

STATE OF WASHINGTON
OFFICE OF THE INSURANCE COMMISSIONER



FINANCIAL EXAMINATION
OF
FARMERS INSURANCE COMPANY OF WASHINGTON
MERCER ISLAND, WASHINGTON

NAIC CODE 21644
December 31, 2009

Participating States:
Washington
California

Farmers Insurance Company of Washington
Order No. 11-151
Exhibit A

SALUTATION

Seattle, Washington
June 21, 2011

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 Joseph Torti, III
Chair, NAIC Financial Condition (E) Committee
Superintendent
State of Rhode Island
Department of Business Regulation
Division of Insurance
1511 Pontiac Avenue, Building 69-2
Cranston, RI 02920

The Honorable Monica J. Lindeen
NAIC Secretary, Western Zone
Commissioner
Montana Office of the Commissioner of Securities and Insurance
840 Helena Avenue
Helena, MT 59601

Dear Commissioners and Superintendent:

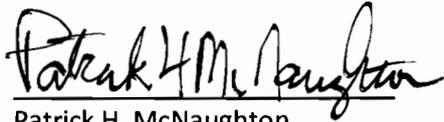
In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

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 Southeast, Mercer Island, Washington 98040. This report is respectfully submitted showing the financial condition and related corporate matters of FICOWA as of December 31, 2009.

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, 2009.



Patrick H. McNaughton
Chief Examiner

6-21-2011

Date

TABLE OF CONTENTS

SCOPE OF THE EXAMINATION	1
INSTRUCTIONS	1
COMMENTS AND RECOMMENDATIONS	2
COMPANY PROFILE	2
Company History	2
Capitalization	2
Territory and Plan of Operation	2
Growth of Company	2
Affiliated Companies	3
Inter-company Agreements.....	4
MANAGEMENT AND CONTROL	4
Board of Directors (BOD).....	4
Officers	4
Conflict of Interest.....	4
Fidelity Bond and Other Insurance	4
Officers', Employees', and Agents' Welfare and Pension Plans.....	5
CORPORATE RECORDS	5
UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES	5
REINSURANCE	6
STATUTORY DEPOSITS	6
ACCOUNTING RECORDS AND INFORMATION SYSTEM	7
SUBSEQUENT EVENTS	7
FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS	7
FINANCIAL STATEMENTS	7
Assets, Liabilities, Surplus and Other Funds.....	8
Statement of Income and Capital and Surplus Account.....	9
Three Year Reconciliation of Surplus.....	10
NOTES TO THE FINANCIAL STATEMENTS	11
ACKNOWLEDGMENT	12
AFFIDAVIT	13

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2007 through December 31, 2009 and comprises a risk focused review of the books and records of the Company. The examination followed 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 through the end of fieldwork on May 17, 2011.

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 performed in compliance with the 2009 NAIC FCEH which requires the examiner to consider the Company's risk management process, corporate governance structure, and control environment. The examiners utilized the information obtained during the examination to assess FICOWA's overall potential risks both currently and on an on-going basis, allowing the examiners to focus on the Company's greatest areas of risk, and providing assurance on the Company's financial statements as of the examination date.

This examination was classified as a coordinated lead state examination. 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 Company.

INSTRUCTIONS

The examiners reviewed the Company's filed 2009 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 outlined in the NAIC Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exception noted while performing this review:

1. Custodial Agreement

The Company responded in its 2009 NAIC Annual Statement, General Interrogatories, Question 26.01, that its custodial agreement with JP Morgan Chase Bank (JP Morgan) complied with the FCEH. However, the JP Morgan custodial agreement did not contain several provisions as required by the FCEH and RCW 48.13.480. RCW 48.05.250 requires a company to file a true statement of its financial condition, transactions, and affairs

The Company is instructed to execute a revised or amended custodial agreement that complies with the FCEH and RCW 48.13.480. The Company is also instructed to comply with RCW 48.05.250

by filing a true statement of its financial condition, transactions and affairs and to follow the NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2).

COMMENTS AND RECOMMENDATIONS

None

COMPANY PROFILE

Company History

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.

Capitalization

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, 2009. 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	100	6,500

Total capital and surplus as of December 31, 2009 was \$176,974,124.

Territory and Plan of Operation

The Company's authorized lines of business are: property, marine and transportation, general casualty, vehicle, and surety. Approximately 93 percent of the business written by the Company was homeowners multiple peril, private passenger auto liability, and auto physical damage insurance. Sales operations of the Company are conducted through approximately 1,243 agents who are appointed as independent contractors to represent the Company.

Growth of Company

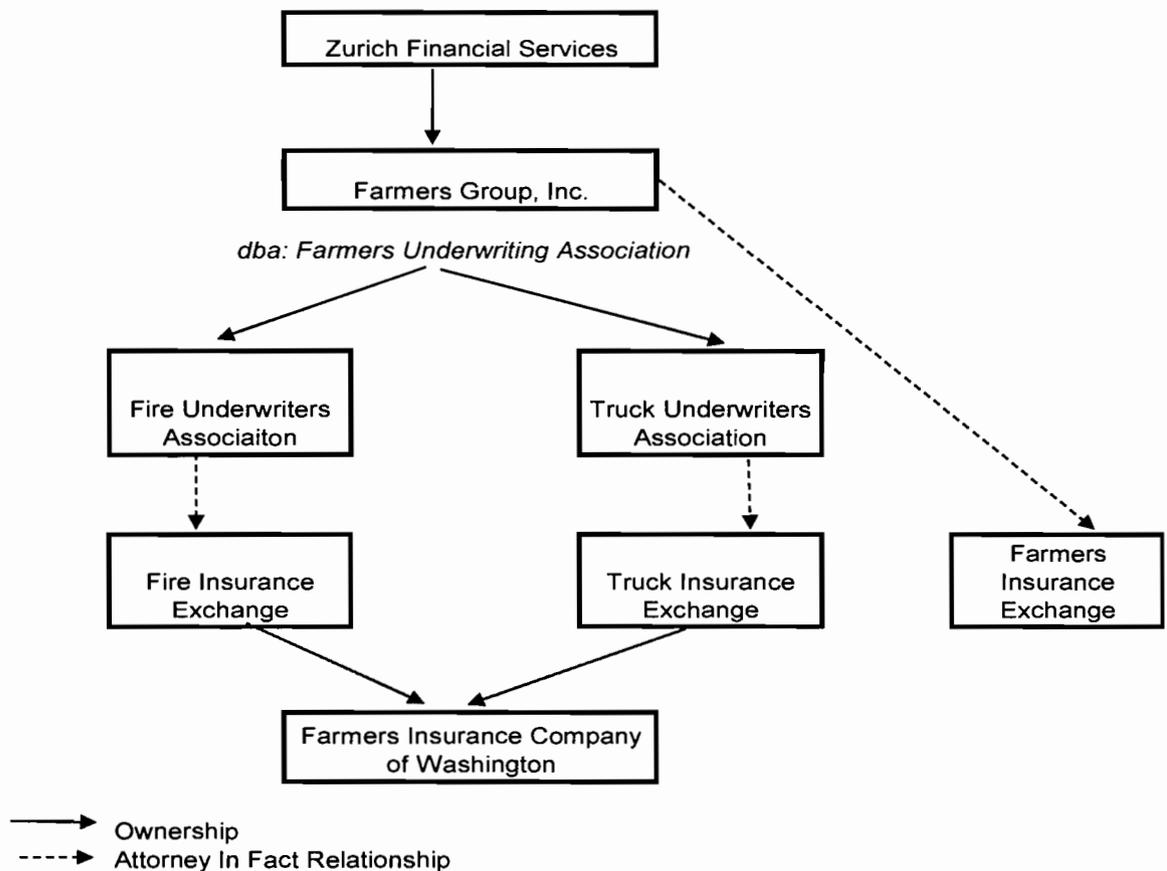
The following reflects the growth of the Company as reported in its filed NAIC Annual Statements for the three year period under examination:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2009	\$463,791,097	\$286,816,973	\$176,974,124
2008	487,964,607	323,634,979	164,329,628
2007	520,217,274	358,635,994	161,581,280

<u>Year</u>	<u>Premium Earned</u>	<u>Net Underwriting Gain (Loss)</u>	<u>Net Investment Gain (Loss)</u>	<u>Net Income</u>
2009	\$203,338,206	\$ 7,079,362	\$14,009,025	\$12,555,331
2008	244,320,993	(11,562,771)	15,334,510	4,328,802
2007	246,875,113	2,163,124	17,650,818	13,331,396

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, and several other insurers that are controlled by Farmers Group, Inc. (FGI). The Company is directly controlled by FIRE, which owns 80 percent of the Company's outstanding common stock. TRUCK owns the remaining 20 percent of the Company's common stock.



Inter-company Agreements

As of December 31, 2009, the Company had the following inter-company agreements in force, with the effective date indicated:

Reinsurance Assumption Agreement	October 1, 1970
Tax Sharing Agreement	May 1, 1995
1999 Inter-Company Reinsurance Agreement	January 1, 1999
Service Agreement	March 1, 2005

MANAGEMENT AND CONTROL

Board of Directors (BOD)

Directors of the Company as of December 31, 2009:

Susan M. Bithell
Jeffrey J. Dailey
Ronald G. Myhan
Constantine P. Patsis
James I. Randolph
Mhayse G. Samalya
Frank R. Woudstra

Officers

Officers of the Company as of December 31, 2009:

Susan M. Bithell	President
Frank J. Ceglar, Jr.	Vice President
Jeffrey J. Dailey	Vice President
Dan C. Dunmoyer	Vice President
Doren E. Hohl	Secretary
Scott R. Lindquist	Vice President
Bryan F. Murphy	Vice President
Ronald G. Myhan	Treasurer, Vice President
James L. Nutting	Vice President
Constantine P. Patsis	Vice President
Mhayse G. Samalya	Vice President
Frank R. Woudstra	Vice President

Conflict of Interest

All members of the BOD and officers signed a Conflict of interest Statement as of December 31, 2009. The purpose of the statement is to detect any activities or participation on the part of the BOD and officers that could possibly be interpreted as a conflict of interest. No exceptions were noted during our review.

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, 2009, which exceeded the NAIC recommended minimum coverage.

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

The Company does not have any direct employees, so it does not have any direct obligations for a defined benefit plan, deferred compensation arrangement, compensated absences or other post retirement benefit plans. All administrative functions of the Company are performed by employees of FGI except for claims processing, which is handled by employees of FIE. Employees of FGI and FIE are covered under the Company's noncontributory pension plans. Substantially all employees who have reached the age of 21 and rendered one year of service are covered under the plans.

The Company had two profit sharing plans that were discontinued as of December 31, 2008. The Deferred Profit Sharing Plan was limited to 10 percent of pretax earnings, as adjusted, or a maximum of 15 percent of the annual salary or wages paid or accrued to the eligible employee and provided 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 provided for annual cash distributions limited to 5 percent of pretax earnings, as adjusted, or 5 percent of the annual salary or wages paid or accrued to the eligible employee.

Effective January 1, 2009, the existing profit sharing programs (described above) were replaced by a new Short Term Incentive Program (STIP) and a 401(k) Savings Plan, both sponsored by FGI. The STIP is a performance-based plan that provides employees an annual incentive pay based on the achievement of certain Farmers P&C Companies' goals and individual employee performance. Regarding the 401(k) Savings Plan, contributions are made by eligible employees up to the yearly maximums allowable as defined by the Internal Revenue Service.

CORPORATE RECORDS

The Company's Articles of Incorporation, Bylaws, and minutes of the BOD and committees were reviewed for the period under examination. All BOD meetings were conducted with a quorum present. Investment purchases, transfers, and disposals were ratified by the BOD and noted in the minutes.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

<u>Year</u>	<u>Losses</u>	<u>Loss Adjustment Expenses</u>
2009	\$110,136,252	\$32,620,378
2008	122,287,990	33,274,810
2007	120,109,371	31,128,112

As shown above, the reserves carried by the Company for its loss and loss adjustment expense liabilities were \$110,136,252 and \$32,620,378, respectively, as of December 31, 2009.

The actuarial consulting firm contracted by the California Department of Insurance (CDI), American Actuarial Consulting Group, LLC (AAGC), reviewed the unpaid losses and loss adjustment expense reserves of the Farmers Insurance Exchange Pool (FIE Pool), which includes FICOWA, and concluded that the reserves for the insurance companies in the FIE Pool were within a range of reasonable estimates.

Therefore, the Company's loss and loss adjustment expense reserves were accepted as reasonable and no adjustments were proposed to the amounts reported in the Company's 2009 NAIC Annual Statement. Furthermore, the CDI actuary reviewed the actuarial work performed by AAGC and concluded that the pooled loss and LAE reserves, for all members of the FIE Pool, were within a reasonable range as of December 31, 2009.

REINSURANCE

In accordance with the 1970 Reinsurance Assumption Agreement, FICOWA cedes 100 percent of its business to FIE, and in accordance with the 1999 Inter-Company Reinsurance Agreement, FIE retrocedes to FICOWA its 2 percent pool participation percentage. As of December 31, 2009, the Company had \$18,931,440 in aggregate unsecured amounts recoverable from FIE.

Under the above agreements, the Company shares its liabilities with all other members of the FIE 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.

The fifteen companies of the Farmers P&C Companies that participated in the 1999 Inter-Company Reinsurance Agreement and their respective percentages of participation as of December 31, 2009 were:

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

STATUTORY DEPOSITS

The Company maintained no statutory deposits during the examination period.

ACCOUNTING RECORDS AND INFORMATION SYSTEM

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting 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.

CDI contracted with Ernst & Young (E&Y) to review certain general Information Technology (IT) controls of FGI and its affiliates as of December 31, 2009. The E&Y review covered certain IT general controls surrounding the systems and applications that support the following significant business cycles:

- Premiums
- Losses and Benefits
- Reinsurance
- Investments
- Administration
- Borrowed Money and Surplus
- 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 review as of December 31, 2009. 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

On February 10, 2010, FICOWA'S President Susan Bithell became Vice President and Chief Underwriting Officer for FGI, and Stephen Brown was named FICOWA's new President.

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

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report instructions and comments have been addressed and corrected.

FINANCIAL STATEMENTS

The following financial statements show the financial condition of Farmers Insurance Company of Washington as of December 31, 2009:

Assets, Liabilities, Surplus and Other Funds
Statement of Income and Capital and Surplus Account
Three Year Reconciliation of Surplus

Farmers Insurance Company of Washington
Assets, Liabilities, Surplus and Other Funds
December 31, 2009

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
Assets			
Bonds	\$344,580,673	\$0	\$344,580,673
Cash, cash equivalents, and short-term investments	21,595,521		21,595,521
Subtotals, cash and invested assets	<u>366,176,194</u>	<u>0</u>	<u>366,176,194</u>
Investment income due and accrued	3,479,346		3,479,346
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	8,330,211		8,330,211
Deferred premiums, agents' balances and installments booked but deferred and not yet due	53,874,625		53,874,625
Accrued retrospective premiums	76,030		76,030
Amounts recoverable from reinsurers	18,931,440		18,931,440
Net deferred tax asset	11,399,144		11,399,144
Aggregate write-ins for other than invested assets	1,524,107		1,524,107
Total Assets	<u>\$463,791,097</u>	<u>\$0</u>	<u>\$463,791,097</u>
Liabilities, Surplus and Other Funds			
Losses	\$110,136,252	\$0	\$110,136,252
Reinsurance payable on paid losses and loss adjustment expenses	12,438,823		12,438,823
Loss adjustment expenses	32,620,378		32,620,378
Taxes, licenses and fees	222,968		222,968
Unearned premiums	84,095,176		84,095,176
Advance premium	1,962,907		1,962,907
Dividends declared and unpaid: Policyholders	61,531		61,531
Ceded reinsurance premiums payable	27,136,310		27,136,310
Payable to parent, subsidiaries and affiliates	14,620,190		14,620,190
Aggregate write-ins for liabilities	3,522,438		3,522,438
Total Liabilities	<u>286,816,973</u>	<u>0</u>	<u>286,816,973</u>
Common capital stock	650,000		650,000
Gross paid in and contributed surplus	143,223,500		143,223,500
Unassigned funds (surplus)	33,100,624		33,100,624
Surplus as regards policyholders	<u>176,974,124</u>	<u>0</u>	<u>176,974,124</u>
Total Liabilities, Surplus and Other Funds	<u>\$463,791,097</u>	<u>\$0</u>	<u>\$463,791,097</u>

Farmers Insurance Company of Washington
Statement of Income and Capital and Surplus Account
For the Year Ended December 31, 2009

	<u>Balance Per Company</u>	<u>Examination Adjustments</u>	<u>Balance Per Examination</u>
Underwriting Income			
Premiums earned	\$203,338,206	\$0	\$203,338,206
Deductions			
Losses incurred	110,103,393		110,103,393
Loss adjustment expenses incurred	22,847,863		22,847,863
Other underwriting expenses incurred	63,307,588		63,307,588
Total underwriting deductions	<u>196,258,844</u>	<u>0</u>	<u>196,258,844</u>
Net underwriting gain or (loss)	<u>7,079,362</u>	<u>0</u>	<u>7,079,362</u>
Investment Income			
Net investment income earned	13,844,242		13,844,242
Net realized capital gains or (losses)	164,783		164,783
Net investment gain or (loss)	<u>14,009,025</u>	<u>0</u>	<u>14,009,025</u>
Other Income			
Net gain or (loss) from agents' or premium balances charged off	(2,069,873)		(2,069,873)
Finance and service charges not included in premiums	1,699,314		1,699,314
Aggregate write-ins for miscellaneous income	(2,288,005)		(2,288,005)
Total other income	<u>(2,658,564)</u>	<u>0</u>	<u>(2,658,564)</u>
Net income before dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	18,429,823		18,429,823
Dividends to policyholders	34,837		34,837
Net income, after dividends to policyholders, after capital gains tax and before all other federal and foreign income taxes	18,394,986		18,394,986
Federal and foreign income taxes incurred	5,839,655		5,839,655
Net income	<u>\$12,555,331</u>	<u>\$0</u>	<u>\$12,555,331</u>
Capital and Surplus Account			
Surplus as regards policyholders, December 31 prior year	<u>\$164,329,628</u>	<u>\$0</u>	<u>\$164,329,628</u>
Gains and (losses) in surplus			
Net income	12,555,331		12,555,331
Change in net unrealized capital gains or (losses)	(1,682,155)		(1,682,155)
Change in net deferred income tax	101,699		101,699
Change in nonadmitted assets	374,084		374,084
Cumulative effect of changes in accounting principles	670,325		670,325
Aggregate write-ins for gains and losses in surplus	625,212		625,212
Change in surplus as regards policyholders for the year	<u>12,644,496</u>	<u>0</u>	<u>12,644,496</u>
Surplus as regards policyholders, December 31 current year	<u>\$176,974,124</u>	<u>\$0</u>	<u>\$176,974,124</u>

**Farmers Insurance Company of Washington
Three Year Reconciliation of Surplus
For the Years Ended December 31,**

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Capital and Surplus, December 31, previous year	<u>\$164,329,628</u>	<u>\$161,581,280</u>	<u>\$147,040,316</u>
Net income or (loss)	12,555,331	4,328,802	13,331,396
Change in net unrealized capital gains or (losses)	(1,682,155)	(94,369)	
Change in net deferred income tax	101,699	(504,006)	763,932
Change in nonadmitted assets	374,084	(306,810)	263,419
Cumulative effects of changes in accounting principles	670,325		
Aggregate write-ins for gains and losses in surplus	625,212	(675,269)	182,217
Change in surplus as regards policyholders for the year	<u>12,644,496</u>	<u>2,748,348</u>	<u>14,540,964</u>
Surplus as regards policyholders, December 31, current year	<u><u>\$176,974,124</u></u>	<u><u>\$164,329,628</u></u>	<u><u>\$161,581,280</u></u>

NOTES TO THE FINANCIAL STATEMENTS

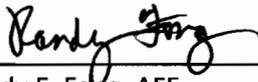
The Company has no special consents or permitted practices from the state of Washington.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers and employees of Farmers Insurance Company of Washington and its affiliates during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Tarik Subbagh, CPA, CFE, Property and Casualty Field Supervising Examiner; Timothy F. Hays, CPA, JD, Investment Specialist; and Edsel R. Dino, Financial Examiner; all from the Washington State Office of the Insurance Commissioner, participated in the examination and in the preparation of this report.

Respectfully submitted,



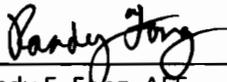
Randy E. Fong, AFE
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
 } ss
COUNTY OF KING }

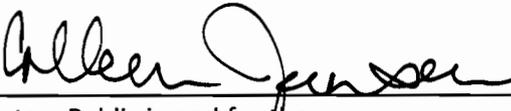
Randy Fong, AFE, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

He attests that the examination of Farmers Insurance Company of Washington was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners.



Randy E. Fong, AFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 21st day of June, 2011.



Notary Public in and for the
State of Washington

