

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION
of

**Farmers Insurance Company of Washington
Mercer Island, Washington**

NAIC CODE 21644
DECEMBER 31, 2006

Order No. 08-102
Farmers Insurance Company
of Washington
Exhibit A

SALUTATION

Seattle, Washington
June 30, 2008

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building-Capitol Campus
302 Sid Snyder Avenue SW, Suite 200
Olympia, WA 98504

The Honorable Alfred W. Gross, Commissioner
Chair, NAIC Financial Condition (E) Committee
Virginia Bureau of Insurance
Commonwealth of Virginia
PO Box 1157
Richmond, VA 23219

The Honorable Morris Chavez, Superintendent
Secretary, NAIC Western Zone
New Mexico Insurance Division
PO Drawer 1269
Santa Fe, NM 87501

The Honorable Steve Poizner, Commissioner
California Department of Insurance
300 Capitol Mall, Suite 1700
Sacramento, CA 95814

Dear Commissioners and Superintendent:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Farmers Insurance Company of Washington

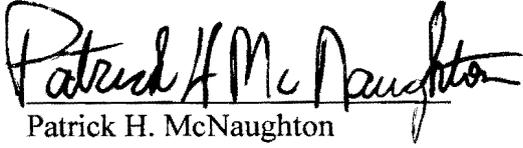
of

Mercer Island, Washington

hereinafter referred to as "FICOWA" or the "Company," at the location of its home office, 3003 77th Avenue SE, Mercer Island, Washington 98040-2890. This report is respectfully submitted showing the condition of the Company as of December 31, 2006.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Farmers Insurance Company of Washington of Mercer Island, Washington. This report shows the financial condition and related corporate matters as of December 31, 2006.



Patrick H. McNaughton
Chief Examiner

6-30-08

Date

TABLE OF CONTENTS

SCOPE OF EXAMINATION.....	1
INSTRUCTIONS.....	1
COMMENTS AND RECOMMENDATIONS.....	4
COMPANY PROFILE	4
HISTORY AND CAPITALIZATION	4
TERRITORY AND PLAN OF OPERATION	4
GROWTH OF COMPANY	5
AFFILIATED COMPANIES	5
INTER-COMPANY CONTRACTS	6
MANAGEMENT AND CONTROL	7
OWNERSHIP	7
DIRECTORS.....	8
OFFICERS.....	8
CONFLICT OF INTEREST	8
FIDELITY BOND AND OTHER INSURANCE	8
OFFICERS', EMPLOYEES', AND AGENTS' WELFARE AND PENSION PLANS.....	9
CORPORATE RECORDS	9
UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES	9
REINSURANCE.....	10
STATUTORY DEPOSITS.....	10
ACCOUNTING RECORDS AND INFORMATION SYSTEMS	10
SUBSEQUENT EVENTS	11
FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS	11
FINANCIAL STATEMENTS	11
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS	12
STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT	13
RECONCILIATION OF SURPLUS FOR THE PERIOD SINCE LAST EXAMINATION	14
ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS RESULTING FROM THE EXAMINATION	15
NOTES TO THE FINANCIAL STATEMENTS.....	16
ACKNOWLEDGMENT.....	17
AFFIDAVIT.....	18

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2004 through December 31, 2006 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

This examination was classified as a coordinated lead state examination of the property and casualty insurance companies of Farmers Insurance Group (FIG), holding company, hereinafter referred to as the Farmers Group. California was designated the lead state of the coordinated examination and examiners from the states of Washington and California participated and assessed the financial condition and corporate affairs of the affiliated companies in the Farmers Group.

INSTRUCTIONS

The examiners reviewed the Company's filed 2006 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review

1. Security Lending Collateral

The Company incorrectly included security lending collateral and established a liability for the collateral of \$19,448,004 within Aggregate write-ins for invested assets and Aggregate write-ins for liabilities, respectively. In accordance with paragraph 56 of SSAP No. 91 (Accounting for Transfers and Servicing Assets and Extinguishments Liabilities), the Company should not reflect the collateral in the Company's balance

sheet as an asset, and should not establish a liability for the return of the collateral when the pledged collateral is not available for the general use (restricted).

The collateral is not available for general use (restricted) according to the Company's security lending agreement with Bank of New York per the Approved Investment clause. Based upon SSAP No. 91, paragraph 56, the collateral for securities lending and the liability for the collateral balance should be zero. (See Note No. 1 to the Financial Statements.)

The Company is instructed to comply with RCW 48.05.073 and SSAP 91 by not reflecting the collateral in the Company's balance sheet as an asset, and by not establishing a liability for the return of the collateral.

2. Annual Statement Errors

The results of the examination disclosed several instances in which the Company's filing of the 2006 NAIC Annual Statement did not conform to the AP&P and the NAIC Annual Statement Instructions. These are as follows:

a. Post Retirement Benefits

The Company incorrectly included post retirement benefits obligations totaling \$1,073,014 within Aggregate write-ins for liability. This amount should be classified as Other expenses according to the NAIC Annual Statement Instructions. (See Note No. 2 to the Financial Statements.)

b. General Interrogatories

The Company incorrectly answered Interrogatory 21.1 of the General Interrogatories - Investment by not revealing the Company's participation in securities lending in the amount of \$19,448,004. As a result, the Company did not provide the amount of securities loaned to others required in Interrogatory 21.21. In addition, the Company did not designate which securities were lent using the designation "LS" in column 3 of Schedule D.

The Company is instructed to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

3. Custodial Agreement Deficiencies

Although the Company responded in its 2006 NAIC Annual Statement General Interrogatories, 24.01, that its custodial agreement with JPMorgan Chase Bank (JPMorgan) complied with the FCEH, it did not contain several provisions required by the FCEH. In addition, the Company's undisclosed custodial agreement with the Bank of New York (BNY) did not contain all provisions required by the FCEH.

JPMorgan Chase Bank, N.A. Custodial Agreement

- The agreement does not state that securities shall be withdrawable upon demand of the Company.

BNY Securities Lending Agreement

- The agreement does not state that the Company's account is labeled in the name of the Company, nor does it state that the Company's securities are held by BNY and separately identified on BNY's records as being owned by the Company.
- The agreement does not state that securities, other than those held to meet deposit requirements, are able to be withdrawn upon demand by the Company.
- The agreement does not require BNY to reimburse the Company for losses caused by BNY's ordinary negligence or employee misconduct.
- The agreement does not require BNY to promptly replace the securities or the value of securities and the value of any loss of rights or privileges resulting from securities loss for which BNY is obligated to indemnify the Company.
- The agreement states that BNY is not liable for acts beyond its control whereas the FCEH requires the term reasonable control. The agreement also erroneously includes BNY's inability to obtain labor, material, equipment, services, or transportation as being beyond BNY's control. The FCEH does not define these scenarios as being beyond a custodian's reasonable control.
- The agreement does not require BNY to enter into a written agreement subjecting the agent to the same liability as BNY for the loss of securities in the event BNY gains entry into a clearing corporation through an agent.
- The agreement does not require BNY to provide written notice to the OIC within three business days if the custodial agreement has been terminated or if 100% of the account assets in any one custodial account have been withdrawn.
- The agreement does not require that an independent accountant selected by the Company and the OIC be allowed to examine BNY's records relating to the Company's securities upon reasonable notice.
- The agreement does not require BNY and its agents, upon reasonable request, to send to the Company all internal control reports received from a clearing corporation, or reports prepared by BNY's outside auditors.
- The agreement does not require BNY to maintain records sufficient to verify certain information relied upon by the Company in preparation of its annual statement and supporting schedules.

- The agreement does not require BNY to provide, upon written request from the OIC or the Company, the appropriate affidavits with respect to the Company's securities held by BNY.
- The agreement does not require BNY to secure and maintain insurance protection in an adequate amount.
- The agreement does not require loaned securities to be held by a qualified custodian under RCW 48.13.450(6).

The Company is instructed to comply with RCW 48.05.250 by filing a true annual statement. The Company is instructed to follow the NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). The Company is instructed to correct all of the deficiencies noted above and to execute a revised or amended custodial agreement.

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

History and Capitalization

The Company was incorporated under the laws of the state of Washington on July 14, 1970 as a stock insurer. It received its Certificate of Authority on July 28, 1970 and commenced business on October 31, 1970. The Company became a member of a holding company system on April 20, 1992 through the filing of an Insurance Holding Company System Registration Statement with the OIC. The Company has no subsidiaries.

Authorized capital of the Company is \$650,000, consisting of 6,500 shares of common stock with a par value of \$100. All authorized shares were issued and outstanding as of December 31, 2006. The stock is owned by affiliated California domiciled companies, as follows:

	<u>Percentage</u>	<u>Shares</u>
Fire Insurance Exchange	80	5,200
Truck Insurance Exchange	<u>20</u>	<u>1,300</u>
Total	<u>100</u>	<u>6,500</u>

Territory and Plan of Operation

The Company's authorized lines of business are: property, marine and transportation, general casualty, and vehicle and surety.

Approximately 95 percent of the business written by the Company was homeowners, auto liability, and auto physical damage insurance. Sales operations of the Company are conducted through approximately 1,197 field agents who are appointed as independent contractors to represent the Company. District managers are independent contractors appointed for the purpose of recruiting and training new agents and providing liaison and advisory services between the Company and the agents.

Growth of Company

The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below:

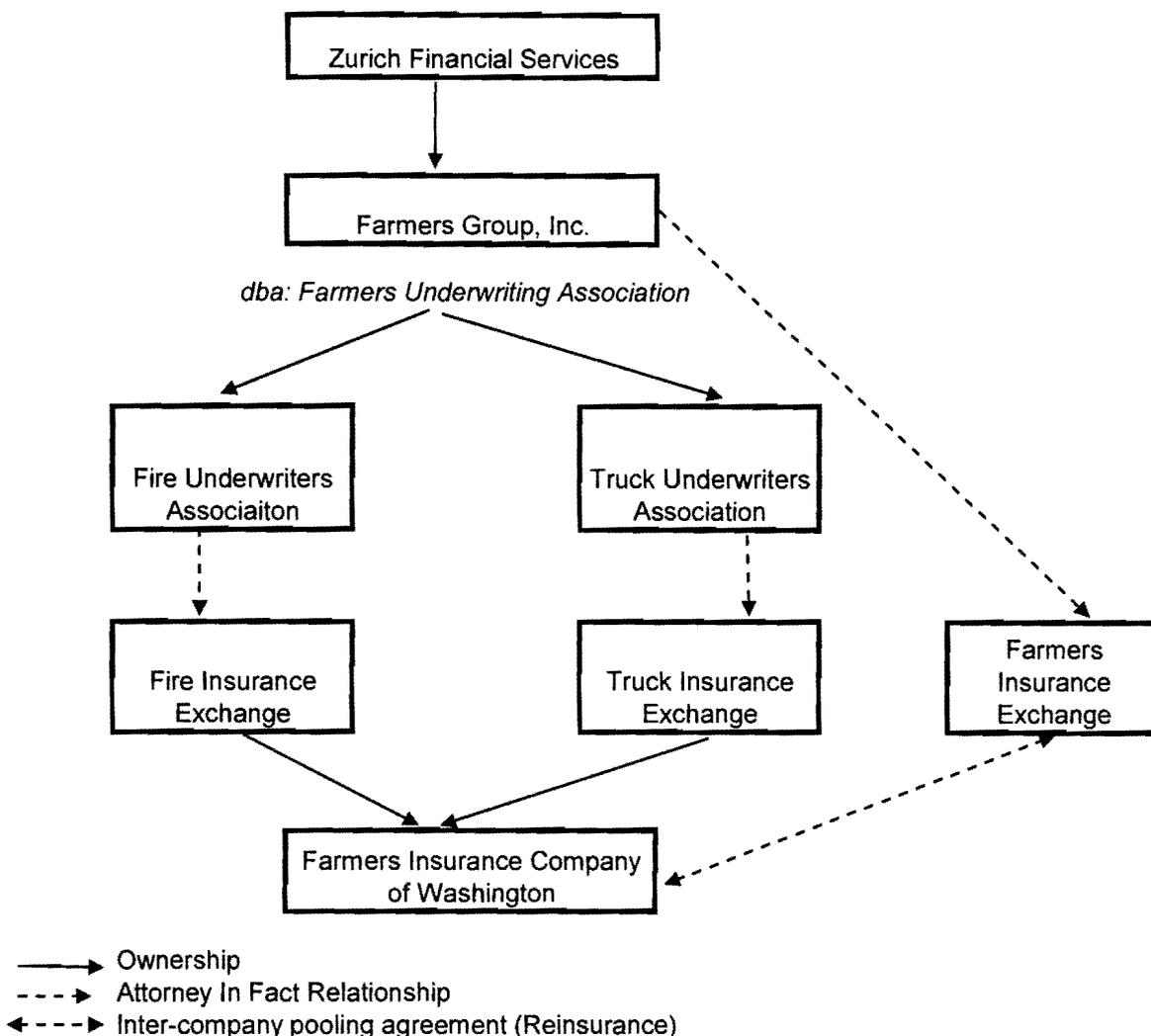
<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2006	\$477,245,919	\$330,205,603	\$147,040,316
2005	438,949,466	307,733,098	131,216,368
2004	342,874,292	224,918,092	117,956,200

<u>Year</u>	<u>Premiums Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gains (Losses)</u>	<u>Net Income</u>
2006	\$227,817,823	\$9,504,101	\$14,572,699	\$15,015,935
2005	209,237,764	9,261,454	12,801,666	15,032,148
2004	186,181,107	10,770,739	13,194,861	9,238,466

Affiliated Companies

The Company is a member of the Farmers Property and Casualty companies (Farmers P&C companies), headquartered in Los Angeles, California. The Farmers P&C companies are comprised of Farmers Insurance Exchange (FIE), Fire Insurance Exchange (FIRE), Truck Insurance Exchange (TRUCK), their respective insurance subsidiaries, Farmers Texas County Mutual Insurance Company, Foremost County Mutual Insurance, Foremost Lloyds of Texas, and Farmers Reinsurance Company (Farmers Re). The Company is directly controlled by FIRE, which owns 80% of the Company's outstanding common stock. TRUCK owns the remaining 20% of the Company's common stock.

The following is an abbreviated organizational chart:



Inter-company Contracts

The following inter-company contracts were in-force as of December 31, 2006:

- **Inter-company Reinsurance Agreement.**

The Company and fourteen members of the Farmers P&C companies participate in an inter-company reinsurance agreement in which they share in the net premiums and ultimate loss of affiliates. FIE is the lead company. Members of the agreement cede all of their direct and assumed personal business to FIE, which then retrocedes a share of the business back to the participants according to their respective participation percentages.

The fifteen companies of the Farmers P&C companies that participated in the inter-company reinsurance pooling agreement and their respective percentages of participation as of December 31, 2006 were:

<u>Company Name</u>	<u>Pooling Percentage</u>
Farmers Insurance Exchange	51.75%
Fire Insurance Exchange	7.50
Mid-Century Insurance Company	16.00
Truck Insurance Exchange	7.75
Farmers New Century Insurance Company	0.75
Texas Farmers Insurance Company	1.00
Illinois Farmers Insurance Company	0.75
Farmers Insurance Company, Inc.	0.75
Farmers Insurance Company of Idaho	0.75
Farmers Insurance Company of Oregon	7.00
Farmers Insurance Company of Washington	2.00
Farmers Insurance of Columbus, Inc.	1.00
Civic Property and Casualty Company	1.00
Exact Property and Casualty Company	1.00
Neighborhood Spirit Property and Casualty Company	<u>1.00</u>
Total	<u>100.00%</u>

- **Management Services Agreement**

FGI provides operating and management services to FIE in its capacity as the attorney-in-fact of FIE, in accordance with the subscription agreement between FIE and its members. All claim adjusting services are performed by employees of FIE. Expenses for claim adjusting, operational, and management services are then allocated from FIE to FICOWA.

- **Agreement of Allocation of Payment of Federal Income Taxes**

The Company's federal income tax return is filed on a consolidated basis with FIRE. The tax liability is allocated to the participants of the tax return based upon the liability or refund that would be produced under separate return calculations. Any expense or benefit so derived is recognized in the Company's current year tax provision. Inter-company tax balances are settled monthly based on estimates with the final settlement made annually within 45 days after the return has been filed.

MANAGEMENT AND CONTROL

Ownership

Management of the Company is vested in a Board of Directors (BOD) made up of not less than five and not more than nine members as provided for by the Company's Bylaws. The BOD and the stockholders meet in March of every year. Directors may, but need not be, stockholders. A majority of the directors constitutes a quorum for the transaction of business.

Directors

Directors as of December 31, 2006:

Susan Marie Bithell
James Innes Randolph
Paul Norman Hopkins
Robert Preston Simmons, Jr.
John Patrick McCoy
Pierre Christopher Wauthier
Constantine Paul Patsis

Officers

Officers as of December 31, 2006:

<u>Name</u>	<u>Title</u>
Susan Marie Bithell	President
John Patrick McCoy	Treasurer
James Innes Randolph	Secretary
Paul Norman Hopkins	Vice President
Bryan Francis Murphy	Vice President
Constantine Paul Patsis	Vice President
Keitha Tullos Schofield	Vice President
Stanley Ray Smith	Vice President
Pierre Christopher Wauthier	Vice President
Kevin Eugene Kelso	Vice President
Ronald Gregory Myhan	Vice President
Mhayse Gokul Samalya	Vice President
Robert Preston Simmons, Jr.	Vice President
Warren Benjamine Tucker	Vice President
Frank Robert Woudstra	Vice President

Conflict of Interest

The Company has a policy whereby members of the BOD and employees are required to sign a conflict of interest statement each year. The purpose of the statement is to detect any activities or participation on the part of an employee that could possibly be interpreted as having a conflict of interest. No such conflicts were noted during the last three years.

Fidelity Bond and Other Insurance

The Company is a named insured, along with other members of the Farmers P&C companies, on fidelity bonds and other types of corporate insurance policies. The aggregate

limit of coverage under the fidelity bond was \$15 million as of December 31, 2006, which exceeded the NAIC recommended minimum coverage.

Officers', Employees', and Agents' Welfare and Pension Plans

The Company has no employees. All administrative functions of the Company are performed by employees of FGI. Claims processing is handled by employees of FIE. Employees of FGI and FIE are covered under the Company's noncontributory pension plan. Substantially all employees who have reached the age of 21 and rendered one year of service are covered under the plan.

The Company has two profit sharing plans. The Deferred Profit Sharing Plan is limited to 10% of pretax earnings, as adjusted, or a maximum of 15% of the annual salary or wages paid or accrued to the eligible employee and provides for an annual payment by the Company to a trust for eventual payment to employees as provided in the plan. The Cash Profit Sharing Plan provides for annual cash distributions limited to 5% of pretax earnings, as adjusted, or 5% of the annual salary or wages paid or accrued to the eligible employee.

CORPORATE RECORDS

The examiners reviewed the corporate records of FICOWA for the period under examination. The minutes of meetings of stockholders, directors, and committees were documented, approved and supported the Company's transactions and events. All BOD meetings were conducted with a quorum present.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The reserve carried by the Company for Unpaid Losses was \$110,038,361 and the reserve for Loss Adjustment Expenses was \$31,142,493 as of December 31, 2006.

Because the business of the Farmers P&C companies is pooled, it was necessary to review the loss and loss adjustment expense reserves on a group-wide basis. American Actuarial Consulting Group, LLC (AACG) was retained by the California Department of Insurance (CDI) to conduct a review and provide an opinion on the loss and loss adjustment expense reserves carried by FIE, and other pooled companies, as of December 31, 2006.

The CDI actuary reviewed the aforementioned actuarial work performed and determined that the pooled loss and loss adjustment expenses reserves, for all members of the pool, were within a reasonable range as of December 31, 2006.

REINSURANCE

The Company is affiliated with a number of the Farmers P&C companies, which are subsidiaries of the ultimate parent, Zurich Financial Services. As such, the Company is party to a 1970 reinsurance assumption agreement, whereby FIE, an affiliated entity, assumes all of FICOWA's net retained liability. FICOWA is also a party to a 1999 inter-company reinsurance agreement which is a pooling agreement where the Company, FIE, and various other affiliates of the Farmers P&C companies cede all of their business in force to FIE, which in turn retrocedes a stipulated portion of the pooled business back to each participating company. Under this pooling agreement, FICOWA receives a 2% share of the pooled business.

Under the above agreements, the Company shares its liabilities with all other members of the pool. Therefore, it is substantially protected from its own unique exposures, but is also exposed to a portion of those from the other pooled companies. Although FIE has various reinsurance agreements with outside reinsurers and its affiliates, the Company is not party to any other reinsurance agreements on a direct basis. As of December 31, 2006, the Company had unsecured, undisputed reinsurance recoverables of \$556.6 million for paid and unpaid losses, IBNR, LAE, and unearned premiums.

STATUTORY DEPOSITS

The Company maintained no statutory deposits during the examination period.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on an accrual Statutory Accounting Principles (SAP) basis. The Company is audited annually by the CPA firm of PricewaterhouseCoopers (PwC). The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The examination of FICOWA's Information Systems (IS) and controls was performed in conjunction with the CDI's examination of FIE and the participating pooling companies as of December 31, 2006. CDI contracted with Ernst & Young (E&Y) to review certain general IS controls of FIE as of December 31, 2006.

The E&Y review covered the following general IS controls surrounding the systems and applications that support the following significant business cycles:

- Premiums
- Losses and Benefits

- Reinsurance
- Investments
- Administration
- Financial Reporting
- Salary, Wages and Employee Benefits

For purposes of the examination of FICOWA, the examiners relied upon the review and summary reports of the E&Y audit as of December 31, 2006. The review of the internal controls for the significant business cycles was sufficient to provide assurance that appropriate controls have been implemented in accordance with NAIC guidelines.

SUBSEQUENT EVENTS

There were no material events adversely impacting the Company between the examination date and the last day of our fieldwork.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

The Company did not modify its custodial agreement with BNY to include all provisions required by FCEH as instructed during the prior examination of the Company. (See Instruction No. 2)

FINANCIAL STATEMENTS

Statement of Assets, Liabilities, Surplus and Other Funds
Statement of Income and Capital and Surplus Account
Reconciliation of Capital and Surplus since the last Examination
Analysis of Changes in Financial Statements Resulting from the Examination

FARMERS INSURANCE COMPANY OF WASHINGTON
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
DECEMBER 31, 2006

	<u>BALANCE PER</u> <u>COMPANY</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>	<u>NOTES</u>
Assets				
Bonds	\$305,424,366	\$0	\$305,424,366	
Stocks:				
Preferred stocks	545,730		545,730	
Cash and short-term investments	34,656,871		34,656,871	
Other invested assets	906,913		906,913	
Aggregate write-ins for invested assets	<u>19,448,004</u>	<u>(19,448,004)</u>	<u>0</u>	1
Subtotal, cash and invested assets	<u>360,981,884</u>	<u>(19,448,004)</u>	<u>341,533,880</u>	
Investment income due and accrued	2,928,780		2,928,780	
Premiums and considerations				
Uncollected premiums and agents' balances in course of collection	9,107,884		9,107,884	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	60,154,209		60,154,209	
Accrued retrospective premium	147,258		147,258	
Amounts recoverable from reinsurers	32,560,053		32,560,053	
Net deferred tax asset	10,105,381		10,105,381	
Guaranty funds receivable or on deposit	168,915		168,915	
Aggregate write-ins for other than invested assets	<u>1,091,555</u>		<u>1,091,555</u>	
Total Assets	<u><u>\$477,245,919</u></u>	<u><u>(\$19,448,004)</u></u>	<u><u>\$457,797,915</u></u>	
Liabilities, Surplus and other Funds				
Losses	\$110,038,361	\$0	\$110,038,361	
Reinsurance payable on paid losses and loss adjustment expenses	11,033,415		11,033,415	
Loss adjustment expenses	31,142,493		31,142,493	
Other expenses (excluding taxes, licenses and fees)	0	1,073,014	1,073,014	2
Taxes, licenses and fees (excluding federal and foreign income taxes)	1,086,399		1,086,399	
Unearned premiums	92,552,308		92,552,308	
Advance premiums	2,222,829		2,222,829	
Dividends declared and unpaid - Policyholders	60,000		60,000	
Ceded reinsurance premiums payable	28,322,318		28,322,318	
Remittances and items not allocated	39,070		39,070	
Payable to parent, subsidiaries and affiliates	29,844,542		29,844,542	
Aggregate write-ins for liabilities	<u>23,863,868</u>	<u>(20,521,018)</u>	<u>3,342,850</u>	1, 2
Total Liabilities	<u>330,205,603</u>	<u>(19,448,004)</u>	<u>310,757,599</u>	
Common capital stock	650,000		650,000	
Gross paid in and contributed surplus	143,223,500		143,223,500	
Unassigned funds (surplus)	3,166,816		3,166,816	
Surplus as regards policyholders	<u>147,040,316</u>	<u>0</u>	<u>147,040,316</u>	
Total Liabilities, Surplus and other Funds	<u><u>\$477,245,919</u></u>	<u><u>(\$19,448,004)</u></u>	<u><u>\$457,797,915</u></u>	

FARMERS INSURANCE COMPANY OF WASHINGTON
STATEMENT OF INCOME AND CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2006

STATEMENT OF INCOME	BALANCE PER COMPANY	EXAMINATION ADJUSTMENT	BALANCE PER EXAMINATION	NOTES
Underwriting Income				
Premiums earned	\$227,817,823	\$0	\$227,817,823	
Deductions				
Losses incurred	126,457,401		126,457,401	
Loss expenses incurred	25,746,502		25,746,502	
Other underwriting expenses incurred	66,109,818		66,109,818	
Aggregate write-ins for underwriting deductions	1		1	
Total underwriting deductions	218,313,722	0	218,313,722	
Net underwriting gain or (loss)	9,504,101	0	9,504,101	
Investment Income				
Net investment income earned	14,704,041		14,704,041	
Net realized capital gains or (losses)	(131,342)		(131,342)	
Net investment gain or (loss)	14,572,699	0	14,572,699	
Other Income				
Net gain from agents' or premiums balances charged off	(1,411,995)		(1,411,995)	
Finance and service charges not included in premiums	516,727		516,727	
Aggregate write-ins for miscellaneous income	(748,873)		(748,873)	
Total other income	(1,644,141)	0	(1,644,141)	
Net income before dividends to policyholders but before federal and foreign income taxes	22,432,660		22,432,660	
Dividends to policyholders	104,067		104,067	
Net income, after dividends to policyholders but before federal and foreign income taxes	22,328,593		22,328,593	
Federal and foreign income taxes incurred	7,312,658		7,312,658	
Net income	\$15,015,935	\$0	\$15,015,935	
CAPITAL AND SURPLUS ACCOUNT				
Surplus as regards policyholders, December 31 prior year	\$131,216,368	\$0	\$131,216,368	
Gains and (Losses) in Surplus				
Net income	15,015,935		15,015,935	
Change in net deferred income tax	1,262,567		1,262,567	
Change in nonadmitted assets	(881,191)		(881,191)	
Aggregate write-in for gains and losses in surplus	426,638		426,638	
Change in surplus as regards policyholders	15,823,948	0	15,823,948	
Surplus as regards policyholders, December 31 current	\$147,040,316	\$0	\$147,040,316	

**FARMERS INSURANCE COMPANY OF WASHINGTON
RECONCILIATION OF SURPLUS
FOR THE YEARS ENDED DECEMBER 31,**

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Capital and surplus, December 31, previous year	<u>\$131,216,368</u>	<u>\$117,956,200</u>	<u>\$107,087,046</u>
Net income	15,015,935	15,032,147	9,238,466
Change in net unrealized capital gains or (losses)		4,760	138,064
Change in net deferred income tax	1,262,566	(367,640)	1,652,168
Change in nonadmitted assets	(881,191)	(987,923)	62,720
Aggregate writ-ins for gains and losses in surplus	<u>426,638</u>	<u>(421,176)</u>	<u>(222,264)</u>
Change in surplus as regards policyholders for the year	<u>15,823,948</u>	<u>13,260,168</u>	<u>10,869,154</u>
Surplus as regards policyholders, December 31, current year	<u><u>\$147,040,316</u></u>	<u><u>\$131,216,368</u></u>	<u><u>\$117,956,200</u></u>

**FARMERS INSURANCE COMPANY OF WASHINGTON
ANALYSIS OF CHANGES IN FINANCIAL STATEMENT RESULTING FROM THE
EXAMINATION
DECEMBER 31, 2006**

	<u>Per Company</u>	<u>Per Examination</u>	<u>Notes</u>	<u>Increase (Decrease) in Surplus</u>	<u>Total</u>
Capital and surplus 12/31/2006 Per Annual Statement					\$147,040,316
Assets					
Aggregate writ-ins for invested assets	\$19,448,004	\$0	1	(\$19,448,004)	
Liabilities					
Other expenses (excluding taxes, licenses and fees)	0	1,073,014	2	(1,073,014)	
Aggregate writ-ins for liabilities	23,863,868	3,342,850	1, 2	<u>20,521,018</u>	
Change in surplus					<u>0</u>
Capital and Surplus, 12/31/2006 per examination					<u>\$147,040,316</u>

NOTES TO THE FINANCIAL STATEMENTS

1. Security Lending Collateral

The Company incorrectly included security lending collateral and the liability for the collateral of \$19,448,004 within Aggregate write-ins for invested assets and Aggregate write-ins for liabilities, respectively. In accordance with paragraph 56 of SSAP No. 91 (Accounting for Transfers and Servicing Assets and Extinguishments Liabilities), the Company should not reflect the collateral in the Company's balance sheet as an asset, and should not establish a liability for the return of the collateral when the pledged collateral is not available for the general use of the transferor (restricted).

Based upon SSAP No. 91, paragraph 56, the collateral for securities lending and the liability for the collateral balance should be zero. (See Instruction No.1.)

2. Inaccurate Classification of Post Retirement Benefits

The Company incorrectly misclassified post retirement benefits by including the balance of \$1,073,014 as part of Aggregate write-ins for liability. This amount should be classified as Other expenses according to the NAIC Annual Statement Instructions. (See Instruction No. 2.a.)

The Company has no special consents, permitted practices, or orders from the state of Washington.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examination team by the officers of Farmers Insurance Company of Washington during the course of this examination.

In addition to the undersigned, the following individuals participated in the examination and the preparation of this report: Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Tarik Subbagh, CPA, CFE, Examiner in Charge; Cynthia Clark, Insurance Examiner; and Ann Kauffman, Insurance Examiner.

Respectfully submitted,



Susan Campbell, CPA, CFE, FLMI
Supervising Examiner
State of Washington



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of)	No. 08-102
)	
The Financial Examination of)	FINDINGS, CONCLUSIONS,
FARMERS INSURANCE COMPANY)	AND ORDER ADOPTING REPORT
OF WASHINGTON)	OF EXAMINATION

A Domestic Insurer.

BACKGROUND

An examination of the financial condition of **FARMERS INSURANCE COMPANY OF WASHINGTON** (the Company) as of December 31, 2006, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of authority as a stock insurer. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and recommendations was transmitted to the Company for its comments on June 13, 2008. The Company's response to the report is attached to this order only for the purpose of a more convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and the submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 16 of the report.



CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **FARMERS INSURANCE COMPANY OF WASHINGTON** and to order the Company to take the actions described in the Instructions section of the report. The Commissioner acknowledges that the Company may have implemented some of the Instructions prior to the date of this order. The Instructions in the report are appropriate responses to the matters found in the examination.

ORDER

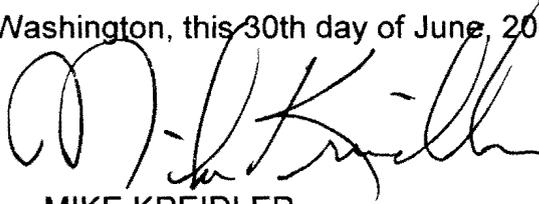
The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions contained in the examination report on pages 1-4.

1. The Company is ordered to comply with RCW 48.05.073 and SSAP 91 by not reflecting the collateral in the Company's balance sheet as an asset, and by not establishing a liability for the return of the collateral. Instruction 1, Examination Report, page 2.
2. The Company is ordered to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P. Instruction 2, Examination Report, page 2.
3. The Company is ordered to comply with RCW 48.05.250 by filing a true annual statement and to follow the NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). The Company is also ordered to correct all of the securities lending deficiencies and execute a revised or amended custodial agreement. Instruction 3, Examination Report, page 4.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Olympia, Washington, this 30th day of June, 2008.

A handwritten signature in black ink, appearing to read "Mike Kreidler". The signature is fluid and cursive, with a large initial "M" and "K".

MIKE KREIDLER
Insurance Commissioner



FARMERS

Farmers Insurance Co. of Washington
3003 77th Ave. SE
Mercer Island, WA 98040-2890

June 20, 2008

Mr. James T. Odiorne, CPA, JD
Deputy Insurance Commissioner
Company Supervision Division
Office of Insurance Commissioner
State of Washington
5000 Capitol Blvd
Tumwater, WA 98501

JUN 25 2008
INSURANCE COMMISSIONER
COMPANY SUPERVISION

**RE: 2006 Washington Department of Insurance Financial Examination of:
Farmers Insurance of Company of Washington ("FICO WA")**

Dear Mr. Odiorne:

We have received and reviewed the examination report for the above Washington domiciled company as of December 31, 2006 and wish to compliment the Department and the examiner on their thoroughness and cooperation. We acknowledge that the report contains certain recommendations and comments. We have carefully reviewed the report and respectfully submit the following responses to your findings.

1. Issue – Security Lending Collateral

The Company should not reflect the collateral securities lending in the Company's balance sheet as an asset, and should not establish a liability for the return of the collateral when the pledged collateral is not available for the general use of the transferor (restricted). The collateral for securities lending and the liability for the collateral balance should be zero. (See Instruction No. 1. a).

Response

FICO WA's Security Lending collateral is Unrestricted (and not restricted as implied in the report) and is the reason for reporting these items as an asset and liability in the 2006 statement. Per Section 56 of SSAP #53, "...if the collateral is available for the general use of the transferor (unrestricted), the collateral shall be recorded as an asset on the transferor's balance sheet and a separate liability shall be established on the transferor's balance sheet to record the obligation to return the collateral..."

The collateral is unrestricted and there is nothing in the existing agreement that precludes FICO WA from accessing and utilizing the funds. In fact, under the Investment cash collateral section of the agreement, it is stated that no additional authorization is required by the Bank in the investing of cash collateral. Accordingly, we properly classified the collateral for the securities lending as asset and established a liability for the return of the collateral. This treatment was disclosed in the notes to the 2006 Annual statement and also in line with the 2006 Audited financial statement. We recognize that the current agreement contains some ambiguity and have been working with the Bank involved to better clarify the terms of the agreement with respect to FICO WA's ability to draw on the cash collateral for any purpose.

In view of this, we propose that this issue be removed from the final report as it does not truly reflect the substance of FICO WA's Security lending collateral arrangement, or a language be added to the effect that the Company is currently in the process of working with the Bank involved to remove any ambiguity in the agreement and to clarify that the collateral is unrestricted. In addition, the company will ensure to report Company's participation in the security lending collateral program in the General Interrogatories and to also designate which securities were lent in Schedule D.

2. Issue – Post Retirement Benefits

The Company included the post retirement benefits as part of Aggregate write-ins for liability. This amount should be classified as Other expenses. (See Instruction No. 1. e).

Response

The balance reported here reflects FICO WA's pooled share of the post retirement benefits. This item is handled by FIE on behalf of all affiliates and any amount involved is settled as part of the monthly inter-company settlement process. However, we will continue to review this issue and make the necessary and appropriate changes as deemed.

As always, we appreciate your attention to this matter, and look forward to hearing from you. Let me know if you wish to discuss further and advice of any have any questions.

Sincerely,



Susan Bithell
President
Farmers Insurance Company of Washington

JH

Cc: Tarik Subbagh
Ron Myhan
Scott Ballew
Joseph Hammond
Carla Kimzey