REPORT OF EXAMINATION
OF THE

FINANCIAL PACIFIC INSURANCE COMPANY

AS OF
DECEMBER 31, 2008

Participating State
and Zone:

California

FILED: May 26th, 2010

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San Francisco, California
March 19, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

FINANCIAL PACIFIC INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office, located at 3880 Atherton Road, Rocklin, California 95765.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2008. The examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The present examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, an evaluation of assets, and a determination of liabilities as of December 31, 2008, as deemed necessary under the circumstances. The examination was conducted concurrently with the Company's affiliates Mercer Insurance Company, Mercer Insurance Company of New Jersey, and Franklin Insurance Company (hereinafter referred to as the Group).

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

SUBSEQUENT EVENTS

In 2009, the Company constructed a new 41,000 square foot building for its office in Rocklin, California. This office replaced the building the Company previously leased in Rocklin for its headquarters. The statutory book value of the Rocklin office was $6.3 million as of December 31, 2009 and the Company stated that there are no encumbrances.

Effective December 31, 2009, the Company's affiliates, Queenstown Holding Company, Inc. and Franklin Holding Company, Inc., were liquidated. As a result of the liquidation, Mercer Insurance Company of New Jersey, Inc. and Franklin Insurance Company became direct subsidiaries of Mercer Insurance Company.

During 2009, the Company declared and paid ordinary cash dividends of $2,014,000 to its parent, Financial Pacific Insurance Group (FPIG).

In addition, during 2009 Mercer Insurance Group contributed $1.1 million in cash to FPIG, which was then contributed to the Company as paid in surplus.

COMPANY HISTORY

During 2004, the Company received capital contributions of $2 million from its immediate parent, Financial Pacific Insurance Group, Inc. (FPIG).

On October 1, 2005, Mercer Insurance Group, Inc. (MIG) acquired all of the outstanding stock of the Company's parent, FPIG, from a group of investors. Under the terms of the acquisition, FPIG Acquisition Corp., a Delaware corporation wholly-owned by MIG, merged with and into

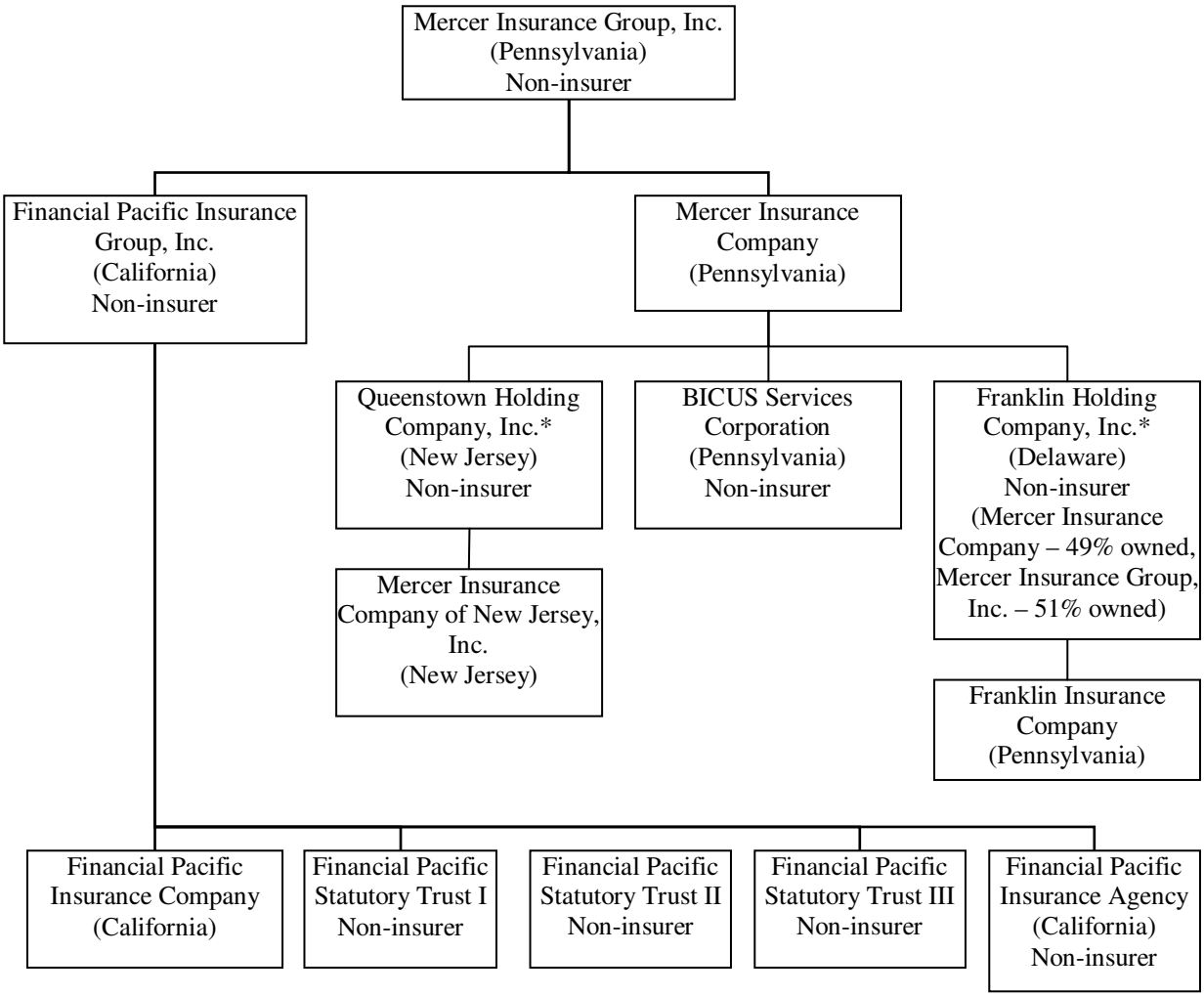
FPIG with FPIG as the surviving entity operating under the certificate of incorporation and bylaws of FPIG Acquisition Corp. The merger and acquisition was approved by the California Department of Insurance on September 29, 2005

The following ordinary cash dividends were declared and paid to the Company's parent during the examination period:

Year Paid	Amount
2004	$790,000
2005	$1,412,000
2006	$1,257,000
2007	$1,302,000
2008	$1,663,000

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system whereby the ultimate controlling entity is Mercer Insurance Group, Inc. (MIG), a publicly traded holding company incorporated in Pennsylvania. The following organization chart depicts the interrelationship of the companies within the holding company system as of December 31, 2008 (all ownership is 100% unless otherwise indicated):



**Subsequently liquidated on December 31, 2009.*

Management of the Company is vested in a three-member Board of Directors elected annually. As of December 31, 2008, the directors and principal officers were as follows:

Directors

Name and Residence	Principle Business Affiliation
John R. Hollingshead Roseville, California	Vice President, Corporate Counsel Financial Pacific Insurance Company
Andrew R. Speaker Newtown, Pennsylvania	Chief Executive Officer and President Mercer Insurance Group

Directors (continued)

Name and Residence	Principle Business Affiliation
Artur A. Terner Folsom, California	Chief Financial Officer Financial Pacific Insurance Company

Principal Officers

Name	Position
Andrew R. Speaker	President and Chief Executive Officer
John R. Hollingshead	Vice President, Corporate Counsel
Artur A. Terner	Chief Financial Officer and Vice President
Edward J. Paoletti	Vice President, Underwriting
Charles E. Wardlaw	Vice President, Claims
Denise A. Johnston	Assistant Vice President, Claims
Robert L. Romanek	Assistant Vice President, Underwriting
Janis L. Hulse	Assistant Vice President, Legal

Intercompany Agreements

Effective January 1, 2006, Mercer Insurance Company, Queenstown Holding Company, Inc., Mercer Insurance Company of New Jersey, Inc., Financial Pacific Insurance Group, Inc., Financial Pacific Insurance Company, Franklin Holding Company, Inc. and Franklin Insurance Company entered into a Services Allocation Agreement with BICUS Services Corporation (BICUS). Under the terms of this agreement, certain services and functions for all of the parties will be performed by BICUS and each company shall reimburse BICUS for their respective share of such services and functions based on actual cost. The services to be performed under this agreement include: underwriting, policyholder services, claims, marketing, accounting, and functional support services. Pursuant to California Insurance Code (CIC) Section 1215.5(b)(4), this agreement was approved by the California Department of Insurance (CDI) on March 3, 2006.

It was noted that the Services Allocation Agreement above is not in compliance with Statements of Statutory Accounting Principles (SSAP) No. 96 and No. 25, paragraph 6, because the

agreement does not provide for timely settlement of amounts owed with a specified due date. It is recommended that this agreement be amended to comply with SSAP No. 96 and No. 25, paragraph 6.

Effective October 1, 2005, the Company entered into a consolidated tax allocation agreement with Mercer Insurance Company, Queenstown Holding Company, Inc., Mercer Insurance Company of New Jersey, Inc, BICUS Services Corporation, Financial Pacific Insurance Group, Inc., Franklin Holding Company, Inc. and Franklin Insurance Company whereby each company is allocated a pro-rata share of the consolidated income tax expense based upon its contribution of taxable income to the consolidated unit. Pursuant to CIC Section 1215.5(b)(4), this agreement was approved by the CDI on March 3, 2006.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to write property and casualty insurance business in the following states:

Alaska	Missouri	Oregon
Arizona	Montana	South Dakota
Arkansas	Nebraska	Utah
California	Nevada	Washington
Colorado	New Mexico	Wisconsin
Idaho	North Dakota	
Kansas	Oklahoma	

Direct premiums written during 2008 were $104.9 million, of which California accounted for 85.4%, followed by Nevada at 8.1%, Arizona at 4.5%, and Oregon at 1.9%. Business is written both directly and through approximately 229 independent agents.

The Company writes commercial package policies and surety. The vast majority of its business is written in rural markets in Northern California with moderate geographical diversification into Nevada, Arizona, and Oregon. The business written outside of these four states is limited to the mail order distribution of license and permit surety bonds. Most of the Company's writings are commercial multiple peril package policies sold to businesses in California's Central Valley

area. During 2008, commercial multiple peril and commercial auto liability premiums accounted for 72% and 17%, respectively, of total direct premiums written.

The Company's strategy is to focus exclusively on custom underwritten accounts, typically with annual premiums of less than $25,000 and for small businesses with one to five employees. The Company targets four main segments of commercial multiple peril business: artisan contractors, commercial property owners, light industrial risks and specialty program. The Company's specialty business includes policies designed for refuse haulers, farm labor contractors, restaurants, automobile repair shops and most recently, ready mix operations and mobile home parks. The Company also offers surety bonds primarily to contractors with infrequent bond needs as well as some specialty surety.

In 2006, the Company's California Certificate of Authority was amended to add workers' compensation. The amendment was necessary to allow the Company to assume workers' compensation business from the intercompany pool (refer to the section "REINSURANCE" below). The Company stated that it does not plan to transact workers' compensation business on a direct basis and will not issue workers' compensation insurance policies.

REINSURANCE

Intercompany Pooling

Effective January 1, 2006, the Company entered into an intercompany pooling agreement with its insurance affiliates: Mercer Insurance Company (MIC), Mercer Insurance Company of New Jersey (MICNJ) and Franklin Insurance Company (FIC). Under the terms of this agreement, MIC is the lead company and assumes 100% of the net business from the Company, MICNJ, and FIC. MIC retains 42% of the pooled business and retrocedes to each company their respective share as follows: the Company – 40%, MICNJ – 13%, and FIC – 5%. Assumed premiums under the intercompany pooling agreement during 2008 were $58.9 million. Pursuant to California Insurance Code Section 1215.5(b)(3), the intercompany pooling agreement was approved by the California Department of Insurance on March 23, 2006.

The Company's intercompany pooling agreement stipulates balances are to be settled on a quarterly basis within forty-five days of the quarter end. The Company did not settle its balances reported as of December 31, 2008, by the stipulated due date. It is recommended the Company settle all balances covered by the intercompany pooling agreement in accordance with the terms of the agreement.

Assumed

The Company did not assume reinsurance during the examination period other than from the intercompany pooling agreement discussed above.

Ceded

The following table is an outline of the Company's ceded reinsurance program as of December 31, 2008:

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Maximum Limit
Casualty XOL	General Reinsurance Corporation	$850,000 each insured each occurrence	1st Excess Cover: $150,000 excess of $850,000 each insured each occurrence 2nd Excess Cover: $1 million excess of $1 million each insured each occurrence 3rd Excess Cover: $3 million excess of $2 million each insured each occurrence
Property XOL	General Reinsurance Corporation	$850,000 per risk	1st Excess Cover: $150,000 excess of $850,000 per risk 2nd Excess Cover: $4 million excess of $1 million per risk 3rd Excess Cover: $2.5 million excess of $5 million per risk
Workers' Compensation XOL	General Reinsurance Corporation	$850,000 each insured each occurrence	1st Excess Cover: $150,000 excess of $850,000 each insured each occurrence 2nd Excess Cover: $1 million excess of $1 million each insured each occurrence

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Maximum Limit
			3rd Excess Cover: $3 million excess of $2 million each insured each occurrence 4th Excess Cover: $5 million excess of $5 million each insured each occurrence
Property Terrorism XOL	General Reinsurance Corporation	$850,000 per risk	$6.65 million excess of $850,000 per risk
Workers' Compensation War & Terrorism XOL	General Reinsurance Corporation	$850,000 each insured each war or terrorism occurrence	$4.15 million excess of $850,000 each insured each war or terrorism occurrence
Property Catastrophe XOL 1st Layer	American Agricultural Insurance Company – 2.5% Arch Reinsurance Company – 10% Odyssey Re – 10% Platinum Underwriters Holding, Inc. – 15% QBE Reinsurance Corp. – 7.5% Ariel Reinsurance Company Ltd – 10% Montpelier Reinsurance Ltd. – 20% Paris Re (Axa Corporate Solutions) – 12.5% R&V Versicherung Aktiengesellschaft – 12.5%	$5 million per occurrence	$5 million excess of $5 million per occurrence
Property Catastrophe XOL 2nd Layer	American Agricultural Insurance – 2.5% Arch Reinsurance Company – 7.5% Odyssey Re – 10% Platinum Underwriters Holding, Inc. – 15% QBE Reinsurance Corp. – 7.5% Ariel Reinsurance Company Ltd – 10% Montpelier Reinsurance Ltd. – 20% Paris Re (Axa Corporate Solutions) – 8% Mapfre Re Compania de Reaseguros SA – 7% R&VVersicherung Aktiengesellschaft – 12.5%	$10 million per occurrence	$10 million excess of $10 million per occurrence
Property Catastrophe	American Agricultural Insurance – 2.5%	$20 million per occurrence	$35 million excess of $20 million per occurrence

Type of Contract	Reinsurer(s)	Company's Retention	Reinsurer's Maximum Limit
XOL 3rd Layer	Arch Reinsurance Company –5% Odyssey Re – 10% Platinum Underwriters Holding, Inc. – 15% QBE Reinsurance Corp. – 7.5% Hannover Re (Bermuda) Ltd. – 5% Ariel Reinsurance Company Ltd – 10% Montpelier Reinsurance Ltd. – 20% Paris Re (Axa Corporate Solutions) – 5% Mapfre Re Compania de Reaseguros SA – 7.5% R&VVersicherung Aktiengesellschaft – 12.5%		
Terrorism Aggregate XOL	Validus Reinsurance, Ltd.	$3 million per occurrence	$10 million excess of $3 million per occurrence
Commercial XOL Automatic Facultative	Berkley Insurance Company	For commercial excess liability policies: none For business owners umbrella liability policies: 25% of first $1 million per occurrence	For commercial excess liability policies: 100% of first $5 million each policy For business owners umbrella liability policies: 75% of first $1 million per occurrence and 100% of $4 million excess of $1 million per occurrence
Surety XOL	General Reinsurance Corporation	$500,000 each principal, plus 10% of the next $4 million excess of $500,000	1st Excess Cover: 90% of $1.5 million excess of $500,000 each principal 2nd Excess Cover: 90% of $1.5 million excess of $2 million each principal 3rd Excess Cover: 90% of $500,000 excess of $3.5 million each principal 4th Excess Cover: 90% of $500,000 excess of $4 million each principal
Equipment Breakdown - Quota Share	Hartford Steam Boiler Inspection and Insurance Company	None	100% quota share, limit of liability of $50 million any one accident, any one policy
Property Facultative XOL	Munich Reinsurance America, Inc.	$7.5 million each risk each occurrence	$50 million excess of $7.5 million each risk each occurrence

ACCOUNTS AND RECORDS

A Claims Specialist from the California Department of Insurance reviewed the Company's claims practices and noted that the Company does not have a formal claims manual. It is recommended that the Company develop a formal claims manual.

The Claims Specialist noted during file reviews that there were violations of Sections 2695.4(a), 2695.3, 2695.7(c)(1), and 2695.9(f) of the California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 7.5, Article I. It is recommended that the Company implement procedures to ensure compliance with CCR, Title 10, Sections 2695.4(a), 2695.3, 2695.7(c)(1), and 2695.9(f).

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2008

Underwriting and Investment Exhibit for the Year Ended December 31, 2008

Reconciliation of Surplus as Regards Policyholders from December 31, 2003 through December 31, 2008

Statement of Financial Condition
as of December 31, 2008

	Ledger and Non-ledger Assets	Non-Admitted Assets	Net Admitted Assets	Notes
Assets				
Bonds	$152,333,790	$	$152,333,790	
Real estate	892,021		892,021	
Cash and short-term investments	15,307,697		15,307,697	
Investment income due & accrued	1,864,753		1,864,753	
Premiums and agents' balances:				
In course of collection	17,141,499	1,187,230	15,954,269	(1)
Booked but deferred and not yet due	21,723,006		21,723,006	
Reinsurance recoverables	8,957,564		8,957,564	
Net deferred tax asset	8,966,437	2,942,526	6,023,911	
Electronic data processing equipment and software	37,743		37,743	
Furniture and equipment	202,312	202,312	0	
Receivable from parent, subsidiaries and affiliates	1,966,392		1,966,392	
Aggregate write-ins for other than invested assets	99,051	99,051	0	
Total assets	$229,492,265	$ 4,431,119	$225,061,146	
Liabilities, Surplus and Other Funds				
Losses			$ 66,499,478	(2)
Reinsurance payable on paid losses and loss adjustment expenses			5,564,914	
Loss adjustment expenses			20,685,257	(2)
Commissions payable, contingent commissions and other similar charges			12,273,822	
Other expenses			3,125,344	
Taxes, licenses and fees			(147,818)	
Current federal and foreign income taxes			389,052	
Unearned premiums			29,325,060	
Ceded reinsurance premiums payable			23,198,924	
Provision for reinsurance			67,396	
Total liabilities			$160,981,429	
Capital common stocks		$ 3,003,000		
Gross paid-in and contributed surplus		26,418,974		
Unassigned funds		34,657,743		
Surplus as regards policyholders			64,079,717	
Total liabilities, surplus and other funds			$225,061,146	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2008

Statement of Income

Underwriting Income		
Premiums earned		$ 61,030,811
Deductions:		
Losses incurred	$ 25,748,620	
Loss expenses incurred	12,352,775	
Other underwriting expenses incurred	21,291,070	
Total underwriting deductions		59,392,465
Net underwriting gain		1,638,346
Investment Income		
Net investment income earned	$ 5,784,923	
Net realized capital loss	(1,867,227)	
Net investment gain		3,917,696
Other Income		
Net loss from agents' or premium balances charged off	$ (132,402)	
Finance and service charges included not included in premiums	1,711,066	
Aggregate write-ins for miscellaneous income	9,438	
Total other income		1,588,102
Net income before federal income taxes		7,144,144
Federal income taxes incurred		1,353,794
Net income		$ 5,790,350

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		$ 60,339,101
Net income	$ 5,790,350	
Change in net unrealized capital losses	(46,024)	
Change in deferred income tax	(423,101)	
Change in nonadmitted assets	(51,255)	
Change in provision for reinsurance	133,646	
Dividends to stockholders	(1,663,000)	
Change in surplus as regards policyholders for the year		3,740,616
Surplus as regards policyholders, December 31, 2008		$ 64,079,717

Reconciliation of Surplus as Regards Policyholders
from December 31, 2003 through December 31, 2008

Surplus as regards policyholders, December 31, 2004, per Examination			$ 40,575,044
	Gain in Surplus	Loss in Surplus	
Net income	$ 25,272,787	$	
Change in net unrealized capital losses		46,024	
Change in net deferred income tax	5,035,205		
Change in nonadmitted assets		2,265,899	
Change in provision for reinsurance		67,396	
Surplus adjustments	2,000,000		
Dividends to stockholders		6,424,000	
Totals	$ 32,307,992	$ 8,803,319	
Net increase in surplus as regards policyholders for the examination period			23,504,673
Surplus as regards policyholders, December 31, 2008, per Examination			$ 64,079,717

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Premiums and Agents' Balances in Course of Collection

The Company is not in compliance with Statements of Statutory Accounting Principles (SSAP) No. 53, paragraph 13, because it recorded advance premiums as an offset against premiums and agents' balances in course of collection. SSAP No. 53, paragraph 13, requires that advance premiums be recorded as a liability. No adjustment was made because the amount involved is immaterial. It is recommended that the Company comply with SSAP No. 53, paragraph 13. Similar comments were made in the prior examination.

(2) Losses and Loss Adjustment Expenses

An analysis of the pooled loss and loss adjustment expense reserves was performed by a Casualty Actuary from the California Department of Insurance who reviewed the Statement of Actuarial Opinion and the supporting actuarial report prepared by the Group's consulting actuary and concluded that the carried loss and loss adjustment expense reserves are reasonable.

The Company is not in compliance with California Insurance Code (CIC) Section 11558 because its carried loss and loss adjustment expense reserves at December 31, 2008 for the three most recent accident years were below the statutory minimum reserves required by CIC Section 11558. The deficiency was not material and no examination adjustment was made. It is recommended that the Company comply with CIC Section 11558.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Intercompany Agreements (Page 5): It is recommended that the Services Allocation Agreement be amended to comply with Statements of Statutory Accounting Principles (SSAP) No. 96 and No. 25, paragraph 6.

Reinsurance – Intercompany Pooling (Page 7): It is recommended the Company settle all balances covered by the intercompany pooling agreement in accordance with the terms of the agreement.

Accounts and Records (Page 11): It is recommended that the Company develop a formal claims manual. It is also recommended that the Company implement procedures to ensure compliance with California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5, Article I, Sections 2695.4(a), 2695.3, 2695.7(c)(1), and 2695.9(f).

Comments on Financial Statement Items – Premiums and Agents' Balances in Course of Collection (Page 16): It is recommended that the Company report advance premiums as a liability in accordance with SSAP No. 53, paragraph 13.

Comments on Financial Statement Items – Loss and Loss Adjustment Expenses (Page 16): It is recommended that the Company establish reserves in accordance with California Insurance Code Section 11558.

Prior Report of Examination

Corporate Records (Page 6): It was recommended that the Company establish written procedures to require annual conflict of interest reporting for its directors, officers and key employees. The Company has complied with this recommendation.

Reinsurance (Page 8): It was recommended that the reinsurance agreements be amended to meet the requirements of California Insurance Code (CIC) Section 922.2(a)(2) and remove any reference to New York laws from the insolvency clause. The insolvency clause in the Company's reinsurance contracts are now in compliance with CIC Section 922.2(a)(2).

It was recommended that the reinsurance agreements be amended to remove any reference to "insolvency." The Company has complied with this recommendation.

It was recommended that the reinsurance agreements be amended to comply with Statements of Statutory Accounting Principles (SSAP) No. 62, paragraph 7, of the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. The Company's reinsurance agreements are now in compliance with SSAP No. 62, paragraph 7.

It was recommended that the governing law clause in the environmental liability quota share reinsurance agreement be deleted. The above reinsurance agreement is no longer inforce.

Comments on Financial Statement Items - Uncollected Premiums and Agents' Balances Booked but Deferred and Not Yet Due (Page 16): The Company's method of accounting for advance premiums was not in compliance with SSAP No. 53, paragraph 13, which requires advance premiums to be recognized as a liability. It was recommended that the Company comply with SSAP No. 53, paragraph 13. The Company has not complied with SSAP No. 53, paragraph 13.

ACKNOWLEDGEMENT

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/

Ber Vang, CFE, AES, CISA
Examiner-in-Charge
Senior Insurance Examiner (Specialist)
Department of Insurance
State of California