# REPORT OF EXAMINATION
# OF THE

# FIRST AMERICAN PROPERTY & CASUALTY INSURANCE COMPANY

AS OF
DECEMBER 31, 2010

Filed December 22, 2011

TABLE OF CONTENTS

Los Angeles, California
October 13, 2011

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 statutory home office located at 114 East Fifth Street, Santa Ana, California 92701.

## SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2007. This examination covers the period from January 1, 2008 through December 31, 2010. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

This examination was conducted concurrently with its affiliate, First American Specialty Insurance Company. The examination was also a coordinated examination and was conducted concurrently with other insurance entities in the holding company 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; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; statutory deposits; and sales and advertising.

## SUBSEQUENT EVENTS

On September 1, 2011, the Company paid a $4 million ordinary cash dividend to its parent, First American Financial Corporation.

## COMPANY HISTORY

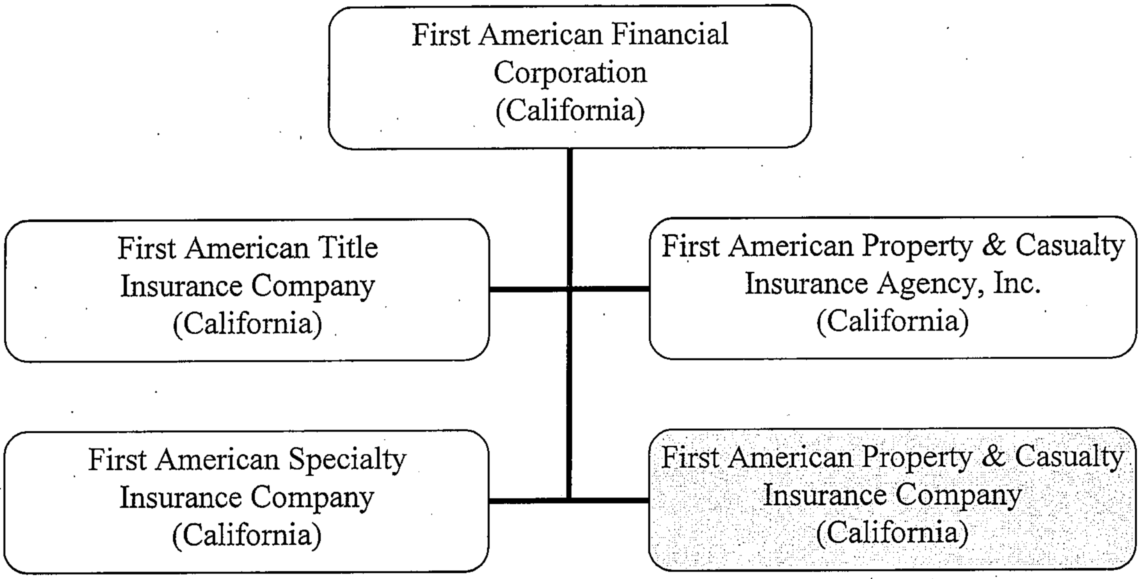
The Company, formerly known as Great Pacific Insurance Company (GPIC), was incorporated under the laws of the State of California on October 17, 1977 and commenced business on September 27, 1979. On August 30, 2000, GPIC changed its name to First American Property & Casualty Insurance Company subsequent 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.

During the examination period, the Company paid ordinary dividends consisting of cash, bonds, and stocks to its parent as follows: $5 million in 2008, $4 million in 2009, and $4.6 million in 2010.

## MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of First American Financial Corporation, a California corporation. The following abridged organizational chart depicts the Company's relationship within the holding company system:




All ownership is 100%

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 on December 31, 2010:

## Directors

| Name and Residence | Principal Business Affiliation |
|---|---|
| James John Court<br>Laguna Niguel, California | Secretary, Chief Information Officer, and Chief Operating Officer<br>First American Property & Casualty Insurance Company<br>First American Specialty Insurance Company |
| Dennis Joseph Gilmore<br>Corona Del Mar, California | Chief Executive Officer<br>First American Financial Corporation |
| George Joseph Grupp<br>Mission Viejo, California | Treasurer and Chief Financial Officer<br>First American Property & Casualty Insurance Company<br>First American Specialty Insurance Company |
| Parker Steven Kennedy<br>Orange, California | Chairman of the Board<br>First American Financial Corporation |
| Dirk Randal McNamee<br>Corona Del Mar, California | President<br>First American Property & Casualty Insurance Company<br>First American Specialty Insurance Company |
| Jeffrey Scott Robinson<br>Lake Forest, California | Associate General Counsel<br>First American Financial Corporation |

## Principal Officers

| Name | Title |
|---|---|
| Dirk Randal McNamee | President |
| George Joseph Grupp | Executive Vice President, Chief Financial Officer, and Treasurer |
| James John Court | Vice President, Chief Information Officer, Chief Operating Officer, and Secretary |

Management Agreements

Management and Services Agreement: The Company and its affiliates are parties to a Management and Services Agreement, effective January 1, 2006. Under the terms of the agreement, First American Title Insurance Company and First American Specialty Insurance Company (FASIC) may provide services to any party to the agreement. The services may include, but are not limited to, accounting, tax and auditing, accounts receivable, actuarial, asset disposition, corporate, data processing, external, internal and regulatory communications, human resources, litigation, payroll, treasury, and investment support. The Company receives services from FASIC for which the Company reimburses FASIC for actual expenses incurred on a monthly basis. Payments made to FASIC for 2008, 2009, and 2010 were $3.7 million, $8.0 million, and $8.5 million, respectively. The agreement was approved by the California Department of Insurance (CDI) on January 25, 2006.

Agency Agreement: The Company entered into an Agency Agreement with its affiliate, First American Property & Casualty Insurance Agency Inc. (FAPCIA), effective January 1, 2009. This agreement replaced a similar agreement dated January 1, 2001. Under the terms of the current 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 Company failed to file the agreement with the CDI for approval in accordance with California Insurance Code (CIC) Section 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI for approval. This was also recommended in the prior examination report.

Tax Allocation Agreement: The Company and its affiliates are parties to a Tax Allocation Agreement with its ultimate parent, First American Corporation (FAC). The Company became a party to the agreement on October 18, 2001 subsequent to its acquisition by FAC. Under the terms of the agreement, allocation of taxes is based upon separate return calculations with inter-company tax balances settled in the quarter subsequent to the filing of the consolidated return. The Company failed to file the agreement with the CDI for approval in accordance with CIC Section 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI for approval. This was also recommended in the prior examination report. The Company has advised the CDI that a new agreement is being drafted as a result of the reorganization and mergers.

## TERRITORY AND PLAN OF OPERATION

As of December 31, 2010, the Company was licensed to transact multiple lines of property and casualty insurance business in all 50 states and the District of Columbia.

The Company offers primarily homeowner and renter insurance marketed through two general agents, First American Property & Casualty Insurance Agency, Inc., an affiliate, and Multifamily Community Insurance Agency. In 2010, the Company had $47.3 million in direct premiums written. The majority of direct premium was written in the states of California, $14.8 million (31.3%); Arizona, $8.5 million (18%); Nevada, $3.5 million (7.4%); Washington, $2.6 million (5.6%); and Texas, $2.3 million (4.8%).

## REINSURANCE

### Assumed

The Company does not assume any reinsurance.

### Ceded

The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2010:

| Type of Contract | Reinsurer's Name | Company's Retention | Reinsurer's Limits |
|---|---|---|---|
| Property Facultative | General Reinsurance Corporation | $1.5 million per risk | $6.0 million all risk per occurrence |
| 1st Property Catastrophe Excess of Loss | Various Authorized and Unauthorized | $5 million per occurrence | $15 million in excess of $5 million per occurrence |
| 2nd Property Catastrophe Excess of Loss | Various Authorized and Unauthorized | $20 million per occurrence | $20 million in excess of $20 million per occurrence |
| 3rd Property Catastrophe Excess of Loss | Various Authorized and Unauthorized | $40 million per occurrence | $60 million in excess of $40 million per occurrence |

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.

As of December 31, 2010, reinsurance recoverables for all ceded reinsurance totaled $4.3 million or 10.3% of surplus as regards policyholders. Of the ceded reinsurance recoverables, 89.1% were from non-affiliated authorized reinsurers.

## ACCOUNTS AND RECORDS

An analysis of the detail claims listing as of December 31, 2010 disclosed various claims that were closed but still had reserve activity. The Company stated that it currently runs monthly reports to identify these claims. It is 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.

It was noted during the examination that the Company did not properly report some of the support schedules and account balances in accordance with the National Association of Insurance

Commissioners' (NAIC) Annual Statement Instructions. It is recommended that the Company implement controls to identify potential errors and properly review its statutory financial statements for compliance with NAIC Annual Statement Instructions before they are submitted to the California Department of Insurance.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2010

Underwriting and Investment Exhibit for the Year Ended December 31, 2010

Reconciliation of Surplus as Regards Policyholders from December 31, 2007 through December 31, 2010

Statement of Financial Condition
as of December 31, 2010

| Assets | Ledger and Nonledger Assets | Assets Not Admitted | Net Admitted Assets | Notes |
|---|---|---|---|---|
| Bonds | $ 64,601,436 | $ | $ 64,601,436 | |
| Preferred stocks | 1,983,575 | | 1,983,575 | (1) |
| Common stocks | 2,383,818 | | 2,383,818 | |
| Cash and short-term investments | 5,938,852 | | 5,938,852 | |
| Investment income due and accrued | 726,970 | | 726,970 | |
| Premiums and considerations: | | | | |
| Uncollected premiums and agents' balances in the course of collection | 14,333 | | 14,333 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 7,337,754 | | 7,337,754 | |
| Reinsurance: | | | | |
| Amounts recoverable from reinsurers | 218,489 | | 218,489 | |
| Other amounts receivable under reinsurance contracts | 3,825 | | 3,825 | |
| Current federal income tax recoverable and interest thereon | 393,991 | | 393,991 | (2) |
| Net deferred tax asset | 2,150,481 | | 2,150,481 | |
| Electronic data processing equipment and software | 595,765 | 595,765 | 0 | |
| Receivables from parent, subsidiaries and affiliates | 41,733 | | 41,733 | |
| Aggregate write-ins for other than invested assets | 13,605,651 | 13,449,364 | 156,287 | |
| Total assets | $ 99,996,673 | $ 14,045,129 | $ 85,951,544 | |

| Liabilities, Surplus and Other Funds | | | | |
|---|---|---|---|---|
| Losses | | | $ 11,767,415 | (3) |
| Loss adjustment expenses | | | 1,623,369 | (3) |
| Commissions payable, contingent commissions and other similar charges | | | 2,182,313 | |
| Other expenses | | | 1,743,199 | (4) |
| Taxes, licenses and fees | | | 72,714 | |
| Unearned premiums | | | 23,244,767 | |
| Funds held by company under reinsurance treaties | | | 5,729 | |
| Amounts withheld or retained by company for account of others | | | 500,654 | |
| Provision for reinsurance | | | 90,873 | |
| Drafts outstanding | | | 2,599,051 | |
| Payable to parent, subsidiaries and affiliates | | | 341,126 | |
| Total liabilities | | | 44,171,210 | |
| Common capital stock | | $ 5,000,000 | | |
| Gross paid in and contributed surplus | | 17,190,000 | | |
| Unassigned funds (surplus) | | 19,590,334 | | |
| Surplus as regards policyholders | | | 41,780,334 | |
| Total liabilities, surplus and other funds | | | $ 85,951,544 | |

## Underwriting and Investment Exhibit
## for the Year Ended December 31, 2010

### Statement of Income

| | | |
|---|---|---|
| **Underwriting Income** | | |
| Premiums earned | | $ 40,302,318 |
| Deductions: | | |
| Losses incurred | $ 24,050,090 | |
| Loss adjustment expenses incurred | 2,430,525 | |
| Other underwriting expenses incurred | 15,740,646 | |
| Total underwriting deductions | | 42,221,261 |
| Net underwriting loss | | (1,918,943) |
| **Investment Income** | | |
| Net investment income earned | $ 2,832,249 | |
| Net realized capital gain | 719,252 | |
| Net investment gain | | 3,551,501 |
| **Other Income** | | |
| Net loss from agents' or premium balances charged off | $ (114,862) | |
| Finance and service charges | 83,256 | |
| Total other income | | (31,606) |
| Net income before federal income taxes | | 1,600,953 |
| Federal income taxes incurred | | 560,334 |
| Net income | | $ 1,040,619 |

### Capital and Surplus Account

| | | |
|---|---|---|
| Surplus as regards policyholders, December 31, 2009 | | $ 45,261,961 |
| Net income | $ 1,040,619 | |
| Change in net unrealized capital gains | 287,715 | |
| Change in nonadmitted assets | (140,510) | |
| Change in provision for reinsurance | (90,873) | |
| Dividends to stockholders | (4,600,000) | |
| Aggregate write-ins for gains in surplus | 21,422 | |
| Change in surplus as regards policyholders for the year | | (3,481,627) |
| Surplus as regards policyholders, December 31, 2010 | | $ 41,780,334 |

## Reconciliation of Surplus as Regards Policyholders from December 31, 2007 through December 31, 2010

| | Gain in Surplus | Loss in Surplus | |
|---|---|---|---|
| Surplus as regards policyholders, December 31, 2007, per Examination | | | $ 46,064,190 |
| Net income | $ 9,780,302 | $ | |
| Change in net unrealized capital losses | | 68,255 | |
| Change in nonadmitted assets | | 14,045,107 | |
| Change in provision for reinsurance | 127,246 | | |
| Dividends to stockholders | | 13,600,000 | |
| Aggregate write-ins for gains in surplus | 13,521,958 | | |
| Total gains and losses | $ 23,429,506 | $ 27,713,362 | |
| Net decrease in surplus as regards policyholders | | | (4,283,856) |
| Surplus as regards policyholders, December 31, 2010, per Examination | | | $ 41,780,334 |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Preferred Stocks

The Company did not properly report its preferred stocks with National Association of Insurance Commissioners' (NAIC) designations 3 to 6 at the lower of cost or fair value in accordance with Statement of Statutory Accounting Principles (SSAP) 32, paragraph 19. Subsequently, the securities were either sold or properly reported in the June 30, 2011 quarterly filing. It is recommended that the Company continue to comply with SSAP 32, paragraph 19.

### (2) Current Federal Income Tax Recoverable and Interest Thereon

The captioned asset consists of amounts due from its parent as a result of overpayment of estimated quarterly taxes. There has been no tax settlement with its parent since 2005. SSAP 25, paragraph 6, states, in part, that amounts owed to the reporting entity over 90 days from the written agreement due date shall be non-admitted. It is recommended that tax settlements are made in a timely manner in accordance with the Tax Allocation Agreement. It is also recommended that the Company non-admit any tax recoverables that are over 90 days due in accordance with SSAP 25, paragraph 6.

### (3) Losses and Loss Adjustment Expenses

The Company's reserves were evaluated by a Casualty Actuary from the California Department of Insurance (CDI). Based on the CDI analysis, the Company's December 31, 2010 reserves for losses and loss adjustment expenses appear reasonable and have been accepted for purposes of this examination.

### (4) Other Expenses

Advance premiums in the amount of $1,192,340 were improperly included in the captioned liability account. It is recommended that the Company record advance premiums as a separate liability in accordance with SSAP 53, paragraph 13 and the NAIC Annual Statement Instructions.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control –Management Agreements: Agency Agreement (Page 5): The Company failed to file the agreement with the California Department of Insurance (CDI) for approval in accordance with California Insurance Code (CIC) Section 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI for approval. This was also recommended in the prior examination report.

Management and Control – Management Agreements: Tax Allocation Agreement (Page 5): The Company failed to file the agreement with the CDI for approval in accordance with CIC Section 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI for approval. . This was also recommended in the prior examination report. The Company has advised the CDI that a new agreement is being drafted as a result of the reorganization and mergers.

Accounts and Records (Page 7): It is 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.

Accounts and Records (Page 7): It is 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 they are submitted to the CDI.

Comments on Financial Statement Items – Preferred Stocks (Page 12): It is recommended that the Company continue to report preferred stocks with NAIC designations 3 to 6 at the lower of cost or fair value in accordance with Statement of Statutory Accounting Principles (SSAP) 32, paragraph 19.

Comments on Financial Statement Items - Current Federal Income Tax Recoverable and Interest Thereon (Page 12): It is recommended that tax settlements are made timely in accordance with the Tax Allocation Agreement. It is also recommended that the Company non-admit any tax recoverables that are over 90 days due in accordance with SSAP 25, paragraph 6.

Comments on Financial Statement Items – Other Expenses (Page 12): It is recommended that the Company record advance premiums as a separate liability in accordance with SSAP 53, paragraph 13 and the NAIC Annual Statement Instructions.

Previous Report of Examination

Management and Control – Affiliated Management Agreements: Tax Allocation Agreement (Page 5): It was recommended that the Company file this agreement with the California Department of Insurance (CDI) for approval to comply with California Insurance Code (CIC) Section 1215.5(b)(4). The Company has not complied. The Company has advised the CDI that a new agreement is being drafted as a result of the reorganization and mergers.

Management and Control – Affiliated Management Agreements: Agency Agreements (Page 5): It was recommended that the Company file its agency agreements with First American Property & Casualty Insurance Agency, Inc. (FAPCIA) and with First Advantage SafeRent Corporation (FASR) with the CDI for approval to comply with CIC Section 1215.5(b)(4). The Company has not filed the agency agreement with FAPCIA. As of December 31, 2010, FASR is no longer an affiliate.

Reinsurance – Ceded (Page 7): It was recommended that the Company amend its reinsurance intermediary agreement to comply with CIC Section 1781.5 and Title 10, California Code of Regulations Section 2303. The Company has complied.

## 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/________________
Deanna Lo, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California