

REPORT ON EXAMINATION
OF
MERCURY INSURANCE COMPANY OF
FLORIDA
CLEARWATER, FLORIDA

AS OF
DECEMBER 31, 2013

BY THE
FLORIDA OFFICE OF INSURANCE REGULATION

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January 26, 2015

Kevin M. McCarty
Commissioner
Office of Insurance Regulation
State of Florida
Tallahassee, Florida 32399-0326

Dear Sir:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, Rule 690-138.005, Florida Administrative Code, and in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners (NAIC), we have conducted an examination as of December 31, 2013, of the financial condition and corporate affairs of:

**MERCURY INSURANCE COMPANY OF FLORIDA
1901 ULMERTON ROAD
CLEARWATER, FLORIDA 33762**

Hereinafter referred to as the "Company". Such report of examination is herewith respectfully submitted.

SCOPE OF EXAMINATION

This examination covered the period of January 1, 2010 through December 31, 2013. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2009. This examination commenced with planning at the Office on May 5, 2014 to May 9, 2014. The fieldwork commenced on May 12, 2014, and concluded as of January 26, 2015.

This financial examination was an association examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and annual statement instructions promulgated by the NAIC as adopted by Rules 69O-137.001(4) and 69O-138.001, Florida Administrative Code, with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

This report of examination is confined to significant adverse findings, a material change in the financial statements or other information of regulatory significance or requiring regulatory action. The report comments on matters that involved departures from laws, regulations or rules, or which were deemed to require special explanation or description.

SUMMARY OF SIGNIFICANT FINDINGS

Current Exam Findings

There were no material findings or exceptions noted during the examination as of December 31, 2013.

Prior Exam Findings

There were no material findings or exceptions noted during the examination as of December 31, 2009.

HISTORY

General

The Company was incorporated in Florida on August 27, 2001, and commenced business on January 2, 2002, as Mercury Insurance Company of Florida.

The Company was authorized to transact the following insurance coverage in Florida on various dates in 2001 and 2002 and continued to be authorized as of December 31, 2013:

Private Passenger Auto Liability
Commercial Auto Liability

Private Passenger Auto Physical Damage
Commercial Auto Physical Damage

The Articles of Incorporation and the Bylaws were not amended during the period covered by this examination.

Dividends to Stockholders

The Company did not declare or pay any dividends during the period of this examination.

Capital Stock and Capital Contributions

As of December 31, 2013, the Company's capitalization was as follows:

Number of authorized common capital shares	1,200,000
Number of shares issued and outstanding	1,200,000
Total common capital stock	\$1,200,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, Mercury General Corporation (MGC), who owned 100 percent of the stock issued by the Company, in turn MGC was owned by controlling stockholders George Joseph and Gloria Joseph, who owned 34.3 percent and 16.7 percent respectively. The remaining 49 percent was owned by public stockholders and traded on the New York Stock Exchange.

Surplus Notes

The Company did not have any surplus notes during the period of this examination.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales through Reinsurance

The Company had no acquisitions, mergers, disposals, and purchase or sales through reinsurance during the period of this examination.

CORPORATE RECORDS

The recorded minutes of the Shareholders, Board of Directors (Board) and certain internal committees were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions and events, in compliance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code, including the authorization of investments as required by Section 625.304, Florida Statutes.

Conflict of Interest

The Company adopted a policy statement requiring periodic disclosure of conflicts of interest in accordance with the NAIC Financial Condition Examiners Handbook adopted by Rule 69O-138.001, Florida Administrative Code.

MANAGEMENT AND CONTROL

Management

The annual shareholder meeting for the election of directors was held in accordance with Section 628.231, Florida Statutes. Directors serving as of December 31, 2013, were:

Directors

Name and Location

Principal Occupation

Bruce Allan Bunner
Winter Park, Florida

Retired; President
Financial Structures Ltd.

Christopher Wadewitz Graves
Palos Verdes Peninsula, California

Vice President and Chief Investment Officer
Mercury General Corporation

Richard Eugene Grayson
Murietta, California

Retired; Senior Vice President
Union Bank

George Joseph
Los Angeles, California

Chairman of the Board
Mercury General Corporation

Donald Patrick Newell
Pinehurst, North Carolina

Retired; Partner
Law Firm of Lathem & Watkins, LLP

Gabriel Tirador
Tustin, California

President and Chief Executive Officer
Mercury General Corporation

Judith Allan Walters
Oxnard, California

Secretary
Mercury General Corporation

In accordance with the Company's bylaws, the Board appointed the following senior officers:

Senior Officers

Name	Title
Gabriel Tirador	President & CEO
Theodore Robert Stalick	Senior Vice President/CFO & Treasurer
Judith Ann Walters	Secretary
Christopher Wadewitz Graves	Vice President
Ronald Anthony Deep	Vice President

The Company's Board appointed several internal committees. Following were the principal internal board committees and their members as of December 31, 2013:

Statutory Audit Committee

Theodore Stalick ¹
Eleanor Ingalla
David Yeager

¹Chairman

Investment Committee

Richard Grayson ¹
Christopher Graves
George Joseph
Gabriel Tirador

The Company maintained an audit committee, as required by Section 624.424(8) (c), Florida Statutes.

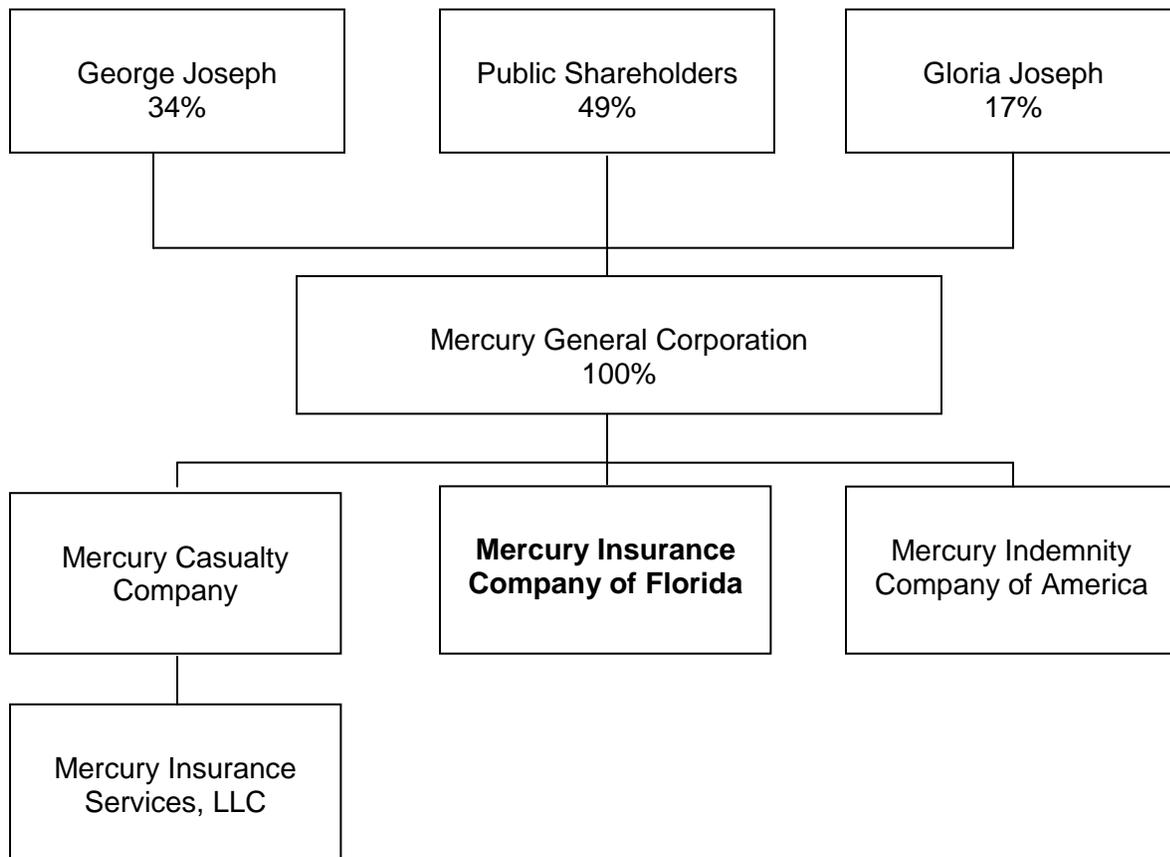
Affiliated Companies

The most recent holding company registration statement was filed with the Office on February 26, 2014, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2013, reflecting the holding company system, is shown below. Schedule Y of the Company's 2013 annual statement provided a list of all related companies of the holding company group.

MERCURY INSURANCE COMPANY OF FLORIDA ORGANIZATIONAL CHART

DECEMBER 31, 2013



The following agreements were in effect between the Company and its affiliates:

Tax Allocation Agreement

The Company, along with its parent, MGC, and affiliates, filed a consolidated federal income tax return. On December 31, 2013, the method of allocation of tax liability between the Company and MGC was on a separate-entity basis.

Management Agreement

The Company had a management agreement with Mercury Insurance Services, LLC (MIS). Pursuant to the agreement, MIS provided all personnel and performed underwriting and loss adjustment services on behalf of the Company for the period under review. The Company utilized independent agents to produce the business and MIS was responsible for the underwriting process and ultimate decisions on binding risk based upon previously established guidelines provided by the Company. MIS was also responsible for adjusting and settling all losses the Company was liable for. The loss adjustments and settlements were performed by MIS and settled out of the Company bank accounts. The fees for the services rendered were billed to the Company at the actual incurred expenses. The Company paid MIS \$29,549,542 during 2013 under the terms of this agreement.

Services Agreement

The Company entered into a Services Agreement with Mercury National Insurance Company (MNIC) effective February 11, 2011. Under the terms of the agreement, the Company pays agent commissions and receives return commissions on behalf of MNIC. No fees are payable under this agreement.

FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$3,000,000 with a deductible of \$100,000, which reached the suggested minimum as recommended by the NAIC.

The Company also maintained Directors and Officers (D&O) liability insurance with limits of \$30,000,000 and a retention point of \$500,000. The policy is maintained at the holding company level but applies to all companies within the group.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had no employees and therefore no pension, stock ownership or insurance plans.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance in the states of Florida and Pennsylvania.

Treatment of Policyholders

The Company established procedures for handling written complaints in accordance with Section 626.9541(1) (j), Florida Statutes.

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim in accordance with Section 626.9541(1) (i) 3a, Florida Statutes.

COMPANY GROWTH

The Company's gross written premiums have declined steadily from 2010 to 2013, reducing by approximately fifty-five percent during the period under examination. As of the beginning of 2011, the Company no longer wrote new business but continued to renew existing business. The decline in written premiums was in line with the Company's expectations. All premiums, claims, loss reserves and loss adjustment expense reserves are ceded to Mercury Casualty Company (MCC), an affiliate.

Profitability of Company

The table below shows the profitability trend (in dollars) of the Company for the period of examination, as reported in the filed annual statements.

	2013	2012	2011	2010
Premiums Earned	0	0	0	0
Net Underwriting Gain/(Loss)	(31,659)	(57,544)	(4,240)	101,244
Net Income	605,828	564,725	554,871	879,525
Total Assets	48,375,019	50,315,331	53,990,654	59,829,099
Total Liabilities	8,885,836	11,318,992	15,340,302	21,989,172
Surplus As Regards Policyholders	39,489,183	38,996,339	38,650,352	37,839,927

As detailed in the table above, the Company has not recorded any premiums earned during the period under review. This is due to the 100 percent quota share agreement with the Company's affiliate, MCC, pursuant to which all earned premiums were ceded to the affiliate in exchange for the affiliate's assumption of all losses and reserve liabilities. Because the

Company does not earn any premiums, but is still responsible for the underwriting expenses, the Company has reported a net underwriting loss for three of the four years under review. These losses are primarily attributed to the licensing fees and taxes associated with the Company's business. The net income amounts were primarily attributed to the net investment Income earned.

LOSS EXPERIENCE

As indicated above, the Company entered into a 100 percent quota share reinsurance agreement with their affiliate, MCC, whereas 100 percent of all losses were ceded to the assuming affiliate.

REINSURANCE

The reinsurance agreements reviewed complied with NAIC standards with respect to the standard insolvency clause, arbitration clause, transfer of risk, reporting and settlement information deadlines.

Assumed

The Company did not assume any reinsurance during the period of this examination.

Ceded

The Company ceded risk on a quota share basis to MCC, an affiliate. The Company ceded 100 percent of the ultimate net loss arising out of each occurrence for all lines written by the Company.

The reinsurance contracts were reviewed during the examination to verify transfer of risk was evident and the contracts were in force for the entire period under review.

ACCOUNTS AND RECORDS

The Company maintained its principal operational offices in Clearwater, Florida. The examination was a coordinated examination with the States of California, Florida, Georgia, Illinois, and Texas, and was primarily conducted at the MGC's corporate headquarters in Los Angeles, California.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with the Bank of New York Mellon executed on August 24, 2001, as amended on November 5, 2010. The agreement was in compliance with Rule 69O-143.042, Florida Administrative Code.

Independent Auditor Agreement

An independent CPA audited the Company's statutory basis financial statements annually for the years 2010, 2011, 2012 and 2013, in accordance with Section 624.424(8), Florida Statutes. Supporting work papers were prepared by the CPA as required by Rule 69O-137.002, Florida Administrative Code.

INFORMATION TECHNOLOGY REPORT

Jack Ho, CFE, CISA, AES, Senior Examiner/IT Specialist with the California Department of Insurance, contracted with Hunter Neumann, Advisory Manager and Viking Wang, Advisory

Senior, Ernst & Young LLP, to perform an evaluation of the information technology and computer systems of the Company. Results of the evaluation were noted in the Information Technology Report provided to the Company.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, Florida Statutes:

STATE	Description	Par Value	Market Value
FL	USTNTS, 1.25%, 08/31/15	<u>\$ 350,000</u>	<u>\$ 355,565</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 350,000</u>	<u>\$ 355,565</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2013, and the results of its operations for the year then ended as determined by this examination. Adjustments made as a result of the examination are noted in the section of this report captioned, "Comparative Analysis of Changes in Surplus."

MERCURY INSURANCE COMPANY OF FLORIDA

Assets

DECEMBER 31, 2013

	Per Company	Examination Adjustments	Per Examination
Bonds	\$12,354,147	\$0	\$12,354,147
Stocks:			
Preferred	3,412,800		3,412,800
Cash and Short-Term Investments	10,761,904		10,761,904
Agents' Balances:			
Uncollected premium	1,971,450		1,971,450
Deferred premium	9,973,852		9,973,852
Reinsurance recoverable	8,149,928		8,149,928
Net deferred tax asset	308,110		308,110
Interest and dividend income due & accrued	137,264		137,264
Receivable from parents, subsidiaries and affiliates	1,305,564		1,305,564
Totals	<u>\$48,375,019</u>	<u>\$0</u>	<u>\$48,375,019</u>

MERCURY INSURANCE COMPANY OF FLORIDA
Liabilities, Surplus and Other Funds

DECEMBER 31, 2013

	Per Company	Examination Adjustments	Per Examination
Commissions payable, contingent commissions and other similar charges	\$1,177,562		\$1,177,562
Other expenses	36,937		36,937
Taxes, licenses and fees	401,995		401,995
Current federal and foreign income taxes	557,083		557,083
Advance premium	571,060		571,060
Ceded reinsurance premiums payable	3,859,078		3,859,078
Remittances and items not allocated	7,030		7,030
Payable to parent, subsidiaries and affiliates	2,275,091		2,275,091
Total Liabilities	\$8,885,836	\$0	\$8,885,836
Common capital stock	\$1,200,000		\$1,200,000
Gross paid in and contributed surplus	32,300,000		32,300,000
Unassigned funds (surplus)	5,989,183		5,989,183
Surplus as regards policyholders	\$39,489,183	\$0	\$39,489,183
Total liabilities, surplus and other funds	\$48,375,019	\$0	\$48,375,019

MERCURY INSURANCE COMPANY OF FLORIDA
Statement of Income

DECEMBER 31, 2013

Underwriting Income

Premiums earned		\$0
	Deductions:	
Losses incurred		\$0
Loss expenses incurred		0
Other underwriting expenses incurred		31,659
Aggregate write-ins for underwriting deductions		0
Total underwriting deductions		\$31,659
Net underwriting gain or (loss)		(\$31,659)

Investment Income

Net investment income earned		\$781,055
Net realized capital gains or (losses)		0
Net investment gain or (loss)		\$781,055

Other Income

Net gain or (loss) from agents' or premium balances charged off		\$0
Finance and service charges not included in premiums		0
Aggregate write-ins for miscellaneous income		0
Total other income		\$0

Net income before dividends to policyholders and before federal & foreign income taxes		\$749,396
Dividends to policyholders		0
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$749,396
Federal & foreign income taxes		143,568
Net Income		\$605,828

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$38,996,339
Net Income		\$605,828
Net unrealized capital gains or losses		(141,106)
Change in net deferred income tax		43,728
Change in non-admitted assets		(15,606)
Change in provision for reinsurance		0
Surplus adjustments: Paid in		0
Aggregate write-ins for gains and losses in surplus		0
Examination Adjustment		0
Change in surplus as regards policyholders for the year		\$492,844
Surplus as regards policyholders, December 31 current year		\$39,489,183

A comparative analysis of changes in surplus is shown below.

**MERCURY INSURANCE COMPANY OF FLORIDA
Comparative Analysis of Changes in Surplus**

DECEMBER 31, 2013

The following is a reconciliation of Surplus as regards policyholders between that reported by the Company and as determined by the examination.

Surplus as Regards Policyholders
December 31, 2013, per Annual Statement \$39,489,183

	<u>PER COMPANY</u>	<u>PER EXAM</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>
ASSETS:			
No Adjustment			
LIABILITIES:			
No Adjustment			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2013, Per Examination			<u><u>\$39,489,183</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$0

The Company properly reported no losses or loss adjustment expense reserves at December 31, 2013. This is due to the 100 percent quota share agreement in place with affiliate MCC.

An outside actuarial firm appointed by the Board of Directors, rendered an opinion that the amounts carried in the balance sheet as of December 31, 2013, made a reasonable provision for all unpaid loss and loss expense obligations of the Company under the terms of its policies and agreements.

Robert C. Holstrom, FSA, MAAA, Senior Casualty Actuary and Frederick A. Urschel, ACAS, Senior Casualty Actuary, both of the State of California Department of Insurance, reviewed the loss and loss adjustment expense work papers provided by the Company and they were in concurrence with this opinion.

Capital and Surplus

The amount of capital and surplus reported by the Company of \$39,489,183, exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

CONCLUSION

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Mercury Insurance Company of Florida** as of December 31, 2013, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$39,489,183, which exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Scott R. Kalna, CFE, MCM, Examiner-In-Charge of Examination Resources LLC, and John Romano, CPA, CFE, Examination Manager representing Baker Tilly Virchow Krause, LLP participated in the examination. Additionally, Robert C. Holstrom, FSA, MAAA, Senior Casualty Actuary and Frederick A. Urschel, ACAS, Senior Casualty Actuary, both of the State of California Department of Insurance, Jack Ho, CFE, CISA, AES, Senior Examiner/IT Specialist with the California Department of Insurance, Hunter Neumann, Advisory Manager and Viking Wang, Advisory Senior, Ernst & Young LLP participated in the examination.

Respectfully submitted,

Robin Brown, CFE
Chief Examiner
Property & Casualty Financial Oversight
Florida Office of Insurance Regulation