiliated general agents and file the agreements with the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Corporate Records (Page 7): It is recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Section 735.

Previous Report of Examination

Management and Control – Management Agreements (Page 5): In accordance with the filing and approval requirements of CIC Section 1215.5(b)(4), it was recommended that the Company update

its agency agreements to reflect the current responsibilities of the agencies and submit the agreements to the CDI for approval. The Company has not complied.

Management and Control – Management Agreements (Page 5): It was recommended that the Company submit an executed copy of its cash management agreement to the CDI for review and approval pursuant to CIC Section 1104.9. The Company has complied.

Reinsurance – Assumed (Page 7): It was recommended that the Company delete the adjustable cession/assumption provisions in the applicable agreements for its intercompany agreements as reinsurance in future annual statement filings. The reinsurance agreements are no longer in force.

Reinsurance – Ceded (Page 8): It was recommended that the Company perform adequate risk transfer analysis on all future reinsurance agreements and account for the agreements in accordance with Statement of Statutory Accounting Principle No. 62. The Company has complied.

