

MERCURY GENERAL CORP
Form 10-K
February 09, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2015
Commission File No. 001-12257

MERCURY GENERAL CORPORATION
(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	95-2211612 (I.R.S. Employer Identification No.)
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4484 Wilshire Boulevard, Los Angeles, California (Address of principal executive offices)	90010 (Zip Code)
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Registrant's telephone number, including area code: (323) 937-1060

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
The aggregate market value of the Registrant's common equity held by non-affiliates of the Registrant at June 30, 2015 was \$1,508,221,904 (which represents 27,101,854 shares of common equity held by non-affiliates multiplied by \$55.65, the closing sales price on the New York Stock Exchange for such date, as reported by the Wall Street Journal).

At February 2, 2016, the Registrant had issued and outstanding an aggregate of 55,164,462 shares of its Common Stock.

Documents Incorporated by Reference

Certain information from the Registrant's definitive proxy statement for the 2016 Annual Meeting of Shareholders is incorporated herein by reference into Part III hereof.

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PART I

Item 1. Business

General

Mercury General Corporation ("Mercury General") and its subsidiaries (referred to herein collectively as the "Company") are primarily engaged in writing personal automobile insurance through 14 insurance subsidiaries (referred to herein collectively as the "Insurance Companies") in 13 states, principally California. The Company also writes homeowners, commercial automobile, commercial property, mechanical breakdown, and umbrella insurance.

The direct premiums written for the years ended December 31, 2015, 2014, and 2013 by state and line of insurance business were:

Year Ended December 31, 2015

(Dollars in thousands)

	Private Passenger Automobile	Homeowners	Commercial Automobile	Other Lines	Total		
California	\$1,946,922	\$333,397	\$78,735	\$96,791	\$2,455,845	81.5	%
Florida ⁽¹⁾	153,206	9	27,281	738	181,234	6.0	%
Other states ⁽²⁾	245,645	68,843	47,495	13,834	375,817	12.5	%
Total	\$2,345,773	\$402,249	\$153,511	\$111,363	\$3,012,896	100.0	%
	77.9	% 13.3	% 5.1	% 3.7	% 100.0	%	

Year Ended December 31, 2014

(Dollars in thousands)

	Private Passenger Automobile	Homeowners	Commercial Automobile	Other Lines	Total		
California	\$1,852,291	\$302,493	\$69,129	\$84,374	\$2,308,287	80.9	%
Florida ⁽¹⁾	131,281	7	26,234	4,676	162,198	5.7	%
Other states ⁽²⁾	239,501	71,936	40,565	30,682	382,684	13.4	%
Total	\$2,223,073	\$374,436	\$135,928	\$119,732	\$2,853,169	100.0	%
	77.9	% 13.1	% 4.8	% 4.2	% 100.0	%	

Year Ended December 31, 2013

(Dollars in thousands)

	Private Passenger Automobile	Homeowners	Commercial Automobile	Other Lines	Total		
California	\$1,760,352	\$267,563	\$53,488	\$72,617	\$2,154,020	78.7	%
Florida ⁽¹⁾	133,947	—	22,331	7,433	163,711	6.0	%
Other states ⁽²⁾	271,258	72,450	28,870	47,163	419,741	15.3	%
Total	\$2,165,557	\$340,013	\$104,689	\$127,213	\$2,737,472	100.0	%
	79.1	% 12.4	% 3.8	% 4.7	% 100.0	%	

(1)The Company is writing and expects to continue writing nominal premiums in the Florida homeowners market.

(2)No individual state accounts for more than 4% of total direct premiums written.

The Company offers the following types of automobile coverage: collision, property damage, bodily injury ("BI"), comprehensive, personal injury protection ("PIP"), underinsured and uninsured motorist, and other hazards.

The Company offers the following types of homeowners coverage: dwelling, liability, personal property, fire, and other hazards.

The following table presents the Company's published maximum limits of liability, net of reinsurance:

Insurance type	Published maximum limits of liability
Private Passenger Automobile - bodily injury (BI)	\$250,000 per person; \$500,000 per accident ⁽¹⁾
Private Passenger Automobile - property damage	\$250,000 per accident ⁽¹⁾
Commercial Automobile (combined policy limits)	\$1,000,000 per accident
Homeowner property	no maximum ⁽²⁾ ⁽³⁾
Homeowner liability	\$1,000,000 ⁽³⁾
Umbrella liability	\$5,000,000 ⁽⁴⁾

(1) The majority of the Company's automobile policies have liability limits that are equal to or less than \$100,000 per person and \$300,000 per accident for BI and \$50,000 per accident for property damage.

(2) The Company obtains facultative reinsurance above a Company retention limit of up to \$7 million.

(3) The majority of the Company's homeowner policies have liability limits of \$300,000 or less and a replacement value of \$500,000 or less.

(4) The majority of the Company's umbrella policies have liability limits of \$1,000,000.

The principal executive offices of Mercury General are located in Los Angeles, California. The home office of the Insurance Companies and the information technology center are located in Brea, California. The Company also owns office buildings in Rancho Cucamonga and Folsom, California, which are used to support California operations and future expansion, and in Clearwater, Florida and in Oklahoma City, Oklahoma, which house Company employees and several third party tenants. The Company has approximately 4,300 employees. The Company maintains branch offices in a number of locations in California; Clearwater, Florida; Bridgewater, New Jersey; Oklahoma City, Oklahoma; and Austin and San Antonio, Texas.

The Company consolidated its non-California office based claims and underwriting operations into hubs located in Clearwater, Florida; Bridgewater, New Jersey; and Austin, Texas, which resulted in a net workforce reduction of approximately 135 employees and a \$10 million pre-tax expense in the first quarter of 2013.

Available Information

The Company's website address is www.mercuryinsurance.com. The Company's website address is not intended to function as a hyperlink and the information contained on the Company's website is not, and should not be considered part of, and is not incorporated by reference into, this Annual Report on Form 10-K. The Company makes available on its website its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and amendments to such periodic reports and proxy statements (the "SEC Reports") filed with or furnished to the Securities and Exchange Commission (the "SEC") pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after each SEC Report is filed with or furnished to the SEC. In addition, copies of the SEC Reports are available, without charge, upon written request to the Company's Chief Financial Officer, Mercury General Corporation, 4484 Wilshire Boulevard, Los Angeles, California 90010. The Company's SEC Reports may be read and copied at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at www.sec.gov that contains the SEC Reports that the Company has filed or furnished electronically with the SEC.

Organization

Mercury General, an insurance holding company, is the parent of Mercury Casualty Company, a California automobile insurer founded in 1961 by George Joseph, the Company's Chairman of the Board of Directors.

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Mercury General conducts its business through the following subsidiaries:

Insurance Companies	Formed or Acquired	A.M. Best Rating	Primary States
Mercury Casualty Company ("MCC") ⁽¹⁾	1961	A+	CA, AZ, NV, NY, VA
Mercury Insurance Company ("MIC") ⁽¹⁾	1972	A+	CA
California Automobile Insurance Company ("CAIC") ⁽¹⁾	1975	A+	CA
California General Underwriters Insurance Company, Inc. ("CGU") ⁽¹⁾	1985	Non-rated	CA
Mercury Insurance Company of Illinois	1989	A+	IL, PA
Mercury Insurance Company of Georgia	1989	A+	GA
Mercury Indemnity Company of Georgia	1991	A+	GA
Mercury National Insurance Company	1991	A+	IL, MI
American Mercury Insurance Company	1996	A-	OK, GA, TX, VA
American Mercury Lloyds Insurance Company ("AML")	1996	A-	TX
Mercury County Mutual Insurance Company	2000	A-	TX
Mercury Insurance Company of Florida	2001	A+	FL, PA
Mercury Indemnity Company of America	2001	A+	FL, NJ
Workmen's Auto Insurance Company ("WAIC") ⁽²⁾	2015	Non-rated	CA
Non-Insurance Companies	Formed or Acquired	Purpose	
Mercury Select Management Company, Inc.	1997	AML's attorney-in-fact	
Mercury Insurance Services LLC	2000	Management services to subsidiaries	
AIS Management LLC	2009	Parent company of AIS and PoliSeek	
Auto Insurance Specialists LLC ("AIS")	2009	Insurance agent	
PoliSeek AIS Insurance Solutions, Inc. ("PoliSeek")	2009	Insurance agent	
Animas Funding LLC ("AFL")	2013	Special purpose investment vehicle	
Fannette Funding LLC ("FFL")	2014	Special purpose investment vehicle	

(1) The term "California Companies" refers to MCC, MIC, CAIC, and CGU.

(2) WAIC was acquired on January 2, 2015. For more detailed information, see Note 20. Acquisition, of the Notes to Consolidated Financial Statements in "Item 8. Financial Statements and Supplementary Data."

Production and Servicing of Business

The Company sells its policies through approximately 9,700 independent agents, its 100% owned insurance agents, AIS and Poliseek, and directly through internet sales portals. All of the independent agents collectively accounted for more than 87% of the Company's direct premiums written in 2015, and no independent agent accounted for more than 1% of the Company's direct premiums written during the last three years. Approximately 1,900 of the independent agents are located in California and approximately 1,500 are located in Florida. The independent agents are independent contractors selected and contracted by the Company and generally also represent competing insurance companies. AIS and Poliseek represented the Company as independent agents prior to their acquisition in 2009, and continue to act as independent agents selling policies for a number of other insurance companies. Policies sold directly through the internet sales portals are assigned to and serviced by the Company's agents.

The Company believes that it compensates its agents above the industry average. Net commissions incurred in 2015 were approximately 16% of net premiums written.

The Company's advertising budget is allocated among television, radio, newspaper, internet, and direct mailing media with the intent to provide the best coverage available within targeted media markets. While the majority of these advertising costs are borne by the Company, a portion of these costs are reimbursed by the Company's independent

agents based upon the number of account leads generated by the advertising. The Company believes that its advertising program is important to generate leads, create brand awareness, and remain competitive in the current insurance climate. In 2015, the Company launched a national

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advertising campaign resulting in net advertising expenditures of \$44 million for the year. In 2016, the Company expects to spend up to \$42 million on advertising.

Underwriting

The Company sets its own automobile insurance premium rates, subject to rating regulations issued by the Department of Insurance or similar governmental agency of each state in which it is licensed to operate ("DOI"). Each state has different rate approval requirements. See "Regulation—Department of Insurance Oversight."

The Company offers standard, non-standard, and preferred private passenger automobile insurance in 13 states. The Company also offers homeowners insurance in 12 states, commercial automobile insurance in 10 states, and mechanical breakdown insurance in most states.

In California, "good drivers," as defined by the California Insurance Code, accounted for approximately 82% of all California voluntary private passenger automobile policies-in-force at December 31, 2015, while higher risk categories accounted for approximately 18%. The private passenger automobile renewal rate in California (the rate of acceptance of offers to renew) averages approximately 95%.

Claims

The Company conducts the majority of claims processing without the assistance of outside adjusters. The claims staff administers all claims and manages all legal and adjustment aspects of claims processing.

Losses and Loss Adjustment Expense Reserves ("Loss Reserves") and Reserve Development

The Company maintains loss reserves for both reported and unreported claims. Loss reserves for reported claims are estimated based upon a case-by-case evaluation of the type of claim involved and the expected development of such claims. Loss reserves for unreported claims are determined on the basis of historical information by line of insurance business. Inflation is reflected in the reserving process through analysis of cost trends and review of historical reserve settlement.

The Company's ultimate liability may be greater or less than management estimates of reported loss reserves. The Company does not discount to a present value that portion of loss reserves expected to be paid in future periods. However, the Company is required to discount loss reserves for federal income tax purposes. The following table provides a reconciliation of beginning and ending estimated reserve balances for the years indicated:

RECONCILIATION OF NET RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

	Year Ended December 31,		
	2015	2014	2013
	(Amounts in thousands)		
Gross reserves at January 1	\$1,091,797	\$1,038,984	\$1,036,123
Less reinsurance recoverable	(14,484)	(13,927)	(12,155)
Net reserves at January 1	1,077,313	1,025,057	1,023,968
Acquisition of WAIC reserves	18,676	—	—
Incurring losses and loss adjustment expenses related to:			
Current year	2,132,837	1,989,315	1,959,730
Prior years	12,658	(3,193)	2,960
Total incurred losses and loss adjustment expenses	2,145,495	1,986,122	1,962,690
Loss and loss adjustment expense payments related to:			
Current year	1,455,245	1,347,967	1,354,074
Prior years	654,097	585,899	607,527
Total payments	2,109,342	1,933,866	1,961,601

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Net reserves at December 31	1,132,142	1,077,313	1,025,057
Reinsurance recoverable	14,546	14,484	13,927
Gross reserves at December 31	\$1,146,688	\$1,091,797	\$1,038,984

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The increase in the provision for insured events of prior years in 2015 of approximately \$12.7 million primarily resulted from the California homeowners and automobile lines of business outside of California, which was partially offset by favorable development in the California automobile line of business.

The decrease in the provision for insured events of prior years in 2014 of approximately \$3.2 million primarily resulted from lower than expected loss severity on California personal automobile lines of insurance business partially offset by adverse development in other states.

The increase in the provision for insured events of prior years in 2013 of approximately \$3.0 million primarily resulted from Florida claims that were re-opened from prior years due to a state supreme court ruling that was adverse to the insurance industry.

The Company experienced estimated pre-tax catastrophe losses and loss adjustment expenses from severe weather events of \$19 million, \$11 million, and \$17 million in 2015, 2014, and 2013, respectively. The losses in 2015 were primarily the result of severe storms outside of California, and rainstorm and wildfire losses in California. The losses in 2014 were primarily related to winter freeze events on the East Coast and severe rainstorms in California. The losses in 2013 were primarily due to tornadoes in Oklahoma and severe storms in the Midwest and the Southeast regions during the second quarter.

The following table presents the development of loss reserves for the period 2005 through 2015. The top section of the table shows the reserves at the balance sheet date, net of reinsurance recoverable, for each of the indicated years. This amount represents the estimated net losses and loss adjustment expenses for claims arising from the current and all prior years that are unpaid at the balance sheet date, including an estimate for loss reserves that had been incurred but not reported ("IBNR") to the Company. The second section shows the cumulative amounts paid as of successive years with respect to that reserve liability. The third section shows the re-estimated amount of the previously recorded reserves based on experience as of the end of each succeeding year, including cumulative payments made since the end of the respective year. Estimates change as more information develops about the frequency and severity of claims for individual years. The bottom line shows favorable (unfavorable) development that exists when the original reserve estimates are greater (less) than the re-estimated reserves at December 31, 2015.

In evaluating the cumulative development information in the table, it should be noted that each amount includes the effects of all changes in development amounts for prior periods. This table does not present accident or policy year development data. Conditions and trends that have affected development of the liability in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future favorable or unfavorable development based on this table.

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	December 31,									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2013
	(Amounts in thousands)									
Gross Reserves for Losses and Loss Adjustment Expenses-end of year ⁽¹⁾	\$1,022,603	\$1,088,822	\$1,103,915	\$1,133,508	\$1,053,334	\$1,034,205	\$985,279	\$1,036,123	\$1,036,123	\$1,036,123
Reinsurance recoverable	(16,969)	(6,429)	(4,457)	(5,729)	(7,748)	(6,805)	(7,921)	(12,155)	(12,155)	(13,900)
Net Reserves for Losses and Loss Adjustment Expenses-end of year ⁽¹⁾	\$1,005,634	\$1,082,393	\$1,099,458	\$1,127,779	\$1,045,586	\$1,027,400	\$977,358	\$1,023,968	\$1,023,968	\$1,023,968
Paid (cumulative) as of:										
One year later	\$632,905	\$674,345	\$715,846	\$617,622	\$603,256	\$614,059	\$600,090	\$607,527	\$607,527	\$585,000
Two years later	891,928	975,086	1,009,141	913,518	889,806	896,363	873,679	862,244	862,244	866,700
Three years later	1,027,781	1,123,179	1,168,246	1,059,627	1,023,137	1,027,006	1,004,373	1,002,371	1,002,371	1,002,371
Four years later	1,077,834	1,187,990	1,229,939	1,118,230	1,075,174	1,080,265	1,064,280			
Five years later	1,101,693	1,211,343	1,252,687	1,138,546	1,094,797	1,104,507				
Six years later	1,111,109	1,219,719	1,262,286	1,146,899	1,106,840					
Seven years later	1,114,241	1,224,026	1,265,882	1,151,551						
Eight years later	1,115,824	1,225,644	1,268,784							
Nine years later	1,116,622	1,227,546								
Ten years later	1,117,085									
Net reserves re-estimated as of:										
One year later	1,026,923	1,101,917	1,188,100	1,069,744	1,032,528	1,045,894	1,019,690	1,026,928	1,026,928	1,021,000
Two years later	1,047,067	1,173,753	1,219,369	1,102,934	1,076,480	1,073,052	1,056,453	1,057,693	1,057,693	1,063,000
Three years later	1,091,131	1,202,441	1,246,365	1,136,278	1,085,591	1,094,494	1,083,686	1,081,434	1,081,434	1,081,434
Four years later	1,104,988	1,217,328	1,263,294	1,141,714	1,095,907	1,113,672	1,095,715			
Five years later	1,112,779	1,225,051	1,263,560	1,147,149	1,109,707	1,119,235				
Six years later										