

REPORT OF EXAMINATION  
OF THE  
FIRST AMERICAN PROPERTY & CASUALTY  
INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2015

Filed on January 13, 2017

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Los Angeles, California  
November 21, 2016

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

FIRST AMERICAN PROPERTY & CASUALTY INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 4 First American Way, Santa Ana, California 92707.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2010. This examination covered the period from January 1, 2011 through December 31, 2015.

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. An examination also includes identifying and evaluating significant risks that could cause an insurer'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 may include 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, during the course of the examination, an adjustment is identified, the impact of such adjustment will 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.

This was a coordinated examination with Nebraska as the lead state of the First American Financial Corporation (FAFC) group. FAFC has two subgroups, title and property and casualty, of which the Company is included in the property and casualty subgroup. This examination was conducted concurrently with other insurance entities within FAFC including its affiliate First American Specialty Insurance Company. The following states participated on the examination: Louisiana and Texas.

### COMPANY HISTORY

The Company, formerly known as Great Pacific Insurance Company (GPIC), was incorporated under the laws of the state of California on October 17, 1977 and commenced business on September 27, 1979. On August 30, 2000, GPIC changed its name to First American Property & Casualty Insurance Company subsequent to the acquisition of its parent company, Great Pacific Insurance Company Holdings, Inc. (GPIC Holdings), by First American Corporation (FAC) in May 1999.

Pursuant to an Agreement and Plan of Merger dated May 13, 2009, FAC merged GPIC Holdings into itself. As a result, the Company became a direct wholly-owned subsidiary of FAC. Effective June 1, 2010, FAC was reorganized into two independent public companies, First American Financial Corporation (FAFC) and CoreLogic, Incorporated. At that time, the Company became a wholly-owned subsidiary of FAFC.

### Capitalization

The Company has 100,000 shares of \$50 par value common stock authorized, all of which are issued and outstanding. The Company has no preferred stock authorized, issued or outstanding.

### Surplus Adjustments: Paid-In

FAFC contributed \$400,000 in 2014 and \$175,000 in 2015 in cash to the Company. The effect of the contributions was a surplus paid-in adjustment in the Company's policyholder surplus.

### Dividends

In September 2011, the Company paid an ordinary cash dividend to FAFC totaling \$4,000,000. The CDI approved this transaction in September 2011.

In September 2012, the Company paid an ordinary cash dividend to FAFC totaling \$4,100,000. The CDI approved this transaction in August 2012.

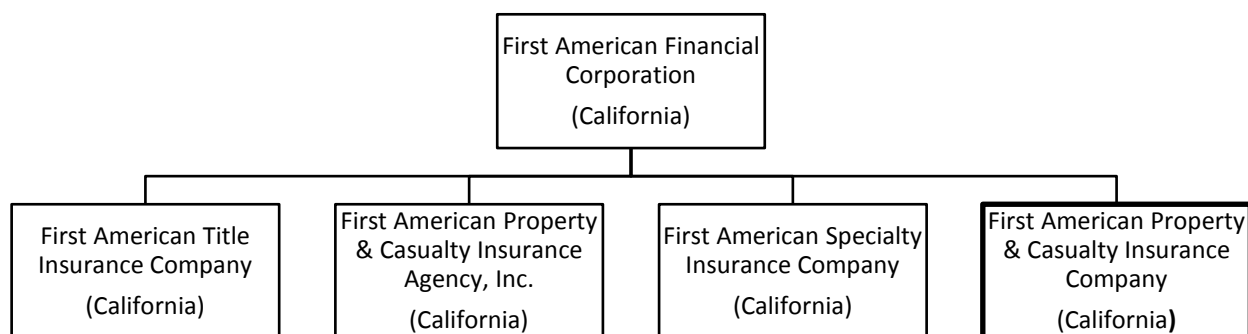
In September 2013, the Company paid an ordinary cash dividend to FAFC totaling \$4,000,000. The CDI approved this transaction in September 2013.

In September 2014, the Company paid an ordinary cash dividend to FAFC totaling \$1,400,000. The CDI approved this transaction in September 2014.

In October 2015, the Company paid an ordinary cash dividend to FAFC totaling \$2,600,000. The CDI approved this transaction in October 2015.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which First American Financial Corporation (FAFC) is the ultimate controlling entity. Following is an abridged organizational chart. All ownership is 100%.



The six 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, 2015:

Directors

Name and Location

Principal Business Affiliation

James J. Court  
Santa Ana, California

Chairman and President  
First American Specialty Insurance  
Company

Larry M. Davidson  
Santa Ana, California

Chief Operating Officer, Specialized  
Division  
First American Financial Corporation

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Dennis J. Gilmore Santa Ana, California	Chief Executive Officer First American Financial Corporation
George J. Grupp Santa Ana, California	Executive Vice President First American Specialty Insurance Company
Jeffrey S. Robinson Santa Ana, California	Corporate Deputy General Counsel First American Financial Corporation
Mark E. Seaton Santa Ana, California	Executive Vice President, Chief Financial Officer First American Financial Corporation.

#### Principal Officers

<u>Name</u>	<u>Title</u>
James J. Court	President and Chairman
George J. Grupp <sup>(a)</sup>	Executive Vice President, Chief Financial Officer, and Treasurer
Ted S. Misogas <sup>(b)</sup>	Vice President, Secretary, Controller, and Assistant Treasurer
Hugh M. McCreadie	Vice President and Treasurer
James H. Rogers	Vice President and Chief Investment Officer
Brian M. Schepperle	Vice President – Chief Information Officer
Robert D. Dalton	Vice President – Claims
Scott J. Callender	Vice President – Escrow/Direct
Cheryl F. Silverman	Vice President – Operations
Mark D. McGrane	Vice President – Product Management and Underwriting
James V. Boxdell, II	Assistant Treasurer
Hieu Le	Assistant Treasurer
Petty Nguyen	Assistant Treasurer
Teri L. Pierce	Assistant Treasurer

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

<sup>(a)</sup> Retired on May 6, 2016 and was replaced by Ted S. Misogas.

<sup>(b)</sup> Replaced the retired George J. Grupp as the Chief Financial Officer on May 9, 2016. The Controller position will be filled in January 2017.

## Management Agreements

Federal Tax Sharing Agreement: Effective June 1, 2015, the Company entered into a Federal Tax Sharing Agreement with its parent, FAFC, which was approved by the California Department of Insurance (CDI) on May 21, 2015. Under the terms of this agreement, the tax liability of the Company will be computed as if it filed a separate stand-alone return. The costs associated with the services are limited to actual costs incurred. Any additional tax payable or refund due will be settled within 30 days after such refund is received from the Internal Revenue Service or notification of the proper amount received. The amount due to the Company for 2015 is \$957,052.

Affiliated Companies Service Agreement: Effective December 31, 2012, an Affiliated Companies Service Agreement was executed with its affiliate First American Title Insurance Company (FATIC), and was approved by the CDI on October 17, 2012. Under the terms of this agreement, FATIC will provide the following services: Accounting and Auditing, Information Technology, and Other Functional Support Services. The costs associated with the services are limited to actual costs incurred. The amounts paid by the Company were \$0, \$0, \$0, and \$544,044 for 2012, 2013, 2014, and 2015, respectively.

Agency Agreement: Effective and approved by the CDI on July 30, 2012, an Agency Agreement was executed between the Company and its affiliate, First American Property & Casualty Insurance Agency, Inc. (FAPCIA). This agreement replaced a similar agreement dated January 1, 2009. Under the terms of the agreement FAPCIA underwrites policies on behalf of the Company. The Company collects premiums directly from customers and pays commissions to FAPCIA monthly based on cash collections. The Company pays FAPCIA a commission of 15% for flood and 17% for all other lines of business. The amounts paid by the Company were \$783,229, \$880,847, \$1,032,346, and \$87,194 for 2012, 2013, 2014, and 2015, respectively.



## 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 neither the officially filed nor the formally prepared draft by the examiner was presented to the board. 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, 2015, the Company was licensed to transact property and casualty insurance business in all 50 states and the District of Columbia. The Company is authorized to write the following lines of business in California: Fire, Marine, Plate Glass, Liability, Burglary, Sprinkler, Team and Vehicle, Automobile, and Miscellaneous insurance.

The Company offers homeowner and dwelling fire insurance marketed through an affiliated general agent, First American Property & Casualty Insurance Agency, Inc., and through a network of independent agents and brokers. In 2015 the Company wrote \$64,617,281 in premiums, of which 23.57% was written in California, 18.27% in Arizona, 12.13% in Washington, 6.49% in Nevada, and 5.03% in New Mexico.

## REINSURANCE

### Assumed

The Company does not assume reinsurance.

## Ceded

The following is a summary of the principal ceded reinsurance treaties in-force as of December 31, 2015:

<b>Line of Business and Type of Contract</b>	<b>Reinsurer's Name</b>	<b>Company's Retention</b>	<b>Reinsurer's Limit</b>
<b>Excess Catastrophe:</b>			
First Layer	Various authorized and unauthorized domestic, foreign and alien companies led by Lloyds Syndicates	\$5 million	\$15 million excess \$5 million, per occurrence
Second Layer	Various authorized and unauthorized domestic, foreign and alien companies led by Lloyds Syndicates	\$20 million	\$20 million excess \$20 million, per occurrence
Third Layer	Various authorized and unauthorized domestic, foreign and alien companies led by Lloyds Syndicates	\$40 million	\$60 million excess \$40 million, each and every loss/risk, per occurrence
Fourth Layer	Various authorized and unauthorized domestic, foreign and alien companies led by Lloyds Syndicates	\$100 million	\$10 million excess \$100 million, per occurrence
Fifth Layer	Various authorized and unauthorized domestic, foreign and alien companies led by Lloyds Syndicates	\$110 million	\$10 million excess \$110 million, per occurrence
<b><u>Quota Share and Excess of loss on Personal Umbrella Liability</u></b>			
First layer	General Re Corp - Unauthorized	10% up to \$2 million	90% up to \$2 million per occurrence 100% in excess of \$2 million per occurrence and up to \$5 million under special circumstances
<b><u>National Flood</u></b> <sup>(a)</sup>			
First Layer	FEMA (National Flood Insurance Protection) - Authorized	\$0	Not applicable
<b><u>Facultative</u></b>			
First Layer	General Re Corp - Unauthorized	\$1.75 Million	\$5.75 million in all risk per occurrence and \$18 million in all occurrences
<b><u>Catastrophe Reimbursement on Florida Loses only</u></b>			
First Layer	Florida Hurricane Catastrophe Fund - Authorized	Multiple calculations per contract	45% of Ultimate Net Paid Losses in excess of Company Retention and 5% of reimbursed ALAE

(a) The Company writes flood business through the National Flood Insurance Program (NFIP) as part of the Write Your Own (WYO) flood insurance program. The NFIP was established pursuant to the National Flood Insurance Act of 1968 and is administered by the Federal Insurance Administration of the Federal Emergency Management Agency (FEMA). The NFIP is designed to involve private insurers in a WYO flood insurance program financially backed by FEMA at no risk to the insurer.

### ACCOUNTS AND RECORDS

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of this review, some findings were noted and were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

## 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, 2015. The accompanying comments on the financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements. There were no examination adjustments made to surplus as a result of the examination.

Statement of Financial Condition as of December 31, 2015

Underwriting and Investment Exhibit for the Year Ended December 31, 2015

Reconciliation of Surplus as Regards Policyholders from December 31, 2010  
through December 31, 2015

Statement of Financial Condition  
as of December 31, 2015

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 58,086,547	\$	\$ 58,086,547	
Common stocks	21,009,878		21,009,878	
Cash and short-term investments	5,528,630		5,528,630	
Investment income due and accrued	587,544		587,544	
Premiums and agents' balances in course of collection	321,969	307,999	13,970	
Premiums, agents' balances and installments booked but deferred and not yet due (including \$ earned but unbilled premiums)	8,032,391		8,032,391	
Other amounts receivable under reinsurance contracts	258,735		258,735	
Current federal and foreign income tax recoverable and Interest thereon	9,946		9,946	
Net deferred tax asset	3,138,590		3,138,590	
Electronic data processing equipment and software	418,097	418,097		
Furniture and equipment	28,597	28,597	0	
Aggregate write-ins for other than invested assets	<u>14,433,736</u>	<u>14,010,541</u>	<u>423,195</u>	
 Total assets	 <u>\$ 111,854,660</u>	 <u>\$ 14,765,234</u>	 <u>\$ 97,089,426</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 15,012,616	(1)
Reinsurance payable on paid loss and loss adjustment expenses			2,102,396	
Commissions payable, contingent commissions and other similar charges			2,816,813	
Other expenses			116,904	
Taxes, licenses and fees			445,927	
Current federal and foreign income taxes (including \$69,886 on realized capital gains)			798,933	
Unearned premiums			31,692,786	
Advance premiums			1,055,126	
Ceded reinsurance premiums payable			12,230	
Amounts withheld or retained by company for account of others			1,097,516	
Payable to parent, subsidiaries and affiliates			1,163,065	
Payable for securities			<u>126,923</u>	
 Total liabilities			 56,441,235	
Common capital stock	\$ 5,000,000			
Gross paid-in and contributed surplus	17,765,000			
Unassigned funds (surplus)	<u>17,883,191</u>			
Surplus as regards policyholders			<u>40,648,191</u>	
 Total liabilities, surplus and other funds			 <u>\$ 97,089,426</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2015

Statement of Income

Underwriting Income

Premiums earned		\$ 58,729,107
Deductions:		
Losses and loss expenses incurred	\$ 42,300,994	
Other underwriting expenses incurred	<u>23,111,855</u>	
Total underwriting deductions		<u>65,412,849</u>
Net underwriting loss		(6,683,742)

Investment Income

Net investment income earned	\$ 2,507,768	
Net realized capital loss less capital gains tax	<u>(170,964)</u>	
Net investment gain		2,336,804

Other Income

Net income from agents' or premium balances charged off	\$ 160,577	
Finance and service charges not included in income	<u>1,404,905</u>	
Total other income		<u>1,565,482</u>
Net loss before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		(2,781,456)
Federal and foreign income taxes incurred		<u>(957,052)</u>
Net loss		<u>\$ (1,824,404)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2014		\$ 46,538,934
Net loss	\$ (1,824,404)	
Change in net unrealized capital loss	(762,260)	
Change in net deferred income tax	(557,157)	
Change in nonadmitted assets	355,544	
Change in provision for reinsurance	18,503	
Surplus adjustments:		
Paid-in	175,000	
Dividends to stockholders	(2,600,000)	
Aggregate write-ins for losses in surplus	<u>(695,969)</u>	
Change in surplus as regards policyholders for the year		<u>(5,890,743)</u>
Surplus as regards policyholders, December 31, 2015		<u>\$ 40,648,191</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2010 through December 31, 2015

Surplus as regards policyholders, December 31, 2010			\$ 41,780,334
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 15,528,626	\$	
Change in unrealized capital losses		1,053,254	
Change in net deferred income tax	264,103		
Change in nonadmitted assets		720,106	
Change in provision for reinsurance	90,873		
Surplus adjustments: Paid-in	575,000		
Dividends to shareholders		16,100,000	
Aggregate write-ins for gains and losses in surplus	<u>282,615</u>	<u></u>	
Total gains and losses	<u>\$ 16,741,217</u>	<u>\$ 17,873,360</u>	
Net decrease in surplus as regards policyholders			<u>(1,132,143)</u>
Surplus as regards policyholders, December 31, 2015			<u>\$ 40,648,191</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

The Company's reserves were evaluated by a Casualty Actuary from the California Department of Insurance. Based on the analysis, the Company's December, 31, 2015 reserves for losses and loss adjustment expenses appear reasonable and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Corporate Records (Page 7): A review of the board minutes disclosed that neither the officially filed report of examination nor the formally prepared draft by the examiner was presented to the board. It is recommended that the Company implement procedures to ensure future compliance with California Insurance Code (CIC) Section 735.

Accounts and Records – Information System Controls (Page 9): As the result of the review of the Company's information systems controls, recommendations for improving these controls were presented to the Company. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

### Previous Report of Examination

Management and Control – Management Agreements: Agency Agreements (Page 5): The Company failed to file the agreement with the California Department of Insurance (CDI) for approval. The Company replaced the agreement with a new Agency Agreement which was effective and approved on July 30, 2012.



Management and Control – Management Agreements: Tax Allocation Agreement (Page 5): The Company failed to file the agreement with the CDI for approval. The Company replaced the agreement with the Federal Tax Sharing Agreement approved by the CDI on May 21, 2015.

Accounts and Records (Page 7): It was recommended that the Company establish and implement procedures and quality control tests to ensure that all information contained in its detail claims listing are accurate. The Company has complied with this recommendation.

Accounts and Records (Page 7): It was recommended that the Company implement controls to identify potential errors and properly review its statutory financial statements for compliance with the National Association of Insurance Commissioners' (NAIC) Annual Statement Instructions before being submitted to the CDI. The Company has complied with this recommendation.

Comments on Financial Statement Items – Preferred Stocks (Page 12): It was recommended the Company continue to report preferred stocks with the NAIC designations 3 to 6 at the lower of cost or market. The Company no longer holds preferred stocks.

Comments on Financial Statement Items – Current federal Income Tax Recoverable and Interest Thereon (Page 12): It was recommended that tax settlements are made timely in accordance with the Tax Allocation Agreement and to non-admit any tax recoverables that are over 90 days due. The Company complied with this recommendation.

Comments on Financial Statement Items – Other Expenses (Page 12): It was recommended that the Company record advance premiums as a separate liability. The Company 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,

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Thomas Podsiadlo, CFE  
Examiner-In-Charge  
Associate Insurance Examiner  
Department of Insurance  
State of California

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Grace Asuncion, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California