

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

AS OF
DECEMBER 31, 2002

BY THE
OFFICE OF INSURANCE REGULATION

TABLE OF CONTENTS

LETTER OF TRANSMITTAL	-
SCOPE OF EXAMINATION	1
Status of Adverse Findings from Prior Examination	2
HISTORY	2
General	2
Capital Stock	4
Profitability	4
Dividends to Stockholders	4
Management	4
Conflict of Interest Procedure	6
Corporate Records	6
Acquisitions, Mergers, Disposals, Dissolutions, and Purchase or Sales through Reinsurance	6
Surplus Debentures	7
AFFILIATED COMPANIES	7
Tax Allocation Agreement	7
Furniture and Equipment	8
Management Agreement	8
MGA Agreement	8
ORGANIZATIONAL CHART	10
FIDELITY BOND AND OTHER INSURANCE	11
PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS	11
STATUTORY DEPOSITS	11
INSURANCE PRODUCTS AND RELATED PRACTICES	12
Territory and Plan of Operation	12
Treatment of Policyholders	12
REINSURANCE	13
Assumed	13
Ceded	13

ACCOUNTS AND RECORDS	14
Custodial Agreement.....	14
CPA Agreement	15
Risk-Based Capital.....	15
FINANCIAL STATEMENTS PER EXAMINATION.....	16
Assets	17
Liabilities, Surplus and Other Funds	18
Statement of Income	19
COMMENTS ON FINANCIAL STATEMENTS.....	20
Assets.....	20
Liabilities	20
Other Expenses	22
COMPARATIVE ANALYSIS OF CHANGES IN SURPLUS.....	22
SUMMARY OF FINDINGS	23
SUBSEQUENT EVENTS.....	23
CONCLUSION	28

Tallahassee, Florida

October 24, 2003

Kevin M. McCarty
Director
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 (FS), 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, 2002, of the financial condition and corporate affairs of:

**MERCURY INSURANCE COMPANY OF FLORIDA
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 August 27, 2001 through December 31, 2002. This is the first examination of the Company. This examination commenced with planning at the Office on May 15, 2003 through May 16, 2003. The fieldwork commenced on May 19, 2003, and was concluded as of October 24, 2003. The examination included any material transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

This financial examination was a statutory financial examination conducted in accordance with the Financial Examiners Handbook, Accounting Practices and Procedures Manual and Annual Statement Instructions promulgated by the NAIC as adopted by Rules 4-137.001(4) and 4-138.001, Florida Administrative Code (FAC), with due regard to the statutory requirements of the insurance laws and rules of the State of Florida.

In this examination, emphasis was directed to the quality, value and integrity of the statement assets and the determination of liabilities, as those balances affect the financial solvency of the Company.

The examination included a review of the corporate records and other selected records deemed pertinent to the Company's operations and practices. In addition, the NAIC IRIS ratio report, the A.M. Best Report, the Company's independent audit reports and certain work papers prepared by the Company's independent certified public accountant were reviewed and utilized where applicable within the scope of this examination.

We valued and/or verified the amounts of the Company's assets and liabilities as reported by the Company in its annual statement as of December 31, 2002. Transactions subsequent to year-end 2002 were reviewed where relevant and deemed significant to the Company's financial condition.

This report of examination is confined to financial statements and comments on matters that involve departures from laws, regulations or rules, or which are deemed to require special explanation or description.

Status of Adverse Findings from Prior Examination

This was the first examination of the Company, therefore no prior examination findings exist.

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.

In accordance with Section 624.401(1), FS, the Company was authorized to transact the following insurance coverage in Florida on December 31, 2002:

Auto Physical Damage
Commercial Automobile Liability
Other Liability

Private Passenger Auto Liability
Commercial Auto Physical Damage

The Company added Commercial Multi-Peril in 2003.

The articles of incorporation were amended during the period covered by this examination.

The Company should amend their by-laws, Section 9.07, which incorrectly refers to Section 628.281, FS, because the Company is not exempt from having their records in the State of Florida.

The Company is not in compliance with Section 628.271, FS or the Department of Financial Services (DFS) Consent Order 43811-01-CO (12); both of which require the records be in the State of Florida.

Capital Stock

As of December 31, 2002, the Company's capitalization was as follows:

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

Control of the Company was maintained by its parent, Mercury General Corporation (MGC). MGC owned 100 percent of the stock issued by the Company. MGC was a publicly traded insurance holding company domiciled in the State of California.

The Company was unable to provide the original stock ledger book; therefore the Company was not in compliance with Section 607.1601(3), FS.

Profitability of Company

The Company reported direct premiums of \$106,002,831, which were 100% ceded to Mercury Casualty Company (MCC). The Company reported net income after taxes, of \$86,741.

Dividends to Stockholders

In accordance with Section 628.371, FS, the Company did not declare or pay dividends to its stockholder in 2002.

Management

The annual shareholder meeting for the election of directors was held in accordance with Sections 607.1601 and 628.231, FS. The Company has a Treasurer, but the shareholder meeting did not include the election of a Treasurer. The Company is required to maintain a Treasurer per their By-

laws and to comply with Section 607.08401(1), FS. Directors serving as of December 31, 2002, were:

Directors

Name and Location	Principal Occupation
Bruce Bunner Fairfield, CT	Director Retired President, FSL Group
Gabriel Tirador Tustin, CA	Director President/COO MGC & Subsidiaries
George Joseph Los Angeles, CA	Director/Chairman CEO MGC & Subsidiaries
Judith Ann Walters Oxnard, CA	Director VP/Corp. Sec. MGC & Subsidiaries
Donald Patrick Newell Rancho Sante Fe, CA	Director Senior VP/The SCPIE Cos.

The Board of Directors in accordance with the Company's bylaws appointed the following senior officers, with the exception of the Treasurer as noted above:

Senior Officers

Name	Title
Gabriel Tirador	President
George Joseph	Treasurer
Judith Ann Walters	Secretary
Theodore Robert Stalick	Vice President
Jack Dougherty	Vice President

Subsequent event: On September 17, 2003, Theodore Stalick was appointed the Treasurer by the Board of Directors.

The Company's board appointed one internal committee in accordance with Section 607.0825, FS. Following is the principal internal board committee and its members as of December 31, 2002:

Executive Committee	Audit Committee	Investment Committee
None	None	George Joseph Gabriel Tirador Chris Graves Richard Grayson

The Company did not maintain an audit committee, as required by Section 624.424(8), FS.

Conflict of Interest Procedure

The Company had adopted a policy statement in their Employee Handbook, but did not maintain a Conflict of Interest Statement, which officers and directors could utilize to disclose information about related party conflicts, in violation of Rule 4-138.001(1), FAC.

Corporate Records

The recorded minutes of the shareholder and Board of Directors meetings were reviewed for the period under examination. The recorded minutes of the Board adequately documented its meetings and approval of Company transactions in accordance with Section 607.1601, FS, including the authorization of investments as required by Section 625.304, FS.

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

The Company had no acquisitions, mergers, disposals, dissolutions, purchase or sales through reinsurance.

Surplus Debentures

The Company had no surplus debentures.

AFFILIATED COMPANIES

The Company was a member of an insurance holding company system as defined by Rule 4-143.045(3), FAC. The latest holding company registration statement was filed with the State of Florida on September 8, 2003, as required by Section 628.801, FS, and Rule 4-143.046, FAC.

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

Tax Allocation Agreement

The Company, along with its parent and various affiliated companies, filed a consolidated federal income tax return. On December 31, 2002, the method of allocation between the Company and its parent with respect to the income tax due, required the Company to pay the parent estimated payments on or before the 10th day prior to the due date an amount equal to the estimated tax payment that the Company would have had to pay if it had been filing a separate return. Final payment was due on or before the 10th day prior to the due date of any such tax payment. The parent and subsidiaries are members of an affiliated group, within the meaning of Section 1504(a) of the Internal Revenue Code. The parties filed the return on a consolidated basis, as required by Section 1502 of the IRS Code.

The Company was not following the repayment due date terms contained in their Tax Allocation Agreement, in violation of Section 607.1601(2), FS and Rule 4-143.047(1)(d), FAC.

The Company was not reporting tax payments to their parent on Schedule Y, Part 2 of the Annual Statement, in violation of Rule 4-137.001(4), FAC.

Furniture and Equipment

The Company did not maintain an agreement to govern the allocation of furniture and equipment expenses among the affiliates.

Management Agreement

The Company had a Management Agreement with Mercury Insurance Services, LLC (MIS). MIS agreed to manage all of the duties that the Company deemed necessary for the complete operation of the Company. Some of the duties in the Agreement included issue and underwrite insurance, settle and adjust any and all losses and claims, prepare records, perform all operating functions, pay operating expenses, including rent, salaries and phone expense.

The Company was not adhering to the terms of the Agreement because the Company's reinsurer was performing duties specified as being the duties of MIS, in violation of Rule 4-143.047(1), FAC. The reinsurance contract did not direct the reinsurer to perform these duties.

MGA Agreement

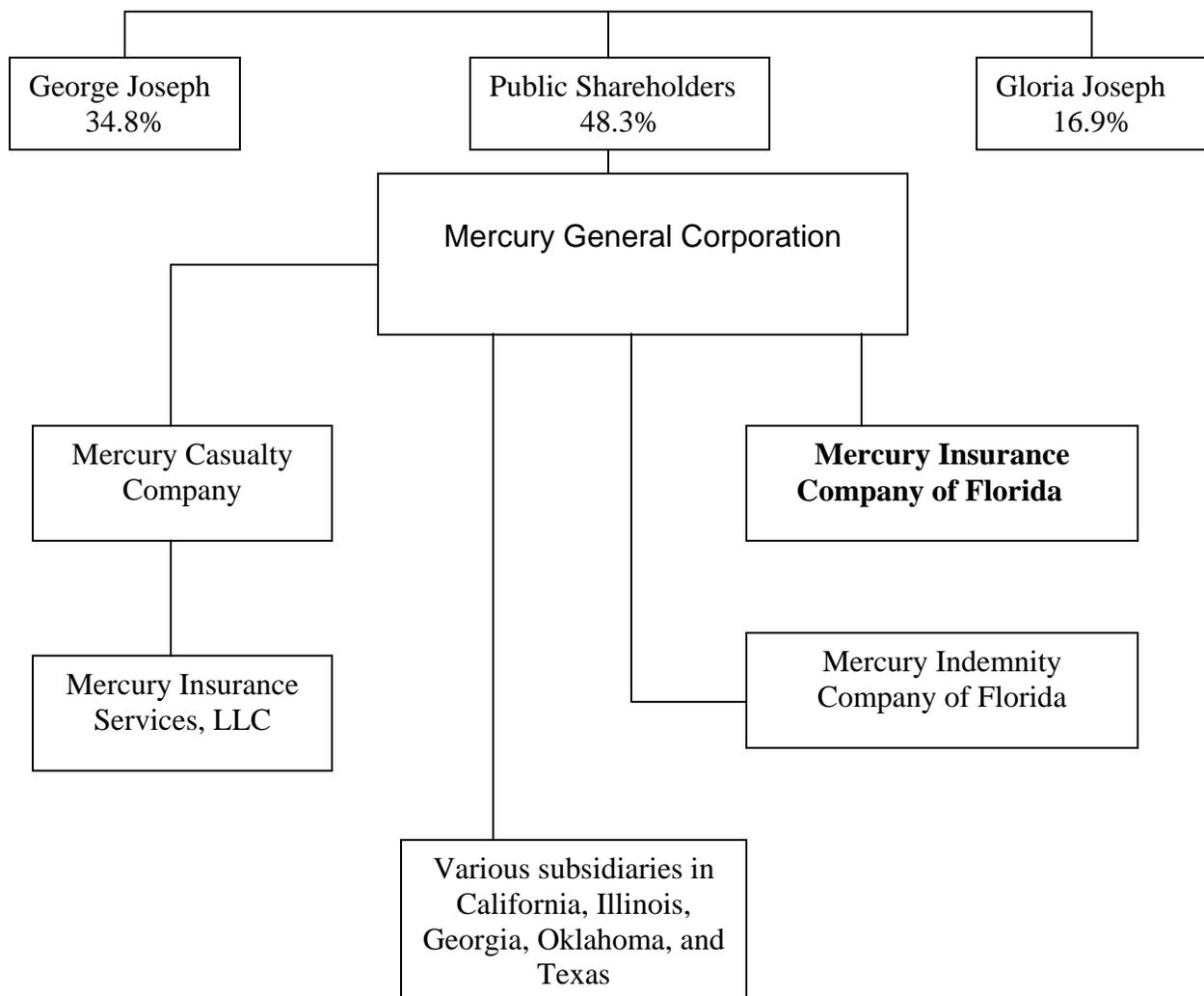
The Company maintained a Managing General Agency Agreement (MGA) with Mercury Group, Inc. (MGI). The Agreement stated the MGA's duties and responsibilities would include, but not be limited to, marketing and sales, underwriting, premium auditing, premium recovery, invoicing and receipts processing, claims administration, safety and loss prevention and policy issuance.

The Agreement stated MGI would perform invoicing and receipts processing. The premiums were in fact being collected by, and deposited into the account of Mercury Casualty Company

(MCC). A contract did not exist to provide MCC the authority to collect premiums on behalf of the Company. MCC was not acting in a fiduciary capacity in violation of the Department of Financial Services (DFS) Consent Order 43811-01-CO (11)(e), in violation of Section 624.444(1)(d), FS.

An organizational chart as of December 31, 2002 reflecting the holding company system, is shown below. Schedule Y of the Company's 2002 annual statement did not provide a list of all related companies of the holding company group, in violation of Rule 4-137.001(4), FAC.

**MERCURY INSURANCE COMPANY OF FLORIDA
ORGANIZATIONAL CHART
DECEMBER 31, 2002**



FIDELITY BOND AND OTHER INSURANCE

The Company maintained fidelity bond coverage up to \$2,500,000 with a deductible of \$100,000, which adequately covered the suggested minimum amount of coverage for the Company as recommended by the NAIC.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Company's employees were paid by MIS and reimbursed by the Company. Company management stated that no benefits were provided by the Company to these employees.

STATUTORY DEPOSITS

The following securities were deposited with the State of Florida as required by Section 624.411, FS, and with various state officials as required or permitted by law:

State	Description	Par Value	Market Value
FL	US TNOTE 5%, 08/15/11	<u>\$ 350,000</u>	<u>\$ 383,796</u>
TOTAL FLORIDA DEPOSITS		<u>\$ 350,000</u>	<u>\$ 383,796</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

There was no current market conduct examination by the Office. An examination was performed on MCC, who is assuming all of the Company's business and servicing all claims on that business for the period January 1999 through June 2001. The examination was completed at the regional office in Clearwater, Florida. The exceptions noted in the issued report did not affect the solvency of the Company.

Territory and Plan of Operation

The Company was authorized to transact insurance in Florida only, in accordance with Section 624.401(2), FS.

Treatment of Policyholders

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

The Company maintained a claims procedure manual that included detailed procedures for handling each type of claim.

REINSURANCE

The reinsurance agreement reviewed complied with NAIC standards with respect to the standard insolvency clause and arbitration clause. The agreement's reporting and settlement information deadlines were insufficient. The reinsurance agreement did not address reports of premiums and losses and did not contain specific due dates for payment of losses no less frequently than on a quarterly basis (depending on activity) per SSAP No. 62, Paragraph (8)(d), which effected the determination of transfer of risk. Timing risk in regard to the receipt and payment of cash flows could not be determined because the agreement did not have specific terms for payments and receipts of premiums; but did include that such shall be deemed due 30 days after the date of transmittal of the initial billing. Hence the agreement was not in compliance with SSAP No. 62, Paragraph 9; however, pursuant to SSAP No. 62, paragraph 15, insignificant risk is retained by the Company; therefore, the Company is considered indemnified against loss or liability relating to insurance risk. The agreement's deficiencies did not have a material effect on the Company's financial statements.

Assumed

The Company did not assume any business.

Ceded

The Company ceded all risk on a quota share basis to MCC. 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 Company's original reinsurance contract was amended to add additional lines of business including Other Liability, Commercial Auto Liability, Commercial Physical Damage and Commercial Multi-Peril.

The reinsurance contract was reviewed by the Company's appointed actuary and was utilized in determining the ultimate loss opinion.

The contract does not contain the required elements for transfer of risk, therefore the Company should report their reinsurance as deposit accounting in all future annual and quarterly statements; or amend the agreement to transfer risk.

ACCOUNTS AND RECORDS

An independent CPA audited the Company's statutory basis financial statements annually for the years 2001 and 2002, in accordance with Section 624.424(8), FS. Supporting work papers were prepared by the CPA as required by Rule 4-137.002, FAC.

The Company's accounting records were maintained on a computerized system. The Company's balance sheet accounts were verified with the line items of the annual statement submitted to the Office, except where noted in this report.

The Company maintained its principal operational offices in Clearwater, Florida, where this examination was conducted. The Company's accounting office was located in Los Angeles, California, in violation of Section 628.271(1), FS.

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 4-143.042(1), FAC.

Independent Auditor Agreement

The Company maintained a contract with an external CPA to perform the annual audit, in compliance with Section 624.424(8), FS.

Risk-Based Capital

The Company reported its risk-based capital at an adequate level.

IT Report

Computer Aid, Inc. performed a computer systems evaluation on the Company. Results of the evaluation were noted in the Information Technology (IT) Report provided to the Company. A summary of those findings were as follows:

Major initiatives in disaster recovery and the renovations of the data center are scheduled to be implemented over the next few months. When these are in place the system of IT controls at Mercury will be adequate.

The IT examiners had numerous recommendations for the Company including, but not limited to:

1. IT department should have a written strategic plan
2. Consideration should be given to consolidating all IT resources under one organization
3. Consideration should be given to formalizing sponsor signoff prior to release and to collecting satisfaction feedback after change in controls
4. A User Satisfaction Survey should be sent to appropriate user community
5. Complete planned renovations to the data center as soon as possible
6. Inventory of IT assets should be conducted and asset tags affixed to equipment.
7. Sensitive written procedures should be reviewed on a schedule basis
8. Consider creating a cross-functional Security Incident Response Team
9. Formal penetration tests should be run at least once a year by an independent third party

FINANCIAL STATEMENTS PER EXAMINATION

The following pages contain financial statements showing the Company's financial position as of December 31, 2002, 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
Analysis of Assets

DECEMBER 31, 2002

Classification	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$4,835,875		\$4,835,875
Cash:			
On deposit	57,052		57,052
Short term investments	10,208,658		10,208,658
Agents' balances:			
Due in course of collection	310,542		310,542
Reinsurance recoverable	2,860,896		2,860,896
FIT Recoverable	0		0
Interest & dividend income due	36,647		36,647
Receivable from parent, subsidiary	7,643,448		7,643,448
Aggregate write-ins for other invested assets	25,300		25,300
Totals	<u>\$25,978,418</u>	<u>\$0</u>	<u>\$25,978,418</u>

MERCURY INSURANCE COMPANY OF FLORIDA
Liabilities, Surplus and Other Funds
DECEMBER 31, 2002

Liabilities	Per Company	Examination Adjustments	Per Examination
Losses	\$0		\$0
Loss adjustment expenses	0		0
Commissions payable, contingent commission and other similar charges	1,644,521		1,644,521
Taxes, licenses and fees	123,677		123,677
Federal and foreign income taxes	15,000		15,000
Ceded reinsurance premiums payable	7,268,159		7,268,159
Funds held by company under reinsurance treaties	1,280,648		1,280,648
Drafts outstanding	273,779		273,779
Payable to parent, subsidiaries and affiliates	<u>256,182</u>		<u>256,182</u>
Total Liabilities	\$10,861,966		\$10,861,966
Common capital stock	\$1,000		\$1,000
Gross paid in and contributed surplus	14,999,000		14,999,000
Unassigned funds (surplus)	<u>116,450</u>		<u>116,450</u>
Surplus as regards policyholders	<u>\$15,116,450</u>		<u>\$15,116,450</u>
Total liabilities, capital and surplus	<u>\$25,978,416</u>	\$0	<u>\$25,978,416</u>

MERCURY INSURANCE COMPANY OF FLORIDA

**Statement of Income
DECEMBER 31, 2002**

Premiums earned	\$0
DEDUCTIONS:	0
Losses incurred	0
Loss expenses incurred	0
Other underwriting expenses incurred	\$11,239
Aggregate write-ins for underwriting deductions	0
Total underwriting deductions	<u>\$11,239</u>
Net underwriting gain or (loss)	(\$11,239)

Investment Income

Net investment income earned	\$157,335
Net realized capital gains or (losses)	(8,355)
Net investment gain or (loss)	<u>\$148,980</u>

Other Income

Total other income	<u>\$0</u>
Net income before dividends to policyholders and before federal & foreign income taxes	\$0
Dividends to policyholders	0
Net Income, after dividends to policyholders, but before federal & foreign income taxes	\$137,741
Federal & foreign income taxes	<u>51,000</u>
Net Income	<u><u>\$86,741</u></u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2001	\$7,029,709
---	-------------

Gains and (Losses) in Surplus

Net Income	\$86,741
Net unrealized capital gains or losses	0
Change in net deferred income tax	0
Change in non-admitted assets	0
Capital changes: Paid in	8,000,000
Cumulative effect of changes in accounting principles	0
Examination Adjustment	0
Change in surplus as regards policyholders for the year	<u>\$8,086,741</u>
Surplus as regards policyholders, December 31, 2002	<u><u>\$ 15,116,450</u></u>

COMMENTS ON FINANCIAL STATEMENTS

Assets

Cash \$57,052

The Company was not maintaining all of its assets in Florida. The Company was maintaining its cash in a California bank, Bank of America, in violation of Section 628.271(2), FS. Premiums were being collected by MCC and deposited into MCC's account without the benefit of a contract agreeing to these services and in violation of DFS Consent Order No. 43811-01 – CO.

Agents' Balances \$310,542

As provide in DFS Consent Order 43811-01-CO(11)(e), an affiliate shall hold all funds collected on behalf of or for the Company as well as all return premiums received from the Company in a fiduciary capacity in trust accounts. MCC did not hold premiums collected in a fiduciary capacity in violation of the Company's Consent Order.

Aggregate Write-ins for Other Than Invested Assets \$25,300

The Company reported Advance Premiums and premium transactions incorrectly on the line item for Aggregate Write-ins for Other Than Invested Assets, in violation of Rule 4-137.001(4)(a), FAC.

Liabilities

Losses and Loss Adjustment Expenses \$0

The actuarial firm appointed by the Board of Directors rendered an opinion that the amounts carried in the balance sheet as of December 31, 2002, for MCC, make a reasonable provision for

all unpaid loss and loss expense obligations of the MCC under the terms of its policies and agreements.

The Office actuary reviewed work papers provided by the Company and rendered an opinion, which agreed with the outside actuarial firm.

Other Expenses

\$0

The Company did not accrue Other Expenses on the Annual Statement, in violation of Section 625.041(4), FS. Adjustments were not made to Surplus as reported on the Annual Statement due to the immateriality of the dollar amounts of those adjustments.

MERCURY INSURANCE COMPANY OF FLORIDA
Comparative Analysis of Changes in Surplus

DECEMBER 31, 2002

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 per December 31, 2002, Annual Statement	\$15,116,450
---	--------------

	<u>PER</u> <u>COMPANY</u>	<u>PER</u> <u>EXAM</u>	<u>INCREASE</u> <u>(DECREASE)</u> <u>IN SURPLUS</u>
ASSETS:			
	\$0	\$0	\$0
LIABILITIES:			
	\$0	\$0	\$0
Net Change in Surplus:			0
Surplus as Regards Policyholders December 31, 2002, Per Examination			\$15,116,450

SUMMARY OF FINDINGS

Current examination comments and corrective action

The following is a brief summary of items of interest and corrective action to be taken by the Company regarding findings in the examination as of December 31, 2002.

General

The Company did not disclose all payments to its parent, MGC, under their tax allocation agreement on Schedule Y, Part 2 of the Annual Statement. **The Company is directed to comply with Rule 4-137.001(4)(a), FAC, and report all tax payments on Schedule Y, Part 2, as required by the NAIC's Annual Statement Instructions, adopted by the State of Florida in all future filings of the quarterly and annual statements.**

The Company did not report Mercury Group Inc., an affiliate, on its Annual Statement organizational chart, Schedule Y, Part 2, in violation of both Rule 4-137.001(4)(a), FAC, and also the Annual and Quarterly Reporting Requirement of NAIC's Annual Statement Instructions. **The Company is directed to report all insurer members of a holding company system and controlled groups in all future filings of the quarterly and annual statements.**

The Company's By-laws incorrectly stated the Company was exempt from maintaining records in Florida in accordance with Section 628.281, FS. **The Company is directed to comply with Section 628.271, FS and DFS Consent Order No. 43811-01-CO, Section (12) and (2) which states that every domestic insurer shall have an office in this state and shall keep therein complete records of its assets, transactions, and affairs, specifically including: (a) Financial**

records and (d) Access to all accounting transactions and access in this state, upon demand by the Department, to all original accounting documents. The Company is directed to amend their By-laws to correct Section 9.07 and to provide documentation of compliance to the Office within 90 days after the report is issued.

The Company was unable to provide the original stock ledger book. The Company is directed to comply with Section 607.1601(3), FS which states that a corporation or its agent shall maintain a record of its shareholders in a form that permits preparation of a list of names and addresses of all shareholders in alphabetical order by class showing the number and series of shares held by each. The Company is to provide documentation of compliance to the Office within 90 days after the report is issued.

The Company did not maintain individual officer and director Conflict of Interest Statements. The Company is directed to comply with Rule 4-138.001(1), FAC which states that the NAIC Financial Handbook is hereby adopted, which states, per Part 1, Section IV, the examiner shall review conflict of interest statements from management and directors. The Company is directed to comply with Section 607.0832, FS and submit their related party contracts or other transactions for review and approval to the Board of Directors. The Company is to provide documentation of compliance to the Office within 90 days after the report is issued.

The Company had various findings regarding their IT systems. The Company is directed to present a plan of action to correct the deficiencies in their systems and to provide documentation of compliance to the Office within 90 days after the report is issued.

Management

The Company did not maintain an audit committee. **The Company is directed to comply with Section 624.424(8)(c), FS which states that the board shall establish an audit committee of three or more directors of the insurer or an affiliated company and to provide documentation of compliance to the Office within 90 days after the report is issued.**

Management Agreements

The Company was not paying estimated and final tax payments on schedule per the terms of their Tax Allocation Agreement with MGC. **The Company is directed to comply with Section 607.1601(2), FS which states that a corporation shall maintain accurate accounting records and Rule 4-143.047(1)(d), FAC which states that material transactions by registered insurers with their affiliates shall be subject to the following standards: (d) The books, accounts and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the precise nature and details of the transactions including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties. The Company is directed to follow the terms of their tax allocation agreement in all future periods.**

The Company's reinsurer (MCC) was collecting and depositing the Company's premiums into their own bank account. The reinsurance agreement did not authorize MCC to collect and deposit the Company's premiums. MCC was not handling premiums in a fiduciary capacity. **The Company is directed to comply with DFS Consent Order 43811-01-CO, Section (11) which states that any arrangement or agreement with an affiliated party for the provision of administrative services shall be evidenced by a written contract, and Section (11)(e) which states that the affiliate shall hold all funds collected on behalf of or for the**

Company as well as all return premiums received from the Company in a fiduciary capacity in trust accounts.

Subsequent event: On February 13, 2004, the Company provided evidence that the premiums are now deposited in a Company account rather than an MCC account.

Reinsurance

The Company's Quota Share Reinsurance Contract does not address reports of premiums and losses, and did not contain specific due dates for payment of losses, no less frequently than on a quarterly basis. Timing risk in regard to the receipt and payment of cash flows could not be determined because the agreement did not have specific terms for payments and receipts of premiums; but did include that such shall be deemed due 30 days after the date of transmittal of the initial billing. Hence the agreement was not in compliance with SSAP No. 62, Paragraph 9, but the agreement's deficiencies did not have a material effect on the Company's financial statements.

The Company is directed to comply with SSAP No. 62 and Section 624.610, FS by amending the reinsurance agreement and any similar subsequent agreements, to address reports of premiums and losses; and to contain specific due dates for payment of losses; and to provide a copy of such amended agreements to the Office within 90 Days after the report is issued.

The Company did not maintain an agreement to govern the allocation of furniture and equipment expenses among the affiliates. **The Company is directed to enter into an agreement with its affiliates sharing such expenses, specifying terms of payment and method of allocation; and to provide documentation of compliance to the Office within 90 days after the report is issued.**

Cash

The Company was not maintaining their cash balance in a Florida bank. **The Company is directed to comply with Section 628.271(2), FS, and maintain its assets in the State of Florida.**

Subsequent event: On February 13, 2004, the Company provided copies of bank statements evidencing their cash is now held in a Florida account.

Aggregate Write-ins for Other Than Invested Assets

The Company was incorrectly reporting Advance premiums and premium transactions on line 25 page 2 of the Annual Statement. **The Company is directed to correctly report account balances on all future annual and quarterly statement filings.**

Other Expenses

The Company did not accrue general office expenses for 2002. **The Company is directed to comply with Section 625.041 (4) , FS which states that in any determination of the financial condition of an insurer, liabilities to be charged against its assets shall include: Taxes, expenses, and other obligations due or accrued at the date of the statement. The Company is directed to correctly report account balances on all future annual and quarterly statement filings.**

CONCLUSION

The customary 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, 2002, consistent with the insurance laws of the State of Florida.

Per examination findings, the Company's surplus as regards policyholders was \$15,116,450, which was in compliance with Section 624.408, FS.

In addition to the undersigned, Mary James, CFE, Financial Examiner/Analyst Supervisor and Doug Haseltine, Actuary, participated in the examination.

Respectfully submitted,

Miriam Bleakley
Financial Examiner/Analyst II
Florida Office of Insurance Regulation