

REPORT ON EXAMINATION
OF
MERCURY INDEMNITY COMPANY OF
AMERICA
CLEARWATER, FLORIDA

AS OF
DECEMBER 31, 2009

BY THE
OFFICE OF INSURANCE REGULATION

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TALLAHASSEE, FLORIDA

November 11, 2010

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Dear Sir and Madam:

Pursuant to your instructions, in compliance with Section 624.316, Florida Statutes, 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, 2009, of the financial condition and corporate affairs of:

**MERCURY INDEMNITY COMPANY OF AMERICA
1901 ULMERTON ROAD, SIXTH FLOOR
CLEARWATER, FLORIDA 33762-2307**

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, 2005, through December 31, 2009. The Company was last examined by representatives of the Florida Office of Insurance Regulation (Office) as of December 31, 2004. This examination commenced with planning at the Office on July 21, 2010. The fieldwork commenced on July 26, 2010, and concluded as of November 11, 2010.

This financial examination was an association zone statutory financial 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, 2009.

Prior Exam Findings

There were no adverse findings contained in the Office's prior examination report as of December 31, 2004.

HISTORY

General

The Company was incorporated in Florida on August 27, 2001, as Mercury Indemnity Company of Florida. The Company changed its name to Mercury Indemnity Company of America during 2003.

The Company did not write any business in the State of Florida. However, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2009:

Private Passenger Auto Liability
Homeowners Multi Peril

PPA Physical Damage

The Company Bylaws were not amended during the period covered by this examination. However, the Company's Articles of Incorporation were amended three times during the period covered by this examination. Two of the amendments increased the number of shares outstanding from 1,000 to 2,000,000 and then to 2,400,000 all with a par value of \$1.00 per share. The third covered the name change. All amendments were filed with the Office.

Dividends to Stockholders

The Company did not declare nor pay any dividends for the period under review.

Capital Stock and Capital Contributions

As of December 31, 2009, the Company's capitalization was as follows:

Number of authorized common capital shares	2,400,000
Number of shares issued and outstanding	2,400,000
Total common capital stock	\$2,400,000
Par value per share	\$1.00

Control of the Company was maintained by its parent, Mercury General Corporation (MGC), a California Corporation, who owned 100% of the stock issued by the Company; in turn, MGC was owned by controlling stockholders' George Joseph and Gloria Joseph, who owned 34.3% and 16.7%, respectively. The remaining 49.0% was owned by public stockholders and traded on the New York Stock Exchange.

Surplus Debentures

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

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

The Company was not party to any acquisitions, mergers, disposals, dissolutions and/or purchases or sales through reinsurance for the period covered by this examination.

CORPORATE RECORDS

The recorded minutes of the shareholder, 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 accordance with Section 607.1601, Florida Statutes, including the authorization of investments as required by Section 625.304, Florida Statutes.

Conflict of Interest

The Company adopted a policy statement requiring annual 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 Sections 607.1601 and 628.231, Florida Statutes. Directors serving as of December 31, 2009, were:

Directors

Name and Location	Principal Occupation
Bruce Bunner Winter Park, FL	Retired; President, Financial Structures Ltd.
Richard Grayson Murietta, CA	Retired; Senior Vice President Union Bank
George Joseph Los Angeles, CA	Chairman of the Board Mercury General Corporation
Donald Newell Pinehurst, NC	Retired; Senior Vice President The SCPIE Companies
Gabriel Tirador Tustin, CA	President & CEO Mercury General Corp.
Judith Walters Oxnard, CA	Secretary Mercury General Corp. & Subsidiaries

The Board in accordance with the Company's bylaws appointed the following senior officers:

Senior Officers

Name	Title
Garbriel Tirador	President & CEO
Theodore Stalick	VP/CFO & Treasurer
Judith Walters	Secretary

The Company's Board appointed several internal committees in accordance with Section 607.0825, Florida Statutes. The following are the principal internal board committees and their members as of December 31, 2009:

Audit Committee	Investment Committee	Compensation Committee	Corp. Gov Committee
Nathan Bessin *	George Joseph *	Donald Spuehler *	Nathan Bessin *
Donald Newell	Gabriel Tirador	Bruce Bunner	Donald Newell
Donald Spuehler	Richard Grayson		Donald Spuehler
Martha Marcon			

* Chairman

Affiliated Companies

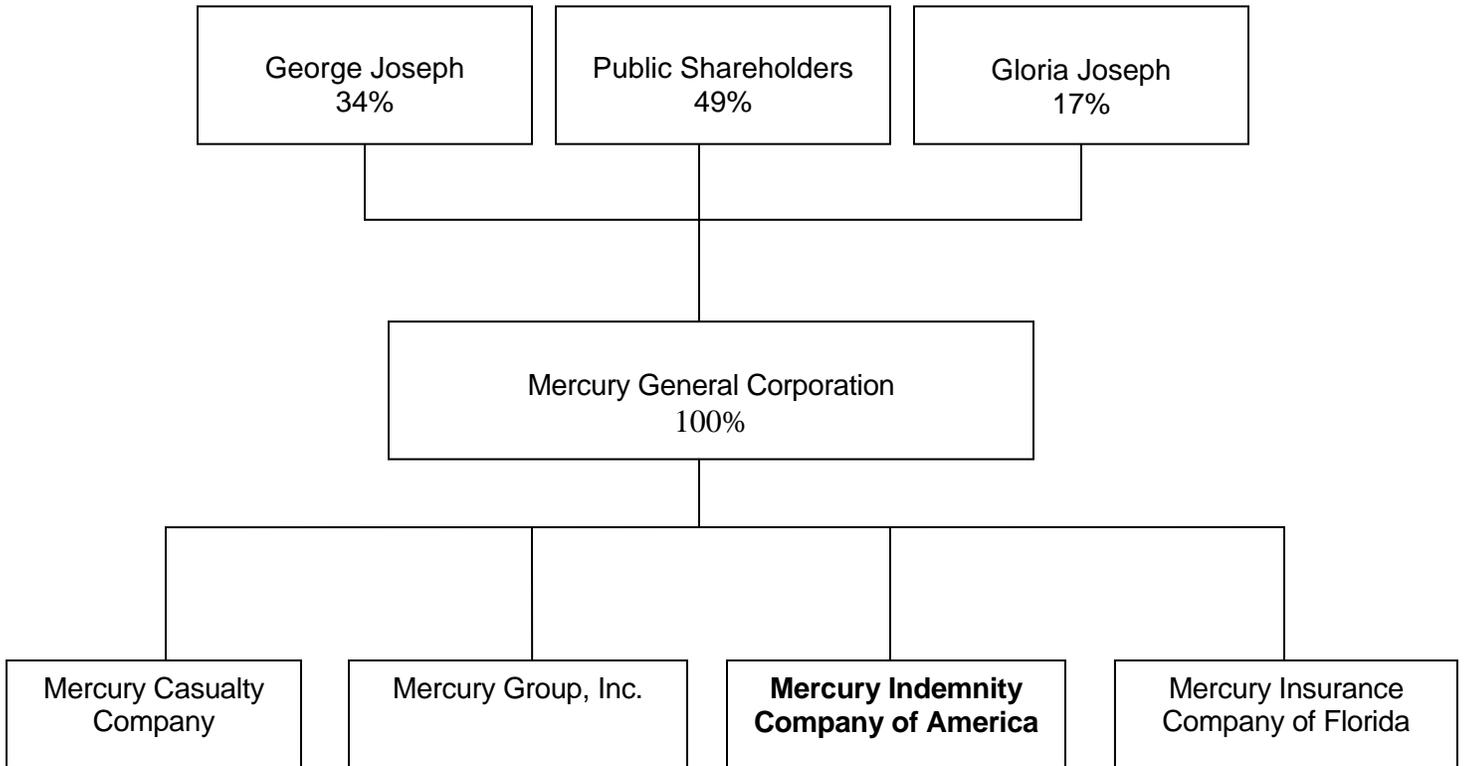
The Company was a member of an insurance holding company system as defined by Rule 69O-143.045(3), Florida Administrative Code. The latest holding company registration statement was filed with the State of Florida on April 28, 2010, as required by Section 628.801, Florida Statutes, and Rule 69O-143.046, Florida Administrative Code.

A simplified organizational chart as of December 31, 2009, reflecting the holding company system, is shown below. Schedule Y of the Company's 2009 annual statement provided a list of all related companies of the holding company group.

MERCURY INDEMNITY COMPANY OF AMERICA

ORGANIZATIONAL CHART

DECEMBER 31, 2009



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

Tax Allocation Agreement

The Company, along with its parent and other affiliated corporations, filed a consolidated federal income tax return. On December 31, 2009, the method of allocation of tax liability between the companies was based upon calculations on a separate return basis.

Management Agreement

The Company had a management agreement with Mercury Insurance Services, LLC (MIS). Pursuant to the agreement, MIS provided all employees 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.

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 insurance coverage in the amount of \$30,000,000, with a retention point of \$500,000. The policy was maintained at the holding company level, but applied to all companies within the group.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company did not have any employees.

TERRITORY AND PLAN OF OPERATIONS

The Company was authorized to transact insurance in the following states:

Florida
New Jersey

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

Profitability of Company

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

	2009	2008	2007	2006	2005
Premiums Earned	0	0	0	0	0
Net Underwriting Gain/(Loss)	0	0	(32,981)	(8,886)	(33,433)
Net Income	67,288	668,564	1,581,247	3,992,603	1,996,698
Total Assets	47,122,636	44,919,038	54,046,314	52,405,534	99,752,391
Total Liabilities	13,991,693	12,773,011	22,910,806	22,417,364	71,403,398
Surplus As Regards Policyholders	33,130,943	32,146,027	31,135,508	29,988,170	28,348,993

As outlined above, the Company had zero Premiums Earned for the entire period under review. This was due to the 100 percent (%) quota share agreement with their affiliate, whereas all earned premiums were ceded to the affiliate in exchange for the 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 shown a Net Underwriting Loss for three of the five 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

The Company had not experienced any losses for the entire period under review and since inception. The Company entered into a 100 percent (%) quota share reinsurance agreement with their affiliate, Mercury Casualty Company (MCC), whereas 100 percent (%) of all losses were ceded to the assuming affiliate, MCC.

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 risks.

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 private passenger automobile and automobile physical damage business 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 primarily conducted in the corporate headquarters of the parent in Los Angeles, California.

An independent CPA firm audited the Company's statutory basis financial statements annually for the years 2005, 2006, 2007, 2008 and 2009, 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.

The Company's accounting records were maintained on the FlexiLedger accounting system. This system had direct interfaces with various premiums and claims systems.

The Company and non-affiliates had the following agreements:

Custodial Agreement

The Company maintained a custodial agreement with the Bank of New York Trust Company. The agreement was in compliance with Rule 69O-143.042(1), Florida Administrative Code.

Independent Auditor Agreement

The Company maintained an agreement with KPMG LLP to perform an annual audit, in compliance with Section 624.424(8), Florida Statutes.

Information Technology Report

ParenteBeard LLC performed 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	US T-NOTE, 5.00 %, 08/15/11	350,000	369,180
TOTAL FLORIDA DEPOSITS		<u>\$350,000</u>	<u>\$369,180</u>

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2009, 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 INDEMNITY COMPANY OF AMERICA
Assets

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Bonds	\$19,245,001		\$19,245,001
Cash:	14,765,831		14,765,831
Investment Income Due & Accrued	246,988		246,988
Reinsurance recoverable	8,479,424		8,479,424
Aggregate write-ins for other than invested assets	4,385,392		4,385,392
	<hr/>		
Totals	\$47,122,636	\$0	\$47,122,636
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MERCURY INDEMNITY COMPANY OF AMERICA
Liabilities, Surplus and Other Funds

DECEMBER 31, 2009

	Per Company	Examination Adjustments	Per Examination
Commissions payable, contingent commissions and other similar charges	\$1,619,445		\$1,619,445
Other expenses	36,436		36,436
Taxes, licenses & fees	748,614		748,614
Current federal and foreign income taxes	745,101		745,101
Net deferred tax liability	941,045		941,045
Advance premium	664,182		664,182
Ceded reinsurance premiums payable	5,609,647		5,609,647
Remittances and items not allocated	335,400		335,400
Payable to parent, subsidiaries and affiliates	3,291,823		3,291,823
Total Liabilities	\$13,991,693	\$0	\$13,991,693
Common capital stock	\$2,400,000		\$2,400,000
Gross paid in and contributed surplus	27,600,000		27,600,000
Unassigned funds (surplus)	3,130,943		3,130,943
Surplus as regards policyholders	\$33,130,943		\$33,130,943
Total liabilities, surplus and other funds	\$47,122,636	\$0	\$47,122,636

MERCURY INDEMNITY COMPANY OF AMERICA
Statement of Income

DECEMBER 31, 2009

Underwriting Income

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

Investment Income

Net investment income earned		\$993,349	
Net realized capital gains or (losses)		-	
Net investment gain or (loss)		-	\$993,349

Other Income

Net gain or (loss) from agents' or premium balances charged off		-	
Finance and service charges not included in premiums		-	
Aggregate write-ins for miscellaneous income		\$27,740	
Total other income		\$27,740	

Net income before dividends to policyholders and before federal & foreign income taxes		\$1,021,089	
Dividends to policyholders		-	
Net Income, after dividends to policyholders, but before federal & foreign income taxes		\$1,021,089	
Federal & foreign income taxes		953,801	\$67,288
Net Income			

Capital and Surplus Account

Surplus as regards policyholders, December 31 prior year		\$32,146,027	
Net Income		\$67,288	
Net unrealized capital gains or losses		-	
Change in net deferred income tax		503,018	
Change in non-admitted assets		414,610	
Change in provision for reinsurance		-	
Capital Changes: Paid in		1,200,000	
Surplus adjustments: Paid in		(1,200,000)	
Aggregate write-ins for gains and losses in surplus		-	
Examination Adjustment		-	
Change in surplus as regards policyholders for the year		\$984,916	\$33,130,943
Surplus as regards policyholders, December 31 current year			

A comparative analysis of changes in surplus is shown below.

MERCURY INDEMNITY COMPANY OF AMERICA
Comparative Analysis of Changes In Surplus

DECEMBER 31, 2009

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, 2009, per Annual Statement \$33,130,943

	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
No Adjustments			
LIABILITIES:			
No Adjustments			
Net Change in Surplus:			<u>0</u>
Surplus as Regards Policyholders December 31, 2009, Per Examination			<u><u>\$33,130,943</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Liabilities

Losses and Loss Adjustment Expenses \$0

The Company did not report any losses or loss adjustment expense reserves on the balance sheet for the year ending December 31, 2009. This was due to the 100% quota share agreement in place with their affiliate.

Capital and Surplus

The amount reported by the Company of \$33,130,943 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 Indemnity Company of America** as of December 31, 2009, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's Surplus as regards policyholders was \$33,130,943, which exceeded the minimum of \$4,000,000 required by Section 624.408, Florida Statutes.

In addition to the undersigned, Michael Brennan, CPA, Examiner In Charge; Phil Schmoyer, Jennifer Cox, and Caner Ozsoy, Participating Examiners and Andrew Wittig, IT Specialist, representing ParenteBeard LLC participated in the examination.

Respectfully submitted,

Kethessa Carpenter, CPA
Financial Examiner/Analyst Supervisor
Florida Office of Insurance Regulation

Mary James, CFE, CPM
Chief Examiner
Florida Office of Insurance Regulation