REPORT OF EXAMINATION
OF THE
MERCED PROPERTY & CASUALTY COMPANY
AS OF
DECEMBER 31, 2014

Filed on May 27, 2016

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San Francisco, California
April 29, 2016

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

MERCED PROPERTY & CASUALTY COMPANY

(hereinafter also referred to as the Company) at its home office located at 971 East Broadway Avenue, Atwater, California, 95301.

SCOPE OF EXAMINATION

We have performed our single-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, 2014.

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.

COMPANY HISTORY

The Company was first incorporated as Hilmar Mutual Fire Insurance Company in 1906. It later changed its name to Merced County Fire Insurance Company in 1936 and subsequently to Merced Mutual Insurance Company in 1982.

Effective April 1, 2013, the Company demutualized and converted from a mutual insurance company to a stock insurance company. As a result of the demutualization, the Company changed its name from Merced Mutual Insurance Company to Merced Property & Casualty Company. The California Department of Insurance (CDI) approved the Company's demutualization and name change on March 28, 2013. The Company has reflected its name change in its Articles of Incorporation and Certificate of Authority.

In conjunction with the Company's demutualization, the United Heritage Financial Group (UHFG), a mutual holding company based in Idaho, filed a Form A - Notice of Acquisition, to acquire the Company by purchasing over 90% of the Company's issued and outstanding common stock pursuant to California Insurance Code Section 1215.2(d). The CDI approved this acquisition on March 28, 2013.

The Company is licensed only in California and is authorized to write fire, surety, plate glass, liability, burglary, and miscellaneous lines of business. The Company amended its Certificate of Authority to add the automotive line of business, effective April 1, 2013. The CDI approved the Amended Certificate of Authority on March 28, 2013.

Capitalization

Effective April 1, 2013, the Company demutualized and converted from a mutual insurance company to a stock insurance company. As a stock insurance company, the Company was authorized to issue 500,000 shares of common stock with a par value of $10 per share. In conjunction with the demutualization, the Company issued 302,857 shares of common stock to policyholders valued at $27.50 per share. Of that amount, 286,689 shares were sold by the policyholders to UHFG resulting in UHFG having nearly 95% ownership of the Company. The CDI approved the Company's demutualization and UHFG's acquisition on March 28, 2013.

As a result of the demutualization, minority shareholders received 16,168 shares of common stock. As of December 31, 2013, minority shareholders sold 713 shares of common stock to UHFG.

On December 1, 2014, the CDI approved the Company's request to enter into a reverse stock split transaction whereby every 275 shares of issues and outstanding common stock, with a par value of $10, were combined into one share of common stock, resulting in a par value of $2,750 per share. All fractional shares resulting from the reverse stock split would be cancelled and minority shareholders would no longer own any shares of the Company. All parties who owned fewer than 275 shares would be paid cash by the Company as consideration for the cancellation of their fractional shares, at a price equal to $33.50 totaling $517,712 as full consideration for their cancelled fractional shares.

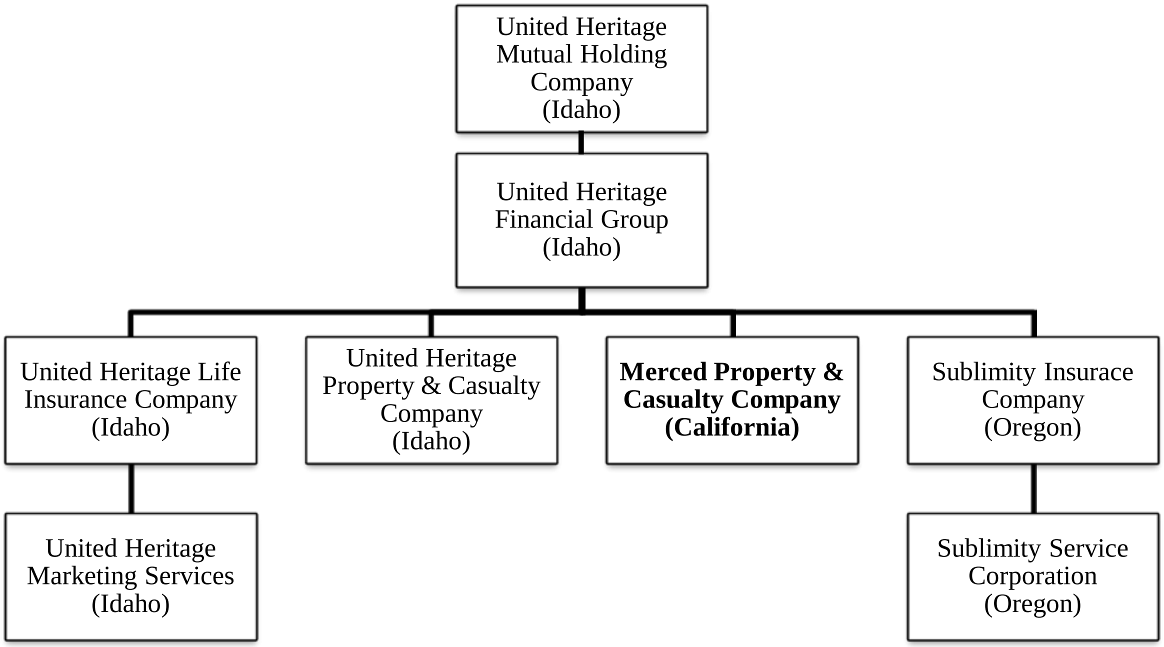
Before the completion of the reverse stock split, the CDI authorized the Company to issue and sell 15,455 shares, at a selling price of $33.50 per share, to UHFG for a total of $517,742. This would be the amount owed to former minority shareholders whose fractional shares would be cancelled by the reverse stock split. The purpose for the prior sale of additional shares to UHFG is to obtain the amount of funds necessary to pay former minority shareholders for their cancelled fractional shares so the Company's capital and surplus would not be reduced by the reverse stock split.

One fractional share resulting from the reverse split was cancelled and the remaining 1,101 shares were reissued to UHFG in place of the 302,857 shares owned prior to the reverse stock split. As a result of this transaction, UHFG now has 100% ownership of the Company.

As of December 31, 2014, there were 1,101 shares of common stock issued and outstanding totaling $3,027,750 in common capital stock; $2,922,136 in surplus notes; and $6,404,322 in gross paid in and contributed surplus. There were no dividends distributed to shareholders during the examination period.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system. At December 31, 2014, the United Heritage Financial Group (UHFG) owned 100% of the issued and outstanding common stock of the Company. UHFG in turn, is owned 100% by the United Heritage Mutual Holding Company. The Company does not have any subsidiaries. The following abridged organizational chart depicts the interrelationship of the Company within the holding company system as of December 31, 2014. All ownership is 100%:



The seven members of the Board of Directors, who are elected annually, oversee the business and affairs of the Company. The following are members of the Board and Principal Officers of the Company serving at December 31, 2014:

Directors

Name and Location	Principal Business Affiliation
Michael M. Brem Turlock, California	Chairman, Board of Directors Merced Property & Casualty Company
Donald R. Duran Modesto, California	President and Chief Executive Officer Merced Property & Casualty Company
Michael E. Gemperle Turlock, California	Partner Gemperle Farms
Kevin W. Lucke Aumsville, Oregon	Senior Vice President United Heritage Financial Group
Garth A. Pecchenino Merced, California	Partner Quad Knopf, Inc.

Name and Location	Principal Business Affiliation
Roger H. Pruitt Los Banos, California	Investment Manager R.H. Pruitt & Company
Thomas K. Sperry Turlock, California	Vice Chairman, Board of Directors Merced Property & Casualty Company

Principal Officers

Name	Title
Donald R. Duran	President and Chief Executive Office
Steven F. Fields(a)	Vice President of Claims
Penni L. Lockard	Vice President of Underwriting
Mary B. Shambaugh	Vice President of Accounting and Administration, Secretary/Treasurer

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

(a) Effective January 15, 2016, Steven Fields resigned as Vice President of Claims. The Company is currently searching for his replacement as Claims Manager. The Company indicated that it will first hire a Claims Manager and would eventually promote that person to the position of Vice President of Claims.

Management Agreements

Cost Sharing and Allocation Agreement: Effective October 4, 2013, the Company entered into a Cost Sharing and Allocation Agreement with its immediate parent, United Heritage Financial Group (UHFG), and its affiliates. Pursuant to the Agreement, UHFG provides management services that include but are not limited to the functional areas of investment and treasury management, information technology services, financial reporting, human resource management, and administrative and legal services. The costs allocated between the companies are without markup or overhead charge. This Agreement was approved by the California Department of Insurance (CDI) on June 14, 2013. The total fees incurred by the Company for services rendered under this Agreement in 2014 were $150,639.

Tax Sharing Agreement: Effective December 31, 2013, the Company entered into an existing Tax Sharing Agreement with its ultimate parent, United Heritage Mutual Holding Company (UHMHC), and its subsidiaries. Under the agreement, all members within the Consolidated Tax Return Group (Group) will file a consolidated federal income tax return and UHFG will be the entity responsible for filing the consolidated tax return and making payments for all federal income tax liabilities of the Group. This Agreement was approved by the CDI on June August 2, 2013. The Company's share of the tax liability under this Agreement in 2014 was $149,582.

TERRITORY AND PLAN OF OPERATION

The Company's operations are conducted solely in California, primarily in the rural regions of the central portion of the state encompassing the Sacramento and San Joaquin valleys. Homeowners' coverage constitutes more than 81.5% of the book of business and is supplemented by writings of dwelling, fire, and personal automobile. The Company's book on earthquake coverage is small due to the location of its risks. The Company's business is produced through approximately 114 independent agents.

The Company reported net premiums in the amount of $4.0 million in 2011 followed by $3.9 million in 2012, $3.9 million in 2013, $4.1 million in 2014, and $4.5 million in 2015.

REINSURANCE

Assumed

During the examination period, the Company assumed immaterial amounts of reinsurance from National Association of Mutual Insurance Companies (NAMIC) and Mutual Reinsurance Bureau, a Regional Reciprocal Catastrophe Pool.

Ceded

The following is a summary of ceded reinsurance agreements in effect as of December 31, 2014:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurers Limits
First Excess of Loss	Munich Reinsurance America, Inc.	Property & Casualty: $150,000 each risk in each occurrence	Property & Casualty: $350,000 excess of $150,000 on each risk in each occurrence, $1.05 Million for all risks in any one occurrence
		Automotive Liability: $75,000 each risk in each occurrence	Automotive Liability: $75,000 excess of $75,000 on each risk in each occurrence, $225,000 for all risks in any one occurrence, limited to a maximum of $1.05 million.
Second Excess of Loss	Munich Reinsurance America, Inc.	Casualty $500,000 each risk in each occurrence	Casualty: $1,500,000 excess of $500,000 on each risk in each occurrence, $7 million for all risks in any one occurrence
		Property $500,000 each risk in each occurrence	Property: $3,500,000 excess of $500,000 on each risk in each occurrence, $7 million for all risks in any one occurrence
Catastrophe First Layer	Munich Reinsurance America, Inc.	$300,000 per occurrence plus 5% of $700,000 in excess of $300,000	95% of $700,000 per occurrence in excess of $300,000
Catastrophe Second Layer	Munich Reinsurance America, Inc.	$1 million per occurrence plus 5% of $1 million in excess of $1 million	95% of $1 million per occurrence in excess of $1 million
Catastrophe Third Layer	Munich Reinsurance America, Inc.	$2 million per occurrence plus 5% of $5 million in excess of $2 million	95% of $5 million per occurrence in excess of $2 million

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurers Limits
Catastrophe Excess of Loss	Mutual Reinsurance Bureau	$5 million any one loss occurrence	$5 million in excess of $5 million on any one loss occurrence, limited to $10 million during the term of the agreement
100% Quota Share – Equipment Breakdown	Hartford Steam Boiler Inspection and Insurance Company	None	100% quota share, subject to a limit of $10,000 for any one accident, any one policy
100% Quota Share – Service Line	Hartford Steam Boiler Inspection and Insurance Company	None	100% quota share, subject to a limit of $15,000 for any one service line failure, any one policy
100% Quota Share – Identity Recovery	Hartford Steam Boiler Inspection and Insurance Company	None	100% quota share, subject to a $15,000 annual aggregate limit as respects each identity recovery insured

ACCOUNTS AND RECORDS

Information Systems Controls

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. It is recommended that the Company make appropriate changes to strengthen its information systems controls.

Vehicle Fraud Assessment

California Insurance Code (CIC) Section 1872.8(a) states, in part, that each insurer doing business in California must pay an annual Vehicle Fraud Assessment Fee for each vehicle insured under an insurance policy it insures in California. The fee provides funding for the increased investigation and prosecution of fraudulent automobile insurance claims and automobile theft in California.

Pursuant to California Code of Regulations (CCR) Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62(b), the assessment shall be due on each vehicle, identified by its vehicle identification number for each quarter that a policy is in force on such vehicle and when a vehicle is added to or replaces one under an existing policy. It was noted that the Company counts only the number of vehicles in force at the end of each quarter instead of counting the number of vehicles in force at the beginning of the quarter plus the number of vehicles added during the quarter as required. It is recommended that the Company amend its vehicle count methodology and properly count vehicles in accordance with CCR Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62(b).

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, 2014. There were no examination adjustments made to surplus as a result of the examination.

Statement of Financial Condition as of December 31, 2014

Statement of Income for the Year Ended December 31, 2014

Reconciliation of Capital and Surplus from December 31, 2010
through December 31, 2014

Statement of Financial Condition
as of December 31, 2014

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 15,473,643	$	$ 15,473,643	
Preferred stocks	236,727		236,727	
Common stocks	3,921,262		3,921,262	
Real estate occupied by the company	521,075		521,075	
Cash and short-term investments	884,922		884,922	
Investment income due and accrued	185,074		185,074	
Uncollected premium and agents' balances in course of collection	64,778		64,778	
Deferred premiums and agents' and installments Booked but deferred and not yet due	86,423		86,423	
Other amounts receivable under reinsurance contracts	64,312		64,312	
Current federal income tax recoverable and interest thereon	158,366		158,366	
Net deferred tax asset	219,683		219,683	
Electronic data processing equipment and software	212,345	212,345		
Furniture and equipment	135,392	135,392		
Aggregate write-ins for other than invested assets	178,883	26,729	152,154	
Total assets	$ 22,342,966	$ 374,547	$ 21,968,419	

Liabilities, Surplus and Other Funds			
Losses		$ 827,192	(1)
Loss adjustment expenses		577,286	(1)
Commissions payable, contingent commission and other similar charges		85,011	
Other expenses		168,830	(2)
Taxes, licenses and fees		3,367	
Unearned premiums		2,416,136	
Advance premium		0	(3)
Amounts withheld or retained by company for account of others		20,988	
Payable to parent, subsidiaries and affiliates		0	(2)
Payable for securities		207,914	
Aggregate write-ins for liabilities		594,449	(4)
Total liabilities		4,901,173	
Common capital stock	$ 3,027,750		
Surplus notes	2,922,136		(5)
Gross paid-in and contributed surplus	6,404,322		
Unassigned funds (surplus)	4,713,038		
Surplus as regards policyholders		17,067,246	
Total liabilities, surplus and other funds		$ 21,968,419	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2014

Underwriting Income

Premiums earned		$ 4,041,525
Deductions:		
Losses incurred	$ 1,290,227	
Loss adjustment expenses incurred	958,813	
Other underwriting expenses incurred	2,415,033	
Total underwriting deductions		4,664,073
Net underwriting gain		$ (622,548)

Investment Income

Net investment income earned	$ 918,183	
Net realized capital gains	628,375	
Net investment gain		1,546,558

Other Income

Net (loss) from agents' or premium balances charged off	(1,831)	
Finance and service charges not included in premiums	$ 17,834	
Total other income		16,003
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes		940,013
Federal and foreign income taxes incurred		91,634
Net income		$ 848,379

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2013		$ 16,649,218
Net income	$ 848,379	
Change in net unrealized capital gains or (losses)	(625,856)	
Change in net deferred income tax	332,975	
Change in nonadmitted assets	(137,470)	
Capital changes:		
Paid in	(820)	
Surplus adjustments:		
Paid in	(1,927)	
Transferred from capital	2,747	
Net in surplus as regards policyholders		418,028
Surplus as regards policyholders, December 31, 2014		$ 17,067,246

Reconciliation of Surplus as Regards Policyholders
from December 31, 2010 through December 31, 2014

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2010			$ 14,953,317
Net income	$ 4,556,036	$	
Change in net unrealized capital gains or (losses)		3,599,640	
Change in net deferred income tax	1,452,252		
Change in nonadmitted assets		251,681	
Change in surplus notes	2,922,135		
Capital changes:			
Paid in		820	
Transferred from surplus (stock dividend)	3,028,570		
Surplus adjustments:			
Paid in		1,927	
Transferred to capital (stock dividend)		5,950,705	
Transferred from capital	2,747		
Aggregate write-ins for gain and losses in surplus		43,036	
Total gains and losses	$ 11,961,740	$ 9,847,809	
Net increase in surplus as regards policyholders			2,113,931
Surplus as regards policyholders, December 31, 2014			$ 17,067,246

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance (CDI), the Company's loss and loss adjustment expense reserves as of December 31, 2014 were found to be reasonably stated and have been accepted for the purpose of this examination.

(2) Payable to Parent, Subsidiaries and Affiliates

At December 31, 2014, the Company reported a liability of $12,970 for services rendered by United Heritage Financial Group (UHFG) under its Cost Sharing and Allocation Agreement. It was noted that this liability was reported as Other Expenses instead of a Payable to Parent, Subsidiaries and Affiliates in its annual statement. It is recommended that the Company report intercompany balances to UHFG as a Payable to Parent, Subsidiaries and Affiliates in accordance with the Annual Statement Instructions prescribed by the National Association of Insurance Commissioners (NAIC).

(3) Advance Premium

It was noted that the Company did not report a liability for advance premiums in its annual statement as of December 31, 2014. The Company indicated that premiums received prior to the policy's effective date were recognized as cash; however, the Company did not report a corresponding credit to advance premiums in the amount of $168,184. It is recommended that the Company report a liability for advance premiums for premiums received prior to the policy's effective date in accordance with the NAIC Statement of Statutory Accounting Principles No. 53.

No examination adjustment will be made as the amount is deemed immaterial.

(4) Aggregate Write-Ins for Liabilities

As a result of the reverse stock split approved by the CDI effective December 1, 2014, policyholders who owned 275 shares or less were given cash as consideration for the cancellation of their fractional shares at $33.50 per share. The amount payable to fractional shareholders totaled $517,712 which is reflected within aggregate write-ins for liabilities.

(5) Surplus Notes

The Company demutualized and converted from a mutual insurance company to a stock insurance company effective April 1, 2013. As a result of the conversion, eligible policyholders received equity in the Company valued at $12.4 million that was either redeemed for cash, certificates of contribution, or common stock. This balance reflects $2.9 million in equity to eligible policyholders in the form of certificates of contribution.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information Systems Controls (Page 9): As a result of the current review of the Company's information systems controls, recommendations for improving these controls were presented to the Company. It is recommended that the Company make appropriate changes to strengthen its information system controls.

Accounts and Records – Vehicle Fraud Assessment Fee Filings (Page 9): It is recommended that the Company update its vehicle count methodology and properly count vehicles in accordance with California Code of Regulations (CCR) Title 10, Chapter 5, Subchapter 9, Article 4, Section 2698.62(b).

Comments on Financial Statement Items – Payable to Parent, Subsidiary, and Affiliates (Page 11): It is recommended that the Company report intercompany balances to UHFG as a Receivable or Payable to Parent, Subsidiaries and Affiliates in accordance with the Annual Statement Instructions prescribed by the National Association of Insurance Commissioners (NAIC).

Comments on Financial Statement Items - Advance Premiums (Page 11): It is recommended that the Company report a liability for advance premium for premiums received prior to the policy's effective date in accordance with the NAIC Statements of Statutory Accounting Principles No. 53.

Previous Report of Examination

Reinsurance – Assumed (Page 11): It was recommended that the Company revise the Net Quota Share Reinsurance Agreement with California Mutual Insurance Company to comply with CCR, Title 10, Chapter 5, Article 3, Section 2303.13(b).

On August 9, 2011, the Company elected not to renew the Agreement and allowed it to expire at the end of the year. Since the Agreement was allowed to expire, the finding is no longer applicable.

Accounts and Records – Claims and Reserving Practices (Page 11): It was recommended that the Company update its claim manual to include the latest Fair Claims Practices Regulations to comply with CCR, Title 10, Chapter 5, subchapter 7.5, Article 1, Section 2695.6(b)(2)(A). It was also recommended that the Company revise its claims manual to include the appropriate depreciation table to comply with CCR Section 2695.9(f). The Company has complied with the recommendations.

Comments on Financial Statement Items - Preferred Stocks (Page 12): It was recommended that the Company report the designations of its preferred stocks with those published by the National Association of Insurance Commissioners (NAIC)

Securities Valuation Office in accordance with the NAIC Annual Statement Instructions. The Company has complied with the 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/_________________________
Donavan Han, CFE
Examiner-In-Charge
Senior Insurance Examiner, Specialist
Department of Insurance
State of California

___/S/_________________________
Kyo Chu, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California