REPORT OF EXAMINATION
OF THE
WESTERN GENERAL INSURANCE COMPANY
AS OF
DECEMBER 31, 2011

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File June 21, 2013

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Los Angeles, California
June 18, 2013

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

WESTERN GENERAL INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 5230 Las Virgenes Road, Suite 100, Calabasas, California 91302.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was made as of December 31, 2008. This examination covers the period from January 1, 2009 through December 31, 2011. 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.

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; and statutory deposits.

COMPANY HISTORY

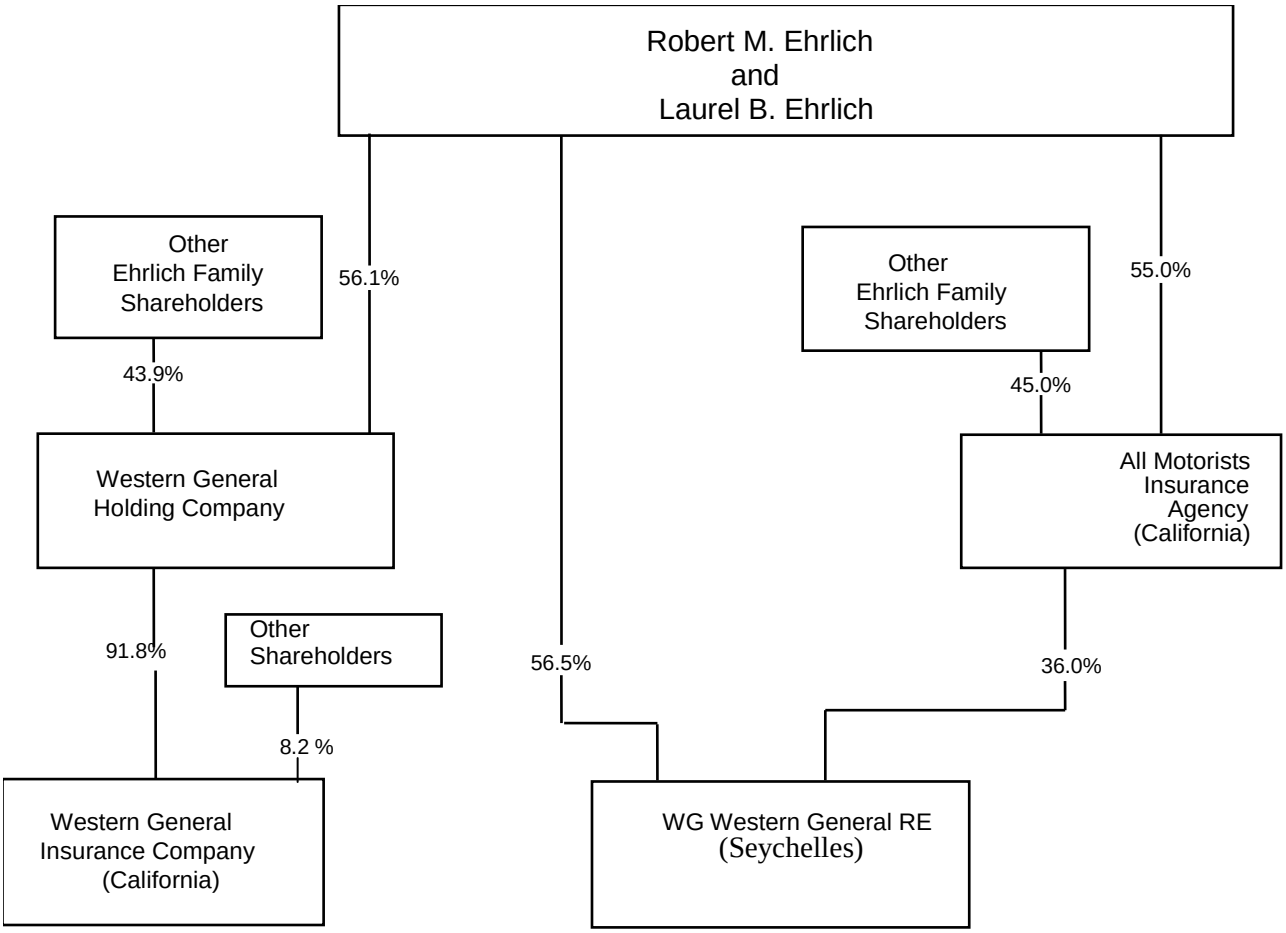
During the examination period, the Company declared and paid ordinary dividends to the shareholders in the form of preferred stock as follows:

Year	Declared	Paid
2009	364,111	427,114
2010	332,075	331,929
2011	330,357	327,624
Total	1,026,543	1,086,667

In 2011, the Company paid quarterly dividends in the amount of $82,747, $81,259, $81,560 and $82,058, which totaled of $327,624. The declared and unpaid dividend was $85,479.19.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's ultimate parent along with its subsidiaries, depicts the Company's interrelationship within the holding company system:



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 serving at December 31, 2011:

Directors

Name and Residence	Principal Business Affiliation
John Albanese Thousand Oaks, California	Chief Financial Officer and Treasurer Western General Insurance Company
Laurel Ehrlich Westlake Village, California	Director of Human Resources Western General Insurance Company
Robert Ehrlich Westlake Village, California	Chairman of the Board, President and Chief Executive Officer Western General Insurance Company

Directors (continued)

Name and Residence	Principal Business Affiliation
Mark Goldsmith Thousand Oaks, California	Vice President of Operations Western General Insurance Company
Marleen Kushner Westlake Village, California	Secretary Western General Insurance Company
Daniel Mallut Calabasas, California	General Counsel and Executive Vice President Western General Insurance Company

Principal Officers

Name	Title
Robert Ehrlich	Chairman of the Board, President, and Chief Executive Officer
Daniel Mallut	General Counsel and Executive Vice President
John Albanese	Chief Financial Officer and Treasurer
Marleen Kushner	Secretary

Management Agreements

General Agent Servicing Agreement: The Company is party to a General Agent Servicing Agreement with All Motorist Insurance Agency (AMIA), an affiliate, dated July 1, 1983. Under this agreement, AMIA has authority to process policies, collect premiums, process claims and perform other responsibilities typical of a servicing general agent. In respect of these services, the Company pays policy fees or servicing fees to AMIA based on the gross premium of each automobile extended warranty, auto liability or property damage policy processed. In addition, the Company pays a claim-servicing fee to AMIA for each claim processed on its behalf. For 2009, 2010, and 2011 the fees paid by the Company to AMIA were $5,858,115, $5,304,771, and $6,127,518, respectively.

Tax Allocation Agreement: Since 2005, the Company has been part of the consolidated federal income tax return of its parent, Western General Holding Company (WGHC). Under the terms of this agreement, the allocation of taxes is based upon separate tax return calculations with all settlements of inter-company tax balances made in the quarter subsequent to the filing of the consolidated return. In 2009, income taxes were recovered in the amount of $500,000 and were paid of $408,381 in 2010. In 2011, the income tax recovered was $555,430. The agreement was filed on June 16, 2010 with California Department of Insurance (CDI) and was approved on March 19, 2012.

Cost Allocation Agreement: Effective August 15, 2006, a Cost Allocation Agreement was executed between the Company and various affiliates who share office expenses and other administrative and support costs. Allocation of costs is determined based on actual time spent performing services through a two week timesheet study performed annually. The shared costs allocated to the Company totaled $2,275,881, $2,252,142, and $2,535,034 for the years ended December 31, 2009, 2010, and 2011, respectively. The agreement was approved by the CDI in July 2006.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact multiple lines of property and casualty insurance in the following jurisdictions:

Alabama	Hawaii	Minnesota	Rhode Island
Alaska	Idaho	Mississippi	South Carolina
Arizona	Illinois	Missouri	Tennessee
Arkansas	Indiana	Nevada	Texas
California	Iowa	New Jersey	Utah
Colorado	Kansas	New Mexico	Virginia
Connecticut	Kentucky	New York	Washington
District of Columbia	Louisiana	North Carolina	West Virginia
Delaware	Maine	Oklahoma	
Florida	Maryland	Oregon	
Georgia	Michigan	Pennsylvania	

The Company writes specialty dealer-originated and agent/broker produced non-

standard automobile insurance. Dealer-originated automobile business is generally written for a period of up to 30 days under the dealer's "buy and drive" program and includes physical damage and liability coverages. The option to continue coverage beyond the 30-day period is also offered to the insured. The agent/broker produced business is written for 6-month and 12-month terms. The Company previously focused on physical damage coverage; however, since 1997, liability coverage was added to the commercial programs, and since 2000, the Company's personal automobile business included liability coverage.

In 2000, the Company began writing non-standard private passenger automobile in California outside of its core dealership-generated business. This has now become the Company's largest business segment. Collateral protection is also provided for banks and finance companies.

As of December 31, 2011, the Company had $45.8 million in total direct premiums. Out of the total direct premiums, the major lines of business are auto physical damage of $26.4 million or 57.5%, private passenger auto liability of $17.5 million or 38.3%, commercial auto liability of $1.0 million or 2.3%, and warranty of $864 thousand or $1.9%.

The Company's business is geographically concentrated in its domestic state of California and Arizona. For 2011, 86.8% and 11.7% of the Company's business were produced from California and Arizona, respectively. The Company also writes a small amount of premium in Texas and Nevada. All business is produced through approximately 735 brokers, and the Company maintains relationships with approximately 550 automobile dealerships and 18 finance companies. Cartel, a general agent appointed by the Company in 2001, produces a significant portion of the Company's written premiums.

On May 15, 2012, the Company filed with the California Department of Insurance (CDI) an amendment of its Certificate of Authority to add fire, plate glass and burglary to its line of business. The amendment was approved by CDI on April 30, 2013.

LOSS EXPERIENCE

The Company reported operating losses in all years under examination as follows:

Year	Net Operating (Loss)	Net Income or (Loss)
2008	$ (1,800,825)	$ 796,228
2009	(1,841,158)	904,203
2010	(2,643,502)	(514,025)
2011	(5,717,352)	(3,928,940)
2012*	(6,825,434)	(5,060,902)

The Company had previously maintained its reported surplus position primarily through investment income. However, in recent years, surplus has declined primarily because of higher underwriting losses combined with lower investment income.

* In 2012, the Company continued to experience unfavorable operating results. The Company provided three-year financial projections for 2013 through 2015 as requested by the Financial Analysis Division (FAD) of the California Department of Insurance. Projections indicated that the Company's operating loss will be decreased in 2013, 2014 and profitable in 2015. FAD will monitor the Company's financial position.

REINSURANCE

Assumed

The Company has a 100% Quota Share reinsurance agreement with Home State County Mutual Insurance Company, a Texas domiciled company, for automobile insurance written in the state of Texas through the Company's Laredo and Cartel program. The Laredo program is a private passenger auto insurance program which was released in February 2011. The Company pays 3% of premiums collected as fronting fees plus premium taxes to Home State County Mutual Insurance Company. The assumed reinsurance premium during 2011 was $1.5 million.

Ceded

The following is a summary of the principal ceded reinsurance treaties inforce as of December 31, 2011:

Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
Excess of loss	Munich Re America	$50K each auto loss occurrence	$250K each loss occurrence
Casualty clash	Munich Re America	$300K each clash loss occurrence	$1 million each loss occurrence
100% quota share MBI (mechanical breakdown insurance) and theft	Lyndon Property Insurance Company		Maximum of $50k
25% quota share on auto policies not produced by Cartel	WG Western General Re of Seychelles	55% each loss occurrence	45% each loss occurrence
20% quota share on auto policies not produced by Cartel	Munich Re America	55% each loss occurrence	45% each loss occurrence
25% quota share on Cartel auto physical damage and liabilities	WG Western General Re of Seychelles	55% each loss occurrence	45% each loss occurrence
20% quota share on Cartel auto physical damage and liabilities	Munich Re America	55% each loss occurrence	45% each loss occurrence
45% quota share commercial auto physical damage excluding Cartel	WG Western General Re of Seychelles	55% each loss occurrence	45% each loss occurrence

Munich Re America and Lyndon Property Insurance Company were authorized unaffiliated insurers. The Company's affiliate, WG Western General Re of Seychelles (WGRE), which was formerly WG Western General Reinsurance Corporation of Nevis Island and re-domesticated to Seychelles in 2011, is an unauthorized reinsurer. The Company withheld $10 million to secure the reinsurance recoverables from WGRE.

As of December 31, 2011, the Company ceded $12 million to its affiliate, WGRE. The Company's reinsurance recoverables for all ceded reinsurance totaled $18.7 million.

ACCOUNTS AND RECORDS

Statement of Statutory Accounting Principles No. 70 established uniform expenses allocation rules to classify expenses into three categories: loss adjustment expenses, investment expenses and other underwriting expenses, on the Underwriting and Investment Exhibit. It was noted that the Company allocated its servicing fees to the affiliated agent, All Motorists Insurance Agency, under the other underwriting expenses as direct commission. It is recommended that the Company make appropriate changes to reclassify its expenses.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2011

Underwriting and Investment Exhibit for the Year Ended December 31, 2011

Reconciliation of Surplus as Regards Policyholders from December 31, 2008 through December 31, 2011

Statement of Financial Condition
as of December 31, 2011

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 33,670,918	$	$ 33,670,918	
Common stocks	3,400,611		3,400,611	
Cash and short-term investments	5,513,311		5,513,311	
Receivable for securities	850,000		850,000	
Investment income due and accrued	437,118		437,118	
Premiums and agents' balances in course of collection	4,584,089		4,584,089	
Premiums, agents' balances and installments booked but deferred and not yet due	12,336,725		12,336,725	
Amount recoverable from reinsurers	2,490,442		2,490,442	
Net deferred tax asset	3,398,411	2,477,678	920,733	
Aggregate write-ins for other than invested assets	139,697	139,697	0	
Total assets	$ 66,821,322	$ 2,617,375	$ 64,203,947	

Liabilities, Surplus and Other Funds		
Losses and loss adjustment expenses		$ 8,785,242
Commissions payable, contingent commissions and other similar charges		1,151,482
Other expenses		398,294
Taxes, licenses and fees		72,689
Unearned premiums		12,911,539
Dividends declared and unpaid: Stockholders		85,479
Ceded reinsurance premiums payable		863,903
Funds held by company under reinsurance treaties		12,101,837
Total liabilities		36,370,465
Common capital stock	$ 3,105,000	
Preferred capital stock	7,640,000	
Gross paid-in and contributed surplus	1,226,000	
Unassigned funds (surplus)	16,090,282	
Less treasury stock at cost:		
552 shares common (value included in above common stock	227,800	
Surplus as regards policyholders		27,833,482
Total liabilities, surplus and other funds		$ 64,203,947

Underwriting and Investment Exhibit
for the Year Ended December 31, 2011

Statement of Income

Underwriting Income		
Premiums earned		$ 27,486,176
Deductions:		
Losses and loss expenses incurred	$ 19,021,139	
Other underwriting expenses incurred	14,182,389	
Total underwriting deductions		33,203,528
Net underwriting loss		(5,717,352)
Investment Income		
Net investment income earned	$ 1,491,364	
Net realized capital gain	292,892	
Net investment gain		1,784,256
Other Income		
Aggregate write-ins for miscellaneous income	4,156	
Total other income		4,156
Net loss		$ (3,928,940)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2010		$ 32,281,031
Net loss	$ (3,928,940)	
Change in net unrealized capital loss	(150,578)	
Change in net deferred income tax	1,603,501	
Change in nonadmitted assets	(1,641,175)	
Dividends to shareholders	(330,357)	
Change in surplus as regards policyholders for the year		(4,447,549)
Surplus as regards policyholders, December 31, 2011		$ 27,833,482

Reconciliation of Surplus as Regards Policyholders
from December 31, 2008 through December 31, 2011

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2008 per Examination			$ 31,252,051
Net loss	$	$ 3,538,762	
Net unrealized capital gains	817,182		
Change in net deferred income tax	2,121,484		
Change in nonadmitted assets		1,791,930	
Dividends to shareholders		1,026,543	
Total gains and losses	$ 2,938,666	$ 6,357,235	
Net decrease in surplus as regards policyholders			(3,418,569)
Surplus as regards policyholders, December 31, 2011, per Examination			$ 27,833,482

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, the Company's loss and loss adjustment expense reserves as of December 31, 2011 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records (Page 9): It is recommended that the Company make appropriate changes to reclassify its expense in accordance with Statement of Statutory Accounting Principles No. 70, which established uniform expenses allocation rules to classify expenses into three categories as loss adjustment expenses, investment expenses and other underwriting expenses on the Underwriting and Investment Exhibit.

Previous Report of Examination

Management Agreements - Consolidated Income Tax Agreement (Page 5): It was recommended that the Company comply with Statements of Statutory Accounting Principles No. 10, Paragraph 12, Section b and California Insurance Code (CIC) Section 1215.5(b)(4), which requires submission of the agreement to the California Department of Insurance (CDI) for prior approval. The Company has complied.

Corporate Records - (Page 5): It was recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Sections 735, 1200, and 1201. The Company has complied.

Reinsurance Ceded - (Page 8): It was recommended that the Company amend the reinsurance agreements to comply with California Code of Regulations, Title 10, Section 2303.13 by including an "entire agreement clause" and submit for CDI approval. 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/_____
Millie Cao, CFE,
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California