

REPORT ON EXAMINATION
OF
FARMERS INSURANCE COMPANY, INC.
17000 W 119TH STREET
OLATHE, KS 66061
AS OF
DECEMBER 31, 2017

FILED

JUN 28 2019

VICKI SCHMIDT
Commissioner of Insurance

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Topeka, Kansas
May 16, 2019

Honorable Vicki Schmidt
Commissioner of Insurance
Kansas Insurance Department
420 SW 9th Street
Topeka, Kansas 66612-1678

Dear Commissioner:

In accordance with your authorization and pursuant to K.S.A. 40-222 – *Examination of condition of company*, an examination has been conducted of the financial condition and business affairs of:

FARMERS INSURANCE COMPANY, INC.

with its statutory home office and main administrative office at:

**17000 W 119TH STREET
OLATHE, KS 66061**

hereinafter referred to as “the Company” or “FICO”. The following report on such examination is respectfully submitted.

SCOPE OF EXAMINATION

The examiners have performed a multi-state financial examination of Farmers Insurance Company, Inc., a Kansas domiciled property and casualty insurance company. The last examination covered the three-year period from January 1, 2011, through December 31, 2013. This examination covers the four-year period from January 1, 2014, through December 31, 2017.

The examination was conducted concurrently with the state of California as part of a coordinated group financial examination of Farmers Insurance Exchange as of December 31, 2017. The coordinated group financial examination included the

participation of Kansas, as well as several state insurance departments with California being the lead state. The various states issued Reports of Examination for their domiciled insurers under separate covers as of December 31, 2017.

The examination was conducted in accordance with the rules, regulations and directives of the Kansas Insurance Department and the observed guidelines and procedures contained in the National Association of Insurance Commissioners (“NAIC”) *Financial Condition Examiners Handbook* (“Handbook”). The Handbook requires the examiners plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company 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, as mentioned in K.S.A. 40-222, *Examination of condition of company*, and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are

not included within the examination report but separately communicated to other regulators and/or the Company.

Independent Audit Reports

Financial statements of the Company were audited by PricewaterhouseCoopers LLP for the years ending December 31, 2014, through December 31, 2017. In each of the years under examination, the auditors concluded that the financial statements present fairly, in all material respects, the admitted assets, liabilities and policyholders' surplus of the Company as of December 31, 2017 and the results of its operations and its cash flows for the years then ended in accordance with the accounting practices prescribed or permitted by the Kansas Insurance Department.

The independent auditor's work papers were reviewed and analyzed by the examiners; whereby significant reliance was placed on select work papers during the course of this examination.

SUMMARY OF SIGNIFICANT FINDINGS

No significant findings were noted during the course of the examination.

COMPANY HISTORY

General

The Midland Empire Insurance Company, Inc. ("Midland") was incorporated on May 28, 1955, as a capital stock, fire and casualty insurance company under the K.S.A. 40-901, *et seq.* – *General provisions relating to fire insurance companies* and K.S.A. 40-1101, *et seq.* – *General provisions relative to casualty, surety and fidelity companies.*

Effective December 31, 1969, all stock of Midland was sold by Southwestern Investment Company, the Company's parent, to Farmers Insurance Exchange, a California domiciled reciprocal exchange. Upon completion of the sale, the name of the Company was changed to Farmers Insurance Company, Inc.

On March 31, 1984, Farmers Insurance Company of Arkansas was merged with and into the Company with the Company being the surviving entity.

Capital Stock

The Company's articles of incorporation authorize the issuance of 10,400 shares of \$250 par value common stock. As of December 31, 2017, 10,400 shares of common stock were issued and outstanding, resulting in total paid-up common capital stock of \$2,600,000. No preferred stock was authorized. Farmers Insurance Exchange and Fire Insurance Exchange, two of the reciprocal insurance exchanges of the Farmer Insurance Group ("Group"), own 100% of the issued and outstanding authorized common stock of the Company at 90% and 10%, respectively.

MANAGEMENT AND CONTROL

The Company's bylaws, as amended and restated December 15, 2011, consist of ten (10) articles that provide the framework for the operation, management and control of this domestic stock property and casualty insurance company.

Directors

The Company is controlled by its stockholders and managed by a board of directors ("Board"). The composition of the Board will be no less than three (3) and not more than eleven (11) directors.

As of December 31, 2017, the directors of FICO and their principal occupations were:

<u>Name</u>	<u>Principal Occupation</u>
Giselle M. Acevedo	Child Therapist The Child and Family Guidance Center
Thomas G. Allen	President Intermountain Electric, Inc.
Keith G. Daly	Farmers Insurance Exchange Chief Claims Officer
Ronald L. Marrone	Co Owner Family Food Services Corporation
Donald E. Rodriguez	Executive Director Boys and Girls Club

Audit Committee

In 2009, the Boards of Governors of the Farmers Insurance Exchange, Fire Insurance Exchange and Truck Insurance Exchange (“Exchanges”) established an Audit Committee to serve as the independent audit committee of the Exchanges, the insurer subsidiaries of the Exchanges and other related insurers. The Company’s Board has designated the Exchanges’ Audit Committee as its Audit Committee.

Officers

The officers of the Company consist of a chairman of the board, a president, a secretary, a treasurer, one or more vice presidents, one or more assistant secretaries, and one or more assistant treasurers. The officers listed below were duly elected as of December 31, 2017:

<u>Name</u>	<u>Position</u>
James A. Reser	President
Doren E. Hohl	Secretary
Ronald G. Myhan	Vice President, Treasurer
Keith G. Daly	Vice President
James L. Nutting	Vice President

Insurance Company Holding System

K.S.A. 40-3301, *et seq.* – *Insurance Holding Companies*, requires a domestic insurer that is part of an insurance holding company system to file appropriate registration statements with the Commissioner of Insurance. The Company has submitted Form “B” and “C” registration statements to the Kansas Insurance Department for each of the years under examination. A review of the registration statements indicated that the Company is properly reporting items and events as required by statute.

The Company’s ultimate controlling person, Farmers Insurance Exchange (“FIE”), is a reciprocal insurance exchange, which along with Fire Insurance Exchange and Truck Insurance Exchange and their subsidiaries, comprise the Farmers Insurance Group of Companies. The Exchanges are owned by their policyholders, with non-claims management services provided by Farmers Group, Inc., and its subsidiaries, as the attorneys-in-fact.

The organizational chart below identifies the Company’s structural relationship with its parent, affiliates and subsidiaries, as of December 31, 2017.

Farmers Insurance Exchange	<u>Ownership</u>
21 st Century Assurance Company	80%
21 st Century Centennial Insurance Company*	80%
21 st Century Insurance and Financial Services, Inc.	80%
21 st Century Insurance Group*	80%
21 st Century North America Insurance Company*	80%
21 st Century Pacific Insurance Company	80%
21 st Century Security Insurance Company*	80%
Bristol West Holdings, Inc.*	42%
Farmers Insurance Company of Arizona	70%
Farmers Insurance Company of Idaho	80%
Farmers Insurance Company of Oregon	80%
Farmers Insurance Company, Inc.	90%
Farmers Insurance Hawaii, Inc.*	80%
Farmers Insurance of Columbus, Inc.	100%
Foremost Insurance Company Grand Rapids, Michigan*	80%
Hawaii Insurance Consultants, Ltd.*	80%
Illinois Farmers Insurance Company	100%
Mid-Century Insurance Company*	80%
Mid-Century Insurance Company of Texas	100%
Texas Farmers Insurance Company	86%
*additional subsidiaries under these companies	

Intercompany/Cost Sharing Agreements

On July 1, 2015, the Company and FIE entered into a Service Agreement to clarify the provisions of services in accordance with the reinsurance arrangements and historical practices of both parties under the previous service agreement. Services provided by FIE to the Company include, but are not limited to, preparation of insurance policies, billing and collections, claims adjustment services, accounting and financial reporting services, investment management services, and other administrative services. The services agreement requires that FIE allocate its costs as prescribed in SSAP No. 70 – *Allocation of Expenses* from the NAIC’s *Accounting Practices and Procedures Manual*.

Pursuant to a service agreement effective March 1, 2001, FICO provides claim handling services and staffing in FIE's facilities located in Oklahoma City, Oklahoma and Olathe, Kansas. This staffing supports FIE's Customer Care Centers, Document Centers, Quality Assurance Centers of Excellence, National Catastrophic Centers of Excellence and Salvage Centers of Excellence. FIE reimburses all expenses incurred by FICO in its performance under the service agreement.

FICO participates with FIE and other participating affiliates ("Affiliates") in a tax allocation agreement. All Affiliates acknowledge under this agreement that FIE files a consolidated tax return inclusive of all Affiliates. The consolidated tax liability will be allocated proportionally to all Affiliates on the basis of the total tax that would have been recognized if all the Affiliates had individually filed their taxes.

Intercompany Reinsurance (Pooling) Agreement

FICO and certain members of Farmers Property and Casualty Companies participate in an intercompany reinsurance program with FIE as the lead company. Pursuant to the 1999 Inter-Company Reinsurance Agreement, FIE assumes 100% of the direct written premiums from FICO and the other participating affiliates. FIE retains 51.75% of all assumed risks and allocates 0.75% to the Company and the remainder among the participating affiliates.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2017, the Company is authorized to transact business in Arkansas, California, Iowa, Kansas, Missouri and Oklahoma. The Company writes a standard book of property and casualty lines of business that includes commercial

automobile coverage, business multi-peril, homeowners and private passenger auto sold through a network of captive agents. Independent agents are used primarily to distribute specialty and small business products.

As of December 31, 2017, the Company's largest lines of business were private passenger auto liability at 38.7% of direct premiums written, homeowners multiple peril at 29.35%, auto physical damage at 28.35% and commercial multiple peril at 3.09%. The remaining .51% represents allied lines, inland marine and earthquake business.

GROWTH OF COMPANY

The exhibit below shows the Company's financial condition (in thousands) for the period of December 31, 2013, through December 31, 2017. The amounts were obtained from annual statements filed by the Company.

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
<i>(in thousands)</i>					
Admitted Assets	276,154	279,009	291,748	295,039	291,767
Liabilities	174,777	174,865	184,557	188,240	185,980
Capital and Surplus	101,378	104,144	107,191	106,799	105,788
Net Underwriting Gain/(Loss)	(1,477)	(1,727)	(2,905)	(5,124)	(2,987)
Net Income	2,508	2,442	2,117	938	1,028
Net Premiums Written	102,277	105,467	111,980	110,714	106,386

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the Kansas Insurance Department and present the financial condition of the Company for the period ending December 31, 2017. The accompanying comments on financial statements reflect any examination adjustments to the amounts

reported in the annual statement and should be considered an integral part of the financial statements.

**FARMERS INSURANCE COMPANY, INC.
ANALYSIS OF ASSETS
AS OF DECEMBER 31, 2017**

	Assets	Assets Nonadmitted	Net Admitted Assets
Bonds	\$ 204,301,304	\$ -	\$ 204,301,304
Cash	1,832,033	-	1,832,033
Investment income due & accrued	1,063,705	-	1,063,705
Uncollected premiums and agents' balances in the course of collection	1,442,445	515,001	927,444
Deferred premiums and agents' balances and installments booked but deferred and not yet due	12,731,516	-	12,731,516
Accrued retrospective premiums	8,250	-	8,250
Amounts recoverable from reinsurers	45,900,644	-	45,900,644
Net deferred tax asset	4,856,771	1,865,474	2,991,297
Guaranty funds receivable or on deposit	689,587	-	689,587
Receivables from parent, subsidiaries and affiliates	13,267,580	-	13,267,580
Business-owned life insurance cash value	8,054,060	-	8,054,060
Totals	<u>\$ 294,147,895</u>	<u>\$ 2,380,475</u>	<u>\$ 291,767,420</u>

**FARMERS INSURANCE COMPANY, INC.
LIABILITIES, SURPLUS AND OTHER FUNDS
AS OF DECEMBER 31, 2017**

Losses	\$ 51,599,884
Reinsurance payable on paid losses and loss adjustment expenses	6,885,575
Loss adjustment expense	14,700,567
Other expenses (excluding taxes, licenses and fees)	130,613
Taxes, licenses and fees (excluding foreign and federal income taxes)	1,807,883
Current federal and foreign income taxes (including \$0 on realized capital gains/(losses)	487,006
Unearned premiums	41,379,891
Advance premiums	1,068,614
Ceded reinsurance premiums payable (net of ceding commissions)	58,466,798
Aggregate write-in for liabilities	9,452,753
Total liabilities	<u>185,979,583</u>
Common capital stock	2,600,000
Gross paid in and contributed surplus	41,213,162
Unassigned funds (surplus)	<u>61,974,675</u>
Surplus as regards policyholders	105,787,837
Totals	<u><u>\$ 291,767,420</u></u>

FARMERS INSURANCE COMPANY, INC.
STATEMENT OF INCOME
CAPITAL AND SURPLUS ACCOUNT
FOR THE YEAR ENDED DECEMBER 31, 2017

<u>Underwriting Income:</u>	
Premiums earned	\$ 108,906,956
<u>Deduct:</u>	
Losses incurred	64,931,831
Loss adjustment expenses incurred	11,076,539
Other underwriting expenses incurred	35,900,418
Aggregate write-ins for underwriting deductions	(14,543)
Total underwriting deductions	<u>111,894,245</u>
Net underwriting gain or (loss)	(2,987,289)
<u>Investment Income:</u>	
Net investment income earned	3,258,506
Net realized capital gains or (losses)	(11,846)
Net investment gain or (loss)	<u>3,246,660</u>
<u>Other Income:</u>	
Net gain (loss) from agents' or premium balances charged off	(650,700)
Finance and service charges not included in premiums	1,565,823
Aggregate write-ins for miscellaneous income	(211,831)
Total other income	<u>703,292</u>
Net income before dividends to policyholders	962,664
Dividends to policyholders	5,043
Net income after dividends to policyholders and before federal income taxes	<u>957,620</u>
Federal and foreign income taxes incurred	(70,827)
Net income	<u>\$ 1,028,447</u>

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2016	\$ 106,798,895
Net income	1,028,447
Change in net unrealized capital gains (losses)	(448)
Change in net deferred income tax	(2,855,898)
Change in nonadmitted assets	815,992
Change in provision for reinsurance	-
Aggregate write-ins for gains and losses in surplus	848
Change in surplus as regards policyholders for the year	<u>(1,011,059)</u>
Surplus as regards policyholders, December 31, 2017	<u>\$ 105,787,837</u>

FARMERS INSURANCE COMPANY, INC.
CAPITAL AND SURPLUS ACCOUNT
RECONCILIATION OF CAPITAL AND SURPLUS SINCE LAST EXAMINATION

Surplus as regards policyholders, December 31, 2013			\$ 101,377,760
Net income	2014	2,441,974	
	2015	2,116,646	
	2016	937,980	
	2017	<u>1,028,447</u>	6,525,047
Change in net unrealized capital gains or (losses)	2014	176	
	2015	1,003	
	2016	1,981	
	2017	<u>(448)</u>	2,712
Change in net deferred income tax	2014	(62,802)	
	2015	1,302,909	
	2016	(674,933)	
	2017	<u>(2,855,898)</u>	(2,290,724)
Change in nonadmitted assets	2014	354,300	
	2015	(369,209)	
	2016	(617,563)	
	2017	<u>815,992</u>	183,520
Change in provision for reinsurance	2014	-	
	2015	-	
	2016	(59,638)	
	2017	<u>-</u>	(59,638)
Aggregate write-ins for gains and losses in surplus	2014	32,492	
	2015	(4,038)	
	2016	19,857	
	2017	<u>848</u>	49,159
Surplus as regards policyholders, December 31, 2017			<u>\$ 105,787,837</u>

ANALYSIS OF CHANGES IN FINANCIAL STATEMENTS

No adjustments were made to surplus as a result of this examination. The capital and surplus of the Company, as of December 31, 2017, was \$105,787,837, which was the same amount, reported by the Company in its 2017 filed Annual Statement.

COMMENTS ON FINANCIAL STATEMENTS

There were no significant or material findings resulting from the examination that warranted inclusion in the Report on Examination.

SUBSEQUENT EVENTS

There were no significant or material subsequent events resulting from the examination that warranted inclusion in the Report on Examination.


SUMMARY OF RECOMMENDATIONS

There were no recommendations resulting from the examination that warranted inclusion in the Report on Examination.

CONCLUSION

The assistance and cooperation by the officers of the Company during the course of this examination is hereby acknowledged and appreciated.

Respectfully submitted,



Jan M. Moenck, CFE
Contract Insurance Examiner
Risk & Regulatory Consulting, LLC
Examiner-In-Charge



Christopher W. Buchanan, CPA, CFE
Senior Insurance Examiner
Kansas Insurance Department

EXHIBIT S
EXAMINER'S AFFIDAVIT AS TO STANDARDS AND
PROCEDURES USED IN AN EXAMINATION

State of ~~Kansas~~ ^{WASHINGTON},


County of ~~Shawnee~~ ^{KING},


Jan Moenck

being duly sworn, states as follows:

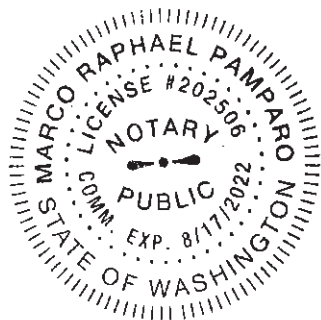
1. I have authority to represent the Kansas Insurance Department in the examination of Farmers Insurance Company, Inc.
2. The Kansas Insurance Department is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination work papers and examination report, and the examination of Farmers Insurance Company, Inc. was performed in a manner consistent with the standards and procedures required by K.S.A. 40-222.

The affiant says nothing further.


Examiner's Signature

Subscribed and sworn before me by  on this
19th day of JUNE, 2019.

(SEAL)



Notary Public

My commission expires 08/17/2022
(date)