REPORT OF EXAMINATION
OF THE
WESTERN GENERAL INSURANCE COMPANY
AS OF
DECEMBER 31, 2016

Filed June 26, 2018

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Los Angeles, California
May 30, 2018

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 as of December 31, 2011. This examination covered the period from January 1, 2012 through December 31, 2016.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report, but separately communicated to other regulators and/or the Company.

COMPANY HISTORY

The Company was incorporated on August 11, 1971, under the laws of California. It began business on July 10, 1973. The Company is a privately held property and casualty insurer with an underwriting focus on specialty dealer-originated and agent/broker produced non-standard automobile insurance.

Dividends

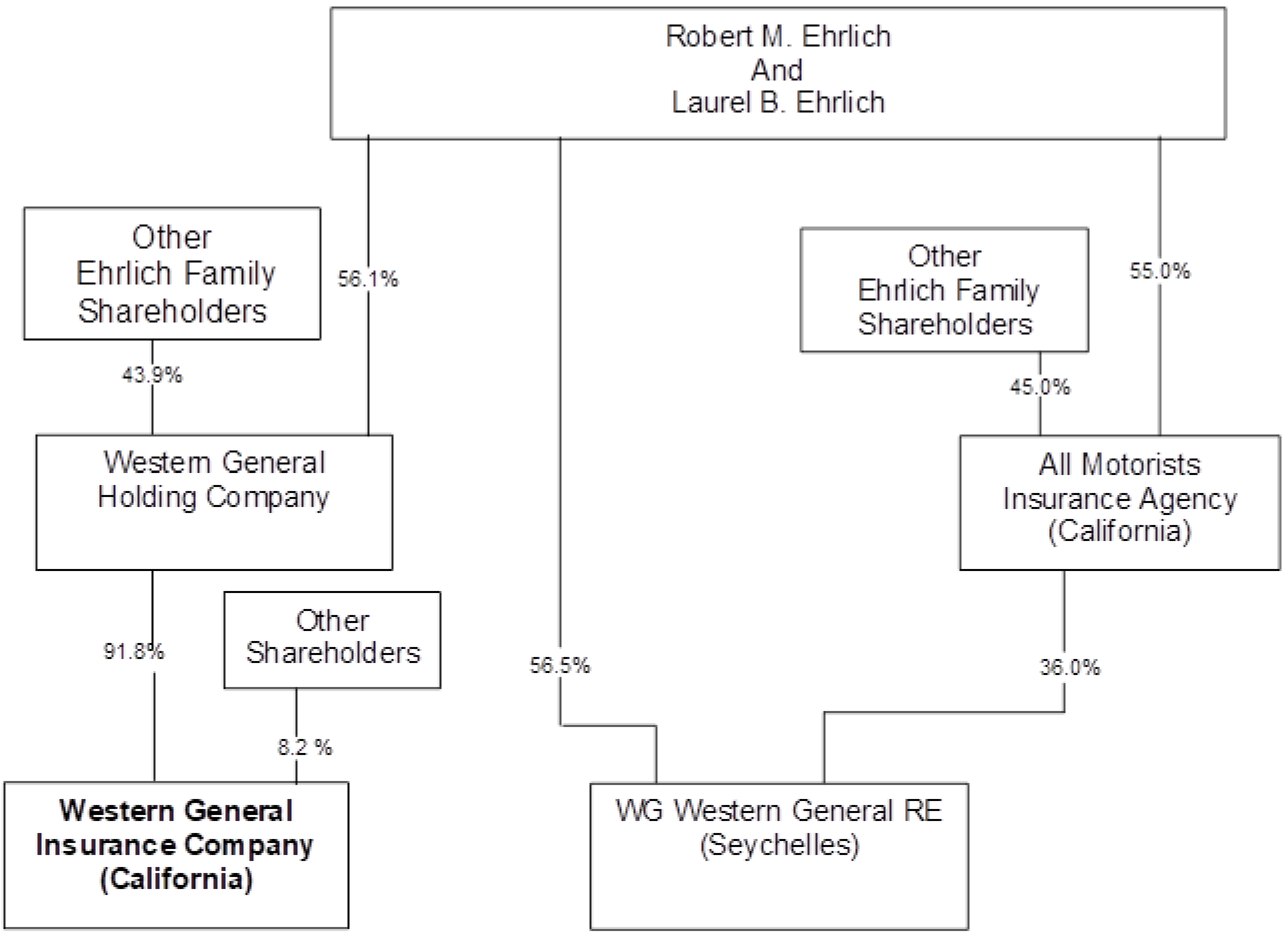
During the examination period, the Company paid ordinary dividends to the shareholders in the form of preferred stock which are as follows:

Year	**Paid**
2012	$343,575
2013	$230,360
2014	$196,756

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which Robert M. Ehrlich and Laurel B. Ehrlich are the ultimate controlling persons.

The following abridged organizational chart depicts the Company's relationship within the holding company group as of December 31, 2016:



The eight 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 of the Company serving at December 31, 2016:

Directors

Name and Location	Principal Business Affiliation
John L. Albanese Thousand Oaks, California	Chief Financial Officer and Treasurer Western General Insurance Company
Laurel B. Ehrlich Westlake Village, California	Director of Human Resources Western General Insurance Company
Robert M. Ehrlich Westlake Village, California	Chairman of the Board, President and Chief Executive Officer Western General Insurance Company
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
Justin M. Martin Simi Valley, California	Product Development Manager Western General Insurance Company
Denise M. Tyson Sherman Oaks, California	Chief Operating Officer and Executive Vice President Western General Insurance Company

Principal Officers

Name	Title
Robert M. Ehrlich	Chairman of the Board, President, and Chief Executive Officer
Daniel Mallut	General Counsel and Executive Vice President

Name	Title
John L. Albanese	Chief Financial Officer and Treasurer
Denise M. Tyson	Chief Operating Officer and Executive Vice President
Marleen Kushner	Secretary

The Company's by-laws state that the maximum number of directors is seven. The Company's filed 2016 Annual Statement Jurat page noted eight members on the Board. The Company is not in compliance with its by-laws. It is recommended that the Company comply with its by-laws.

Management Agreements

Policy Administration and Claims Handling Agreement: Effective April 5, 2012, the Company is a party to a General Agent Services Agreement (Agreement) with All Motorist Insurance Agency (AMIA), an affiliate. Under this agreement, AMIA has the authority to process policies and claims and collect premiums on behalf of the Company. AMIA retains out of the premiums collected 100% of all policy fees for each automobile extended warranty, automobile liability or property damage policy it issued, unless the premiums are produced by a General Agent in which case, AMIA will only retain its portion of the policy fees. In addition, the Company pays a claim-servicing fee to AMIA for each loss processed on its behalf. The California Department of Insurance (CDI) approved the agreement in March of 2012. For years 2012, 2013, 2014, 2015, and 2016, the total fees paid to AMIA under the agreement were $6,929,701, $6,985,588, $8,201,083, $10,897,526, and $14,705,272, respectively.

Cost Sharing Allocation Agreement: Effective August 15, 2006, a Cost Sharing Allocation Agreement (Agreement) was executed between the Company and various affiliates who share office expenses and other administrative and support services. Allocation of costs is determined based on actual time spent performing services through a two week timesheet study performed annually. The CDI approved the

Agreement in July 2006. For years 2012, 2013, 2014, 2015, and 2016, the shared costs allocated to the Company were $2,443,656, $2,300,292, $2,322,062, $1,511,964, and $1,292,958, respectively.

Tax Allocation Agreement: Effective January 1, 2005, the Company has been part of the consolidated federal income tax return with its parent, Western General Holding Company. Under the terms of the Tax Allocation Agreement (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. The CDI approved the Agreement in January of 2011.

TERRITORY AND PLAN OF OPERATION

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

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

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 "point of sale" program and includes physical damage and liability coverages. The option to continue coverage beyond the 30-day period is also offered to the insureds. The agent/broker produced business is written for 6-month and 12-month terms.

In 2000, the Company, began writing non-standard private passenger automobile in California. It has become the Company's largest business segment.

As of December 31, 2016, the Company had $112.4 million in total direct premiums. The major lines of business are automobile physical damage of $59.1 million (52.6%), private passenger automobile liability of $48.1 million (42.8%), commercial automobile liability of $5.0 million (4.4%), and warranty of $0.2 million ($0.2%).

The Company's business is geographically concentrated in its domestic state of California. For 2016, $97.3 million (86.6%), $7.8 million (7.0%), $4.6 million (4.1%), and $1.8 million (1.7%) of the Company's direct business was produced in California, Texas, Utah, and Arizona, respectively. All Motorists Insurance Agency (AMIA), it's affiliated managing general agency, produced business through 1,208 producers and 11 finance companies. Cartel, a general agent appointed by the Company, produced business through 616 automobile dealerships in 2016. Carnegie General Insurance Agency, appointed by the Company in 2012, produced business through 969 producers in 2016. Stonewood Insurance Services, a general agent appointed by the Company in 2013, produced its business in 2016 through 116 producers. Sun Coast General Insurance Agency, appointed by the Company in 2014, produced business through 336 producers in 2016. The gross written premium of $146,434,140 in 2016 reported by the Company was produced mainly through the following five general agents: AMIA accounted for 49.4%, Carnegie for 19.8%, Cartel for 17.2%, Stonewood for 8.0%, and Sun Coast for 5.4%.

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 lines of business. The amendment was approved by the CDI on April 30, 2013. The Company has not written any rental coverage as of the exam date.

GROWTH OF COMPANY

Year	Direct Premiums Written		Gross Premium Written		Net Premium Written	
	Amount	% Growth	Amount	% Growth	Amount	% Growth
2012	$ 50,912,111		$ 53,250,389		$ 34,857,166	
2013	$ 47,391,646	-6.91%	$ 52,077,418	-2.20%	$ 34,015,176	-2.42%
2014	$ 59,593,659	25.75%	$ 69,279,098	33.03%	$ 47,819,901	40.58%
2015	$ 71,201,334	19.48%	$ 86,330,598	24.61%	$ 54,554,228	14.08%
2016	$ 112,387,163	57.84%	$ 146,434,140	69.62%	$ 58,981,288	8.11%

The Company has experienced rapid growth in its gross and direct premiums written for the last four years ranging from $52 million in 2013 to $146.4 million in 2016 for gross written premium and $47.3 million in 2013 to $112.3 million in 2016 in direct premiums written. The increase in gross premiums is primarily due to a 100% quota share arrangement for business assumed in Texas, which accounted for $34 million of the gross premium written. Also, with competitors exiting the non-standard automobile market, the Company has experienced a significant increase in the direct written premiums of 58% for 2016.

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 general agents Laredo and Cartel. The Company pays 3% of premiums collected as a ceding commission plus premium taxes to Home State County Mutual Insurance Company. As noted in the "Growth of Company" section above, the assumed reinsurance premium totaled $34 million for 2016.

Ceded

Maiden Reinsurance Company

Effective January 1, 2014, the Company ceded 40% of its private passenger automobile business (excluding Cartel), and 45% of its business produced through the Finance Program to Maiden Reinsurance Company (Maiden Re). The Company increased the 40% ceded to Maiden Re for private passenger automobile business (excluding Cartel) to 50% on January 1, 2015; 60% on January 1, 2016, 75% on July 1, 2016; and 80% on October 1, 2016.

Maiden Re calculates the sliding scale commissions and reports the adjusted commission after 6 months from the end of each agreement year, and after the end of each subsequent 12-month period thereafter until all losses are settled. Maiden Re pays a provisional ceding commission of 23% of all premiums ceded. The sliding scale commission for January 1, 2015 to December 31, 2016 is listed as follows:

Loss Ratio	**Adjusted Commission Rate**
>79%	16.50%
<79% but equal to or greater than 72.50%	16.50% plus the difference in percentage points between 79% and the actual loss ratio.
<72.50% but greater than 67%	23% plus the difference in percentage points between 72.50% and the actual loss ratio.
≤67% but equal to or greater than 72.50%	28.50%

Qatar Reinsurance Company, LTD

The Company also cedes 100% of its business produced by Sun Coast General Insurance Agency to Qatar Reinsurance Company, LTD (Qatar Re). Qatar Re is an unauthorized Bermuda based reinsurer; however, the cession is secured by a Letter of Credit. As of December 31, 2016, the Company was not in compliance with California Insurance Code 922.5 (b) in regards to providing a Letter of Credit satisfactory to the commissioner that covers reinsurance recoverables from Qatar Reinsurance Company, LTD (Qatar Re). It was recommended that the Company use the Letter of Credit for Reinsurance Form acceptable to the California Commissioner published in California Code of Regulations (CCR) Title 10, Chapter 5, Subsection 3, Article 3 § 2303.22. During 2018, the Company complied by providing an updated Letter of Credit that covers reinsurance recoverables from Qatar Re acceptable with CCR Title 10, Chapter 5, Subsection 3, Article 3 § 2303.22.

The following is a summary of the principal ceded reinsurance treaties in-force as of December 31, 2016:

Line of Business and Type of Contract	Reinsurer's Name	Company's Retention	Reinsurer's Limit
Quota Share:			
80% quota share on Private Passenger Automobile Physical Damage & Liability excluding Cartel	Maiden Reinsurance Company (Authorized)	20% each automobile loss occurrence	80% with $1M limit on Automobile Physical Damage for all risks in any loss occurrence
45% quota share on Private Passenger Automobile Physical Damage on Finance Program	Maiden Reinsurance Company (Authorized)	55% each automobile loss occurrence	45% with $750K limit for all risks in any loss occurrence
100% quota share on Sun Coast business	Qatar Reinsurance Company, LTD. (Unauthorized)	No retentions	100%

ACCOUNTS AND RECORDS

California Insurance Code (CIC) Section 734 states that every company or person from whom information is sought, and its officers, directors, employees, and agents, shall provide to the examiners appointed pursuant to this article, timely, convenient, and free access at all reasonable hours at its offices to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the company being examined. The Company was not in compliance with CIC Section 734. During the course of this examination, the Company failed to timely provide, or failed to provide the requested examination information and documents. It is recommended that the Company implement procedures to comply with CIC Section 734.

CIC Section 735 states that the Company must inform the Board members of the receipt of the examination report; both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the Commissioner, and enter that fact in the board minutes. A review of the board minutes did not disclose that the officially filed 2011 examination report nor the first formally prepared draft report by the examiners were presented to the Board. It is also recommended that the Company comply with CIC Section 735.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance, and present the financial condition of the Company for the period ending December 31, 2016. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements, and should be considered an integral part of the financial statements.

Statement of Financial Condition as of December 31, 2016

Underwriting and Investment Exhibit for the Year Ended December 31, 2016

Reconciliation of Surplus as Regards Policyholders from December 31, 2011 through December 31, 2016

Analysis of Changes to Surplus as of December 31, 2016

Statement of Financial Condition
as of December 31, 2016

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 20,555,406	$	$ 20,555,406	
Common stocks	2,389,404		2,389,404	
Cash and short-term investments	11,213,224		11,213,224	
Investment income due and accrued	290,025		290,025	
Premiums and agents' balances in course of collection	12,445,808		12,445,808	
Premiums, agents' balances and installments booked but deferred and not yet due (including $0 earned but unbilled premiums)	30,152,522		30,152,522	
Amount recoverable from reinsurers	3,591,299		3,591,299	
Net deferred tax asset	6,245,306	5,633,313	611,993	
Receivables from parent, subsidiaries and affiliates	1,644,630		1,644,630	
Aggregate write-ins for other than invested assets	139,697	139,697	0	
Total assets	$ 88,667,321	$ 5,773,010	$ 82,894,311	
Liabilities, Surplus and Other Funds				
Losses and loss adjustment expenses			$ 16,526,031	(1)
Commissions payable, contingent commissions and other similar charges			625,658	
Other expenses			531,832	
Taxes, licenses and fees			1,916,612	
Federal and foreign income taxes			33,866	
Unearned premiums			13,053,050	
Ceded reinsurance premiums payable			29,695,717	(2)
Funds held by company under reinsurance treaties			402,129	
Total liabilities			62,784,895	
Common capital stock		$ 3,105,000		
Preferred capital stock		7,640,000		
Gross paid-in and contributed surplus		1,226,000		
Unassigned funds (surplus)		8,366,216		
Less treasury stock at cost:				
552 shares common (value included in above common stock		227,800		
Surplus as regards policyholders			20,109,416	
Total liabilities, surplus and other funds			$ 82,894,311	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2016

Statement of Income

Underwriting Income		
Premiums earned		$ 60,088,755
Deductions:		
Losses and loss expenses incurred	$ 35,373,403	
Other underwriting expenses incurred	25,263,883	
Total underwriting deductions		60,637,286
Net underwriting loss		(548,531)
Investment Income		
Net investment income earned	$ 680,664	
Net realized capital gain	46,904	
Net investment gain		727,568
Other Income		
Aggregate write-ins for miscellaneous income	$ 1,733	
Total other income		1,733
Net income before dividends to policyholders, after capital gains tax and before federal and foreign income taxes		180,770
Net income after dividends to policyholders, after capital gains tax and before federal and foreign income taxes		180,770
Federal and foreign income taxes incurred		12,202
Net income		$ 168,568

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2015		$ 19,166,830
Net income	$ 168,568	
Change in net unrealized capital gains	162,025	
Change in net deferred income tax	(168,765)	
Change in nonadmitted assets	780,758	
Change in surplus as regards policyholders for the year		942,586
Surplus as regards policyholders, December 31, 2016		$ 20,109,416

Reconciliation of Surplus as Regards Policyholders from December 31, 2011 through December 31, 2016

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2011			$ 27,833,482
Net loss	$	$ 5,904,607	
Net unrealized capital loss		388,637	
Change in net deferred income tax	2,895,703		
Change in nonadmitted assets		3,155,635	
Dividends to stockholders		967,805	
Aggregate write-ins for gains and losses in surplus		203,085	
Total gains and losses	$ 2,895,703	$ 10,619,769	
Net decrease in surplus as regards policyholders			(7,724,066)
Surplus as regards policyholders, December 31, 2016			$ 20,109,416

Analysis of Changes to Surplus as of December 31, 2016

As a result of the examination, the following adjustment was made to the Company's reported balance sheet item. Ceded reinsurance premiums payable was increased due to an increase in booked ceded ultimate loss ratios used for calculating the sliding scale contingent commission of the quota share agreement with Maiden Reinsurance Company. The sum of the effect on surplus is shown below:

	Increase	Decrease	
Surplus as regards policyholders, December 31, 2016, per Annual Statement		$	20,809,416
Ceded reinsurance premiums payable		(700,000)	
Net increase or (decrease)			(700,000)
Surplus as regards policyholders, December 31, 2016, after adjustment			$ 20,109,416

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance (CDI), the Company's loss and loss adjustment expense reserves as of December 31, 2016 were found to be within reasonable range given what was known as of year-end 2016.

(2) Ceded reinsurance premiums payable

Based on an analysis by a Casualty Actuary from the CDI, the captioned liability was determined to be deficient by $700,000. The deficiency was due to the increase in booked ceded loss ratios and the sliding scale calculation of contingent commission of the quota share agreement with Maiden Reinsurance Company.

SUBSEQUENT EVENTS

Loss and Loss Adjustment Expense Reserves

A Casualty Actuary from the California Department of Insurance (CDI) reviewed the 2016 and 2017 Annual Statements along with the 2016 and 2017 Actuarial Opinions and supporting Actuarial Reports prepared by the Company's opining actuary. Based on the review it was determined that there was additional loss and loss adjustment expense (LAE) development during 2017 of $3.5 million for accident year 2016 which the Company recognized.

Contingent Commissions

It was determined that the Company calculates commission adjustments based on ceded case incurred loss and LAE ratios rather than ultimate loss and LAE ratio, and does not properly reflect a provision for contingent commissions on its financial statement related to the quota-share reinsurance agreement with Maiden Reinsurance Company (Maiden Re). A calculation of the contingent commission portion of the Company's quota-share reinsurance agreement with Maiden Re indicated that an additional $5.9 million in reinsurance commissions for accident year 2016 and prior will be payable to the reinsurer subsequent to December 31, 2016.

In addition, for treaty year 2017, the Company reported contingent ceding commission at the maximum rate of 28.5% due to the exclusion of Incurred But Not Reported (IBNR) loss and LAE reserves. Accordingly, there will be contingent commission payable due for treaty year 2017 to appropriately reflect the inclusion of the IBNR loss and LAE reserves in the contingent commission calculation.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – (Page 3): The Company's filed 2016 Annual Statement Jurat page listed eight members of the Board of Directors which is not in compliance with its by-laws. It is recommended that the Company comply with its b-laws.

Accounts and Records (Page 10): It is recommended that the Company implement procedures to comply with CIC Section 734, in regards to providing access to its books and records. It is also recommended that the Company comply with CIC Section 735.

Previous Report of Examination

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

ACKNOWLEDGMENT

Respectfully submitted,

____/s/_______________________

Ralph Oseguera, AFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

_____/s/______________________

Grace Asuncion, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California