MERCURY GENERAL CORP
Form 10-K
February 14, 2011
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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, 2010

Commission File No. 001-12257

MERCURY GENERAL CORPORATION

(Exact name of registrant as specified in its charter)

California	**95-2211612**

(State or other jurisdiction	**(I.R.S. Employer**
of incorporation or organization)	**Identification No.)**
4484 Wilshire Boulevard, Los Angeles, California	**90010**
(Address of principal executive offices)	**(Zip Code)**

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 x 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 x

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 x 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 x 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. x

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):

Large accelerated filer	x	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 x

The aggregate market value of the Registrant s common equity held by non-affiliates of the Registrant at June 30, 2010 was $1,106,324,219 (which represents 26,697,013 shares of common equity held by non-affiliates multiplied by $41.44, the closing sales price on the New York Stock Exchange for such date, as reported by the Wall Street Journal).

At February 4, 2011, the Registrant had issued and outstanding an aggregate of 54,804,677 shares of its Common Stock.

Documents Incorporated by Reference

Certain information from the Registrant s definitive proxy statement for the 2011 Annual Meeting of Shareholders is incorporated herein by reference into Part III hereof.

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MERCURY GENERAL CORPORATION

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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 automobile insurance through 13 insurance subsidiaries (referred to herein collectively as the Insurance Companies) in a number of states, principally California. The Company also writes homeowners, mechanical breakdown, fire, umbrella, and commercial automobile and property insurance. The direct premiums written for the years ended December 31, 2010, 2009, and 2008 by state and line of business were:

Year Ended December 31, 2010

(Amounts in thousands)

	Private Passenger Auto	Homeowners	Commercial Auto	Other Lines	Total	
California	$ 1,627,938	$ 219,749	$ 57,451	$ 54,601	$ 1,959,739	76.6%
Florida	156,959	12,250	13,984	6,225	189,418	7.4%
Texas	63,788	1,552	5,874	16,678	87,892	3.4%
New Jersey	86,510	1,144		388	88,042	3.4%
Other states	180,568	26,865	7,194	19,107	233,734	9.2%
Total	$ 2,115,763	$ 261,560	$ 84,503	$ 96,999	$ 2,558,825	100%
	82.7%	10.2%	3.3%	3.8%	100%	

Year Ended December 31, 2009

(Amounts in thousands)

	Private Passenger Auto	Homeowners	Commercial Auto	Other Lines	Total	
California	$ 1,696,378	$ 205,469	$ 65,685	$ 52,830	$ 2,020,362	77.9%
Florida	142,823	14,859	13,998	6,402	178,082	6.9%
Texas	71,064	1,724	6,679	16,451	95,918	3.7%
New Jersey	81,225			251	81,476	3.1%
Other states	166,548	18,833	7,593	24,756	217,730	8.4%
Total	$ 2,158,038	$ 240,885	$ 93,955	$ 100,690	$ 2,593,568	100%
	83.2%	9.3%	3.6%	3.9%	100%	

Year Ended December 31, 2008

(Amounts in thousands)

	Private Passenger Auto	Homeowners	Commercial Auto	Other Lines	Total

California	$ 1,842,129	$ 204,027	$ 72,050	$ 52,993	$ 2,171,199	78.9%
Florida	145,952	15,892	16,272	8,921	187,037	6.8%
Texas	74,690	1,473	9,995	17,368	103,526	3.8%
New Jersey	84,028			304	84,332	3.1%
Other states	157,438	12,641	8,826	26,895	205,800	7.4%
Total	$ 2,304,237	$ 234,033	$ 107,143	$ 106,481	$ 2,751,894	100%
	83.7%	8.5%	3.9%	3.9%	100%	

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The Company offers automobile policyholders the following types of coverage: bodily injury (BI) liability, underinsured and uninsured motorist, personal injury protection (PIP), property damage liability, comprehensive, collision and other hazards. The Company s published maximum limits of liability for private passenger automobile insurance are, for BI, $250,000 per person and $500,000 per accident, and for property damage, $250,000 per accident. The combined policy limits may be as high as $1,000,000 for vehicles written under the Company s commercial automobile program. However, for the majority of the Company s automobile policies, the limits of liability 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.

The principal executive offices of Mercury General are located in Los Angeles, California. The home office of the Company s California insurance subsidiaries 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 its California operations and future expansion, and in St. Petersburg, Florida and in Oklahoma City, Oklahoma, which house the Company s employees and several third party tenants. The Company maintains branch offices in a number of locations in California; Richmond, Virginia; Latham, New York; Bridgewater, New Jersey; Vernon Hills, Illinois; Atlanta, Georgia; and Austin, Houston, and San Antonio, Texas. The Company has approximately 4,800 employees.

Website Access to Information

The internet address for the Company s website is *www.mercuryinsurance.com*. The internet address provided in this Annual Report on Form 10-K is not intended to function as a hyperlink and the information on the Company s website is not and should not be considered part of this report and is not incorporated by reference in this document. The Company makes available on its website its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements, and amendments to such reports and proxy statements (the SEC Reports) filed with or furnished to the Securities and Exchange Commission (SEC) pursuant to federal securities laws, 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.

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Organization

Mercury General, an insurance holding company, is the parent of Mercury Casualty Company (MCC), a California automobile insurer founded in 1961 by George Joseph, the Company s Chairman of the Board of Directors. Including MCC, Mercury General has 21 subsidiaries. The Company s operations are conducted through the following subsidiaries:

Insurance Companies	Date Formed or Acquired	A.M. Best Ratings	Primary States
Mercury Casualty Company (MCC[(1)])	January 1961	A+	CA, AZ, FL, NV, NY, VA
Mercury Insurance Company (MIC[(1)])	November 1972	A+	CA
California Automobile Insurance Company (CAIC[(1)])	June 1975	A+	CA
California General Underwriters Insurance Company, Inc. (CGU[(1)])	April 1985	Non-rated	CA
Mercury Insurance Company of Illinois (MIC IL)	August 1989	A+	IL, PA, NJ
Mercury Insurance Company of Georgia (MIC GA)	March 1989	A+	GA
Mercury Indemnity Company of Georgia (MID GA)	November 1991	A+	GA
Mercury National Insurance Company (MNIC)	December 1991	A+	IL, MI
American Mercury Insurance Company (AMI)	December 1996	A-	OK, FL, GA, TX, VA
American Mercury Lloyds Insurance Company (AML)	December 1996	A-	TX
Mercury County Mutual Insurance Company (MCM)	September 2000	A-	TX
Mercury Insurance Company of Florida (MIC FL)	August 2001	A+	FL, PA
Mercury Indemnity Company of America (MIDAM)	August 2001	A+	NJ

Non-Insurance Companies	Date Formed or Acquired	Purpose
Mercury Select Management Company, Inc. (MSMC)	August 1997	AML s attorney-in-fact
American Mercury MGA, Inc. (AMMGA)	August 1997	General agent
Concord Insurance Services, Inc. (Concord)	October 1999	Inactive insurance agent since 2006
Mercury Insurance Services LLC (MIS LLC)	November 2000	Management services to subsidiaries
Mercury Group, Inc. (MGI)	July 2001	Inactive insurance agent since 2007
AIS Management LLC (AISM[(2)])	January 2009	Parent company of AIS and PoliSeek
Auto Insurance Specialists LLC (AIS[(2)])	January 2009	Insurance agent
PoliSeek AIS Insurance Solutions, Inc. (PoliSeek[(2)])	January 2009	Insurance agent

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

(2) On October 10, 2008, MCC entered into a Stock Purchase Agreement (the Purchase Agreement) with Aon Corporation, a Delaware corporation, and Aon Services Group, Inc., a Delaware corporation. Pursuant to the terms of the Purchase Agreement effective January 1, 2009, MCC acquired all of the membership interest of AISM, a California limited liability company, which is the parent company of AIS and PoliSeek.

Production and Servicing of Business

The Company sells its policies through approximately 5,700 independent agents and brokers, of which over 1,100 are located in each of California and Florida. The remaining agents and brokers are located in Georgia, Illinois, Texas, Oklahoma, New York, New Jersey, Virginia, Pennsylvania, Arizona, Nevada, and Michigan. Over half of the Company s agents in California have represented the Company for more than ten years. The agents, most of whom also represent one or more competing insurance companies, are independent

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contractors selected and contracted by the Company. No independent agent or broker accounted for more than 2% of the Company s direct premiums written during 2010 and 2009. However, AIS produced approximately 15% of the Company s direct premiums written during 2008 prior to the AIS acquisition.

The Company believes that it compensates its agents and brokers above the industry average. During 2010, total commissions incurred were approximately 17% of net premiums written.

The Company s advertising budget is allocated among television, radio, newspaper, internet, and direct mailing media 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 create brand awareness and to remain competitive in the current insurance climate. During 2010, net advertising expenditures were $30 million.

Underwriting

The Company sets its own automobile insurance premium rates, subject to rating regulations issued by the Departments of Insurance (DOI) or similar governmental agencies of the applicable states. 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. Private passenger automobile policies in force for non-California operations represented approximately 22% of total private passenger automobile policies in force at December 31, 2010. In addition, the Company offers mechanical breakdown insurance in many states and homeowners insurance in Florida, Illinois, Oklahoma, New York, Georgia, Texas, New Jersey, Virginia, and Arizona. The Company is in the process of withdrawing from the Florida homeowners market and expects to complete the withdrawal in 2012.

In California, good drivers (as defined by the California Insurance Code) accounted for approximately 81% of all California voluntary private passenger automobile policies in force at December 31, 2010, while higher risk categories accounted for approximately 19%. The private passenger automobile renewal rate in California (the rate of acceptance of offers to renew) averages approximately 96%. The Company also offers homeowners, mechanical breakdown, and commercial automobile and property insurance in California.

Claims

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

Losses and Loss Adjustment Expenses Reserves and Reserve Development

The Company maintains losses and loss adjustment expenses reserves for both reported and unreported claims. Losses and loss adjustment expenses 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 claim. Losses and loss adjustment expenses reserves for unreported claims are determined on the basis of historical information by line of insurance. 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 losses and loss adjustment expenses reserves. Reserves are closely monitored and are analyzed quarterly by the Company s actuarial consultants using current information on reported claims and a variety of statistical techniques. The

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Company does not discount to a present value that portion of losses and loss adjustment expenses reserves expected to be paid in future periods. The Tax Reform Act of 1986, however, requires the Company to discount losses and loss adjustment expenses reserves for federal income tax purposes.

The following table presents the development of losses and loss adjustment expenses reserves for the period 2000 through 2010. 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 losses 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 becomes known 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, 2010.

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.

						December 31,					
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
						(Amounts in thousands)					
Gross Reserves for Losses and Loss Adjustment Expenses-end of year(1)	$ 492,220	$ 534,926	$ 679,271	$ 797,927	$ 900,744	$ 1,022,603	$ 1,088,822	$ 1,103,915	$ 1,133,508	$ 1,053,334	$ 1,034,205
Reinsurance recoverable	(28,417)	(18,334)	(14,382)	(11,771)	(14,137)	(16,969)	(6,429)	(4,457)	(5,729)	(7,748)	(6,805)
Net Reserves for Losses and Loss Adjustment Expenses-end of year(1)	$ 463,803	$ 516,592	$ 664,889	$ 786,156	$ 886,607	$ 1,005,634	$ 1,082,393	$ 1,099,458	$ 1,127,779	$ 1,045,586	$ 1,027,400
Paid (cumulative) as of:											
One year later	$ 321,643	$ 360,781	$ 432,126	$ 461,649	$ 525,125	$ 632,905	$ 674,345	$ 715,846	$ 617,622	$ 603,256	
Two years later	431,498	481,243	591,054	628,280	748,255	891,928	975,086	1,009,141	913,518		
Three years later	462,391	528,052	637,555	714,763	851,590	1,027,781	1,123,179	1,168,246			
Four years later	476,072	538,276	655,169	740,534	893,436	1,077,834	1,187,990				
Five years later	478,158	545,110	664,051	750,927	906,466	1,101,693					
Six years later	481,775	549,593	667,277	754,710	915,086						
Seven years later	484,149	550,768	668,443	760,300							
Eight years later	485,600	550,827	671,474								
Nine years later	485,587	551,255									
Ten years later	485,889										
Net reserves re-estimated as of:											
One year later	480,732	542,775	668,954	728,213	840,090	1,026,923	1,101,917	1,188,100	1,069,744	1,032,528	
Two years later	481,196	549,262	660,705	717,289	869,344	1,047,067	1,173,753	1,219,369	1,102,934		
Three years later	483,382	546,667	662,918	745,744	894,063	1,091,131	1,202,441	1,246,365			
Four years later	482,905	545,518	666,825	750,859	910,171	1,104,988	1,217,328				
Five years later	480,740	550,123	668,318	755,970	914,547	1,112,779					
Six years later	483,392	551,402	669,499	757,534	918,756						
Seven years later	485,328	551,745	670,225	762,242							
Eight years later	486,078	551,505	672,387								
Nine years later	486,157	551,721									

Ten years later	486,360									
Net cumulative development favorable (unfavorable)	$ (22,557)	$ (35,129)	$ (7,498)	$ 23,914	$ (32,149)	$ (107,145)	$ (134,935)	$ (146,907)	$ 24,845	$ 13,058
Gross re-estimated liability-latest	$ 526,163	$ 581,688	$ 698,790	$ 791,649	$ 946,628	$ 1,144,164	$ 1,236,327	$ 1,261,953	$ 1,111,963	$ 1,040,308
Re-estimated recoverable-latest	(39,803)	(29,967)	(26,403)	(29,407)	(27,872)	(31,385)	(18,999)	(15,588)	(9,029)	(7,780)
Net re-estimated liability-latest	$ 486,360	$ 551,721	$ 672,387	$ 762,242	$ 918,756	$ 1,112,779	$ 1,217,328	$ 1,246,365	$ 1,102,934	$ 1,032,528
Gross cumulative development favorable (unfavorable)	$ (33,943)	$ (46,762)	$ (19,519)	$ 6,278	$ (45,884)	$ (121,561)	$ (147,505)	$ (158,038)	$ 21,545	$ 13,026

(1) Under statutory accounting principles (SAP), reserves are stated net of reinsurance recoverable whereas under U.S. generally accepted accounting principles (GAAP), reserves are stated gross of reinsurance recoverable.

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The Company experienced favorable development of approximately $13 million on the 2009 and prior accident years losses and loss adjustment expenses reserves due primarily to the result of re-estimates of accident year 2009 California BI losses. See Critical Accounting Estimates Reserves in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

For the year 2008, the Company experienced favorable development of approximately $25 million on prior accident years losses and loss adjustment expenses reserves. The favorable development is primarily due to the result of re-estimates of accident year 2008 and 2007 California BI losses, partially offset by unfavorable development from earlier accident periods.

For the years 2005 through 2007, the Company experienced unfavorable development of approximately $107 million to $147 million on prior accident years losses and loss adjustment expenses reserves. The unfavorable development from these years relates primarily to increases in loss severity estimates and loss adjustment expense estimates for the California BI coverage as well as increases in the provision for losses in New Jersey and Florida. Reserves from these years showed further unfavorable development after December 31, 2008 primarily as a result of re-estimates of the 2005 and 2006 accident year loss reserves in New Jersey and re-estimates of the 2005 and 2006 accident year loss adjustment expenses reserves in New Jersey and California.

For 2004, the unfavorable development relates to an increase in the Company s prior accident years loss estimates for personal automobile insurance in Florida and New Jersey. In addition, an increase in estimates for loss severity for the 2004 accident year reserves for California and New Jersey automobile lines of business contributed to the deficiencies.

For 2003, the favorable development largely relates to lower inflation than originally expected on the BI coverage reserves for the California automobile line of insurance. In addition, the Company experienced a reduction in expenditures to outside legal counsel for the defense of personal automobile claims in California. This led to a reduction in the ultimate expense amount expected to be paid out and therefore favorable development in the reserves at December 31, 2003, partially offset by unfavorable development in the Florida automobile lines of business.

For years 2000 through 2002, the Company s previously estimated loss reserves produced deficiencies that were reflected in the subsequent years incurred losses. The Company attributes a large portion of the unfavorable development to increases in the ultimate liability for BI, physical damage, and collision claims over what was originally estimated. The increases in these losses relate to increased severity over what was originally recorded and are the result of inflationary trends in health care costs, auto parts, and body shop labor costs.

Statutory Accounting Principles

The Company s results are reported in accordance with GAAP, which differ in some respects from amounts reported under SAP prescribed by insurance regulatory authorities. Some of the significant differences under GAAP are described below:

- Policy acquisition costs such as commissions, premium taxes, and other costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts, are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned, rather than expensed as incurred, as required by SAP.

- Certain assets are included in the consolidated balance sheets whereas, under SAP, such assets are designated as nonadmitted assets, and charged directly against statutory surplus. These assets consist primarily of premium receivables outstanding more than 90 days, deferred tax assets that do not meet statutory requirements for recognition, furniture, equipment, leasehold improvements, capitalized software, and prepaid expenses.

- Amounts related to ceded reinsurance are shown gross as prepaid reinsurance premiums and reinsurance recoverables, rather than netted against unearned premium reserves and losses and loss adjustment expenses reserves, respectively, as required by SAP.

Fixed-maturity securities are reported at fair value rather than at amortized cost, or the lower of amortized cost or fair value, depending on the specific type of security as required by SAP.

The differing treatment of income and expense items results in a corresponding difference in federal income tax expense. Changes in deferred income taxes are reflected as an item of income tax benefit or expense, rather than recorded directly to statutory surplus as regards policyholders, as required by SAP. Admittance testing under SAP may result in a charge to unassigned surplus for non-admitted portions of deferred tax assets. Under GAAP, a valuation allowance may be recorded against the deferred tax assets and reflected as an expense.

Certain assessments paid to regulatory agencies that are recoverable from policyholders in future periods are expensed whereas these amounts are recorded as receivables under SAP.

Operating Ratios (SAP basis)

Loss and Expense Ratios

Loss and expense ratios are used to interpret the underwriting experience of property and casualty insurance companies. Under SAP, losses and loss adjustment expenses are stated as a percentage of premiums earned because losses occur over the life of a policy, while underwriting expenses are stated as a percentage of premiums written rather than premiums earned because most underwriting expenses are incurred when policies are written and are not spread over the policy period. The statutory underwriting profit margin is the extent to which the combined loss and expense ratios are less than 100%. The Insurance Companies loss ratio, expense ratio, combined ratio, and the private passenger automobile industry combined ratio, on a statutory basis, are shown in the following table. The Insurance Companies ratios include lines of insurance other than private passenger automobile. Since these other lines represent only 17.3% of premiums written, the Company believes its ratios can be compared to the industry ratios included in the following table.

	Year Ended December 31,				
	2010	**2009**	**2008**	**2007**	**2006**
Loss Ratio	71.0%	67.8%	73.3%	68.0%	67.4%
Expense Ratio	29.1%	28.6%	28.5%	27.1%	27.1%
Combined Ratio	100.1%	96.4%	101.8%	95.1%	94.5%
Industry combined ratio (all writers)[1]	99.0%[2]	100.8%	99.8%	98.3%	95.5%
Industry combined ratio (excluding direct writers)[1]	N/A	100.5%	100.8%	96.2%	94.7%

(1) Source: A.M. Best, *Aggregates & Averages* (2007 through 2010), for all property and casualty insurance companies (private passenger automobile line only, after policyholder dividends).

(2) Source: A.M. Best, *Best s Special Report U.S. Property/Casualty-Review & Preview*, February 14, 2011

Premiums to Surplus Ratio

The following table presents, for the periods indicated, the Insurance Companies statutory ratios of net premiums written to policyholders surplus. Widely recognized guidelines established by the National Association of Insurance Commissioners (the NAIC) indicate that this ratio should be no greater than 3 to 1.

	Year Ended December 31,				
	2010	**2009**	**2008**	**2007**	**2006**
	(Amounts in thousands, except ratios)				
Net premiums written	$ 2,555,481	$ 2,589,972	$ 2,750,226	$ 2,982,024	$ 3,044,774
Policyholders surplus[1]	$ 1,322,270	$ 1,517,864	$ 1,371,095	$ 1,721,827	$ 1,579,248

Ratio	1.9 to 1	1.7 to 1	2.0 to 1	1.7 to 1	1.9 to 1

(1) The decrease in policyholders surplus in 2010 was primarily due to a $270 million extraordinary intercompany dividend declared by MCC in the fourth quarter of 2010. The dividend is payable to Mercury General in 2011.

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Investments

The Company s investments are directed by the Chief Investment Officer under the supervision of the Board of Directors. The Company s investment strategy emphasizes safety of principal and consistent income generation, within a total return framework. The investment strategy has historically focused on maximizing after-tax yield with a primary emphasis on maintaining a well diversified, investment grade, fixed income portfolio to support the underlying liabilities and achieve a return on capital and profitable growth. The Company believes that investment yield is maximized by selecting assets that perform favorably on a long-term basis and by disposing of certain assets to enhance after-tax yield and minimize the potential effect of downgrades and defaults. The Company believes that this strategy maintains the optimal investment performance necessary to sustain investment income over time. The Company s portfolio management approach utilizes a market risk and asset allocation strategy as the primary basis for the allocation of interest sensitive, liquid and credit assets as well as for monitoring credit exposure and diversification requirements. Within the ranges set by the asset allocation strategy, tactical investment decisions are made in consideration of prevailing market conditions.

Tax considerations, including the impact of the alternative minimum tax (AMT), are important in portfolio management. Changes in loss experience, growth rates, and profitability produce significant changes in the Company s exposure to AMT liability, requiring appropriate shifts in the investment asset mix between taxable bonds, tax-exempt bonds, and equities in order to maximize after-tax yield. The Company closely monitors the timing and recognition of capital gains and losses to maximize the realization of any deferred tax assets arising from capital losses. At December 31, 2010, the Company had a capital loss carry forward of approximately $42.1 million.

Investment Portfolio

The following table presents the composition of the Company s total investment portfolio:

	December 31,					
	2010		2009		2008	
	Cost(1)	Fair Value	Cost(1)	Fair Value	Cost(1)	Fair Value
	(Amounts in thousands)					
Taxable bonds	$ 200,468	$ 223,017	$ 261,645	$ 270,093	$ 362,147	$ 299,561
Tax-exempt state and municipal bonds	2,417,188	2,429,263	2,411,434	2,434,468	2,360,874	2,179,178
Redeemable preferred stocks					5,450	2,934
Total fixed maturities	2,617,656	2,652,280	2,673,079	2,704,561	2,728,471	2,481,673
Equity investments including non-redeemable preferred stocks	336,757	359,606	308,941	286,131	403,773	247,391
Short-term investments	143,378	143,371	156,126	156,165	208,278	204,756
Total investments	$ 3,097,791	$ 3,155,257	$ 3,138,146	$ 3,146,857	$ 3,340,522	$ 2,933,820

(1) Fixed maturities and short-term bonds at amortized cost and equities and other short-term investments at cost.

The Company applies the fair value option to all fixed maturity and equity securities and short-term investments as of the time the eligible item is first recognized. For more detailed discussion, see Liquidity and Capital Resources Invested Assets in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 2 of Notes to Consolidated Financial Statements.

At December 31, 2010, 77.0% of the Company s total investment portfolio at fair value and 91.6% of its total fixed maturity investments at fair value were invested in tax-exempt state and municipal bonds. For more detailed information including credit ratings, see Liquidity and Capital Resources Portfolio Composition in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

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The nominal average maturity of the overall bond portfolio was 11.8 years (11.3 years including all short-term instruments) at December 31, 2010, and is heavily weighted in investment grade tax-exempt municipal bonds. Fixed maturity investments purchased by the Company typically have call options attached, which further reduce the duration of the asset as interest rates decline. The call-adjusted average maturity of the overall bond portfolio was 6.3 years (6.0 years including all short-term instruments) related to holdings which are heavily weighted with high coupon issues that are expected to be called prior to maturity. The modified duration of the overall bond portfolio reflecting anticipated early calls was 4.7 years (4.5 years including all short-term instruments) at December 31, 2010, including collateralized mortgage obligations with a modified duration of 2.2 years and short-term bonds that carry no duration. Modified duration measures the length of time it takes, on average, to receive the present value of all the cash flows produced by a bond, including reinvestment of interest. As it measures four factors (maturity, coupon rate, yield, and call terms) which determine sensitivity to changes in interest rates; modified duration is considered a better indicator of price volatility than simple maturity alone. The longer the duration, the more sensitive the asset is to market interest rate fluctuations.

Equity holdings consist of non-redeemable preferred stocks and common stocks on which dividend income is partially tax-sheltered by the 70% corporate dividend received deduction. At year end, 88.1% of short-term investments consisted of highly rated short-duration securities redeemable on a daily or weekly basis. The Company does not have any direct equity investment in subprime lenders.

Investment Results

The following table presents the investment results of the Company for the most recent five years:

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(Amounts in thousands)				
Average invested assets at cost[1]	$ 3,121,366	$ 3,196,944	$ 3,452,803	$ 3,468,399	$ 3,325,435
Net investment income:					
Before income taxes	143,814	144,949	151,280	158,911	151,099
After income taxes	128,888	130,070	133,721	137,777	127,741
Average annual yield on investments:					
Before income taxes	4.6%	4.5%	4.4%	4.6%	4.5%
After income taxes	4.1%	4.1%	3.9%	4.0%	3.8%
Net realized investment gains (losses) after income taxes[2][3]	37,108	225,189	(357,838)	13,525	10,033
Net increase in unrealized gains on investments after income taxes[3]	$	$	$	$ 10,905	$ 3,103

(1) Fixed maturities and short-term bonds at amortized cost and equities and other short-term investments at cost.
(2) Includes investment impairment write-down, net of tax benefit, of $14.7 million in 2007 and $1.3 million in 2006. 2007 also includes $1.3 million gain, net of tax, and $0.9 million loss, net of tax benefit, related to the change in the fair value of trading securities and hybrid financial instruments, respectively.
(3) Effective January 1, 2008, the Company adopted the fair value option with changes in fair value reflected in net realized investment gains or losses in the consolidated statements of operations.

Competitive Conditions

The Company operates in the highly competitive property and casualty industry subject to competition on pricing, claims handling, consumer recognition, coverage offered and other product features, customer service, and geographic coverage. Some of the Company s competitors are larger and well-capitalized national companies which have broad distribution networks of employed or captive agents.

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Reputation for customer service and price are the principal means by which the Company competes with other automobile insurers. In addition, the marketing efforts of independent agents and brokers can provide a competitive advantage. Based on the most recent regularly published statistical compilations of premiums written in 2010, the Company was the fifth largest writer of private passenger automobile insurance in California and the twelfth largest in the United States.

The property and casualty insurance industry is highly cyclical, characterized by periods of high premium rates and shortages of underwriting capacity (hard market) followed by periods of severe price competition and excess capacity (soft market). In management s view, 2004 through 2007 was a period of very profitable results for companies underwriting automobile insurance. Many in the industry have experienced declining profitability since 2007. Since 2009, many of the Company s largest competitors increased rates on both private passenger auto insurance and homeowners insurance. Rate increases generally indicate that the market is hardening.

Reinsurance

The Company has reinsurance through the Florida Hurricane Catastrophe Trust Fund (FHCF) that provides coverage equal to approximately 90 percent of $44 million in excess of $12 million per occurrence based on the latest information provided by FHCF. The coverage is expected to change when new information is available in March 2011.

For California homeowners policies, the Company has reduced its catastrophe exposure from earthquakes by placing earthquake risks with the California Earthquake Authority (CEA). However, the Company continues to have catastrophe exposure to fires following an earthquake. For more detailed discussion, see Regulation Insurance Assessments.

The Company carries a commercial umbrella reinsurance treaty and seeks facultative arrangements for large property risks. In addition, the Company has other reinsurance in force that is not material to the consolidated financial statements. If any reinsurers are unable to perform their obligations under a reinsurance treaty, the Company will be required, as primary insurer, to discharge all obligations to its insured in their entirety.

Regulation

The Insurance Companies are subject to significant regulation and supervision by insurance departments of the jurisdictions in which they are domiciled or licensed to operate business.

Department of Insurance Oversight

The powers of the DOI in each state primarily include the prior approval of insurance rates and rating factors and the establishment of capital and surplus requirements, solvency standards, restrictions on dividend payments and transactions with affiliates. DOI regulations and supervision are designed principally to benefit policyholders rather than shareholders.

California Proposition 103 requires that property and casualty insurance rates be approved by the California DOI prior to their use and that no rate be approved which is excessive, inadequate, unfairly discriminatory, or otherwise in violation of the provisions of the initiative. The proposition specifies four statutory factors required to be applied in decreasing order of importance in determining rates for private passenger automobile insurance: (1) the insured s driving safety record, (2) the number of miles the insured drives annually, (3) the number of years of driving experience of the insured and (4) whatever optional factors are determined by the California DOI to have a substantial relationship to risk of loss and are adopted by regulation. The statute further provides that insurers are required to give at least a 20% discount to good drivers, as defined, from rates that would otherwise be charged to such drivers and that no insurer may refuse to insure a good driver. The Company s rate plan was approved by the California DOI and operates under these rating factor regulations.

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Insurance rates in Georgia, New York, New Jersey, Pennsylvania, and Nevada require prior approval from the state DOI, while insurance rates in Illinois, Texas, Virginia, Arizona, and Michigan must only be filed with the respective DOI before they are implemented. Oklahoma and Florida have a modified version of prior approval laws. In all states, the insurance code provides that rates must not be excessive, inadequate, or unfairly discriminatory.

The DOI in each state in which the Company operates is responsible for conducting periodic financial and market conduct examinations of the Insurance Companies in their states. Market conduct examinations typically review compliance with insurance statutes and regulations with respect to rating, underwriting, claims handling, billing, and other practices. The following table presents a summary of current financial and market conduct examinations:

State	Exam Type	Period Under Review	Status
OK	Financial	2008 to 2010	Fieldwork will begin in the first quarter of 2011.
OK	Market Conduct	2007 to 2009	Fieldwork will begin in the first quarter of 2011.
CA	Financial	2008 to 2010	Fieldwork began on January 31, 2011.
FL	Financial	2005 to 2009	Received final report on February 4, 2011.
TX	Financial	2005 to 2009	Received final report draft on December 20, 2010.
TX	Market Conduct	Mar 2009 to Feb 2010	Received final report on September 29, 2010.
IL	Market Conduct	Jul 2009 to Jun 2010	Fieldwork completed. Awaiting final report.
IL	Financial	2005 to 2009	Fieldwork began on August 30, 2010.

During the course of and at the conclusion of these examinations, the examining DOI generally reports findings to the Company, and none of the findings reported to date is expected to be material to the Company s financial position.

For discussion of current regulatory matters in California, see Regulatory and Legal Matters in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The operations of the Company are dependent on the laws of the states in which it does business and changes in those laws can materially affect the revenue and expenses of the Company. The Company retains its own legislative advocates in California. The Company made financial contributions of $133,350 and $148,200 to officeholders and candidates in 2010 and 2009, respectively. The Company believes in supporting the political process and intends to continue to make such contributions in amounts which it determines to be appropriate.

The Company supported the Continuous Coverage Auto Insurance Discount Act (Proposition 17), a California initiative on the June 2010 ballot which did not pass. It would have provided for a portable persistency discount, allowing insurance companies to offer new customers discounts based on having continuous insurance coverage from any insurance company. Currently, the California DOI allows insurance companies to provide persistency discounts based on continuous coverage only with existing customers. The Company made financial contributions of $12.1 million and $3.5 million in 2010 and 2009, respectively, related to this initiative. The Company continues to offer a competitive product in California.

Risk-Based Capital

The Insurance Companies must comply with minimum capital requirements under applicable state laws and regulations, and must have adequate reserves for claims. The minimum statutory capital requirements differ by state and are generally based on balances established by statute, a percentage of annualized premiums, a percentage of annualized loss, or risk-based capital (RBC) requirements. The RBC requirements are based on guidelines established by the NAIC. The RBC formula was designed to capture the widely varying elements of risks undertaken by writers of different lines of insurance having differing risk characteristics, as well as writers of similar lines where differences in risk may be related to corporate structure, investment policies, reinsurance arrangements, and a number of other factors. At December 31, 2010, each of the Insurance Companies had sufficient capital to exceed the highest level of minimum required capital.

Insurance Assessments

The California Insurance Guarantee Association (CIGA) was created to pay claims on behalf of insolvent property and casualty insurers. Each year, these claims are estimated by CIGA and the Company is assessed for its pro-rata share based on prior year California premiums written in the particular line. These assessments are limited to 2% of premiums written in the preceding year and are recouped through a mandated surcharge to policyholders in the year after the assessment. There were no CIGA assessments in 2010.

During 2010, the Company paid approximately $1.7 million in assessments to the New Jersey Unsatisfied Claim and Judgment Fund and the New Jersey Property-Liability Insurance Guaranty Association for assessments relating to its personal automobile line of insurance. As permitted by state law, the New Jersey assessments paid during 2010 are recoupable through a surcharge to policyholders. The Company recouped a portion of these assessments in 2010 and expects to continue to recoup them in the future. It is possible that there will be additional assessments in 2011.

The CEA is a quasi-governmental organization that was established to provide a market for earthquake coverage to California homeowners. The Company places all new and renewal earthquake coverage offered with its homeowner policy through the CEA. The Company receives a small fee for placing business with the CEA, which is recorded as other revenue in the consolidated statements of operations. Upon the occurrence of a major seismic event, the CEA has the ability to assess participating companies for losses. These assessments are made after CEA capital has been expended and are based upon each company s participation percentage multiplied by the amount of the total assessment. Based upon the most recent information provided by the CEA, the Company s maximum total exposure to CEA assessments at April 1, 2010, the most recent date at which information was available, was approximately $55.6 million.

The Insurance Companies in other states are also subject to the provisions of similar insurance guaranty associations. There were no material assessment payments during 2010 in other states.

Holding Company Act

The California Companies are subject to California DOI regulation pursuant to the provisions of the California Insurance Holding Company System Regulatory Act (the Holding Company Act). The California DOI may examine the affairs of each of the California Companies at any time. The Holding Company Act requires disclosure of any material transactions among affiliates within a Holding Company System. Some transactions and dividends defined to be of an extraordinary type may not be affected if the California DOI disapproves the transaction within 30 days after notice. Such transactions include, but are not limited to, extraordinary dividends; management agreements, service contracts, and cost-sharing arrangements; all guarantees that are not quantifiable; derivative transactions or series of derivative transactions; certain reinsurance transactions or modifications thereof in which the reinsurance premium or a change in the insurer s liabilities equals or exceeds 5 percent of the policyholders surplus as of the preceding December 31; sales, purchases, exchanges, loans, and extensions of credit; and investments, in the net aggregate, involving more than the lesser of 3% of the respective California Companies admitted assets or 25% of statutory surplus as regards policyholders as of the preceding December 31. An extraordinary dividend is a dividend which, together with other dividends or distributions made within the preceding 12 months, exceeds the greater of 10% of the insurance company s statutory policyholders surplus as of the preceding December 31 or the insurance company s statutory net income for the preceding calendar year.

An insurance company is also required to notify the California DOI of any dividend after declaration, but prior to payment. There are similar limitations imposed by other states on the Insurance Companies ability to pay dividends. On December 16, 2010, the California DOI notified the Company that MCC was authorized to pay a $270 million extraordinary dividend to Mercury General in 2011. Mercury General intends to use the proceeds from the dividend to repay the $125 million senior notes and to fund shareholder dividends. As of December 31, 2010, the Insurance Companies are permitted to pay, without extraordinary DOI approval, $31.9 million in dividends, of which $14.0 million would be payable from the California Companies.

The Holding Company Act also provides that the acquisition or change of control of a California domiciled insurance company or of any person who controls such an insurance company cannot be consummated without the prior approval of the California DOI. In general, a presumption of control arises from the ownership of voting securities and securities that are convertible into voting securities, which in the aggregate constitute 10% or more of the voting securities of a California insurance company or of a person that controls a California insurance company, such as Mercury General. A person seeking to acquire control, directly or indirectly, of the Company must generally file with the California DOI an application for change of control containing certain information required by statute and published regulations and provide a copy of the application to the Company. The Holding Company Act also effectively restricts the Company from consummating certain reorganizations or mergers without prior regulatory approval.

Each of the Insurance Companies is subject to holding company regulations in the state in which it is domiciled. These provisions are substantially similar to those of the Holding Company Act.

Assigned Risks

Automobile liability insurers in California are required to sell BI liability, property damage liability, medical expense, and uninsured motorist coverage to a proportionate number (based on the insurer s share of the California automobile casualty insurance market) of those drivers applying for placement as assigned risks. Drivers seek placement as assigned risks because their driving records or other relevant characteristics, as defined by Proposition 103, make them difficult to insure in the voluntary market. In 2010, assigned risks represented less than 0.1% of total automobile direct premiums written and less than 0.1% of total automobile direct premium earned. The Company attributes the low level of assignments to the competitive voluntary market. Many of the other states in which the Company conducts business offer programs similar to that of California. These programs are not a significant contributor to the business written in those states.

Executive Officers of the Company

The following table presents certain information concerning the executive officers of the Company as of February 4, 2011:

Name	Age	Position
George Joseph	89	Chairman of the Board
Gabriel Tirador	46	President and Chief Executive Officer
Allan Lubitz	52	Senior Vice President and Chief Information Officer
Joanna Y. Moore	55	Senior Vice President and Chief Claims Officer
John Sutton	63	Senior Vice President Customer Service
Christopher Graves	45	Vice President and Chief Investment Officer
Robert Houlihan	54	Vice President and Chief Product Officer
Kenneth G. Kitzmiller	64	Vice President and Chief Underwriting Officer
Brandt N. Minnich	44	Vice President Marketing
Theodore R. Stalick	47	Vice President and Chief Financial Officer
Charles Toney	49	Vice President and Chief Actuary
Judy A. Walters	64	Vice President Corporate Affairs and Secretary

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Mr. Joseph, Chairman of the Board of Directors, has served in this capacity since 1961. He held the position of Chief Executive Officer of the Company for 45 years from 1961 through December 2006. Mr. Joseph has more than 50 years experience in the property and casualty insurance business.

Mr. Tirador, President and Chief Executive Officer, served as the Company s assistant controller from 1994 to 1996. In 1997 and 1998, he served as the Vice President and Controller of the Automobile Club of Southern California. He rejoined the Company in 1998 as Vice President and Chief Financial Officer. He was appointed President and Chief Operating Officer in October 2001 and Chief Executive Officer in January 2007. Mr. Tirador has over 20 years experience in the property and casualty insurance industry and is an inactive Certified Public Accountant.

Mr. Lubitz, Senior Vice President and Chief Information Officer, joined the Company in January 2008. Prior to joining the Company, he served as Senior Vice President and Chief Information Officer of Option One Mortgage from 2003 to 2007. He held executive roles including Chief Information Officer of Ditech Mortgage and President of ANR Consulting Group from 2000 to 2003. Prior to 2000, he held several positions at TRW, Experian, and First American Corporation, most recently as a Senior Vice President and Chief Information Officer.

Ms. Moore, Senior Vice President and Chief Claims Officer, joined the Company in the claims department in 1981. She was named Vice President of Claims in 1991 and Vice President and Chief Claims Officer in 1995. She was promoted to Senior Vice President and Chief Claims Officer on January 1, 2007.

Mr. Sutton, Senior Vice President Customer Service, joined the Company as Assistant to the Chief Executive Officer in July 2000. He was named Vice President in September 2007 and Senior Vice President in January 2008. Prior to joining the Company, he served as President and Chief Executive Officer of the Covenant Group from 1994 to 2000. Prior to 1994, he held various executive positions at Hanover Insurance Company.

Mr. Graves, Vice President and Chief Investment Officer, has been employed by the Company in the investment department since 1986. Mr. Graves was appointed Chief Investment Officer in 1998, and named Vice President in April 2001.

Mr. Houlihan, Vice President and Chief Product Officer, joined the Company in his current position in December 2007. Prior to joining the Company, he served as National Product Manager at Bristol West Insurance Group from 2005 to 2007 and Product Manager at Progressive Insurance Company from 1999 to 2005.

Mr. Kitzmiller, Vice President and Chief Underwriting Officer, has been employed by the Company in the underwriting department since 1972. Mr. Kitzmiller was appointed Vice President in 1991, and named Chief Underwriting Officer in January 2010.

Mr. Minnich, Vice President Marketing, joined the Company as an underwriter in 1989. In 2007, he joined Superior Access Insurance Services as Director of Agency Operations and rejoined the Company as an Assistant Product Manager in 2008. In 2009, he was named Senior Director of Marketing, a role he held until appointed to his current position later in 2009. Mr. Minnich has over 20 years experience in the property and casualty insurance industry and is a Chartered Property and Casualty Underwriter.

Mr. Stalick, Vice President and Chief Financial Officer, joined the Company as Corporate Controller in 1997. In October 2000, he was named Chief Accounting Officer, a role he held until appointed to his current position in October 2001. Mr. Stalick is an inactive Certified Public Accountant.

Mr. Toney, Vice President and Chief Actuary, joined the Company in 1984 as a programmer/analyst. In 1994, he earned his Fellowship in the Casualty Actuarial Society and was appointed to his current position. Mr. Toney is Mr. Joseph s nephew.

Ms. Walters, Vice President Corporate Affairs and Secretary, has been employed by the Company since 1967, and has served as its Secretary since 1982. Ms. Walters was named Vice President Corporate Affairs in 1998.

Item 1A. Risk Factors

The Company s business involves various risks and uncertainties in addition to the normal risks of business, some of which are discussed in this section. It should be noted that the Company s business and that of other insurers may be adversely affected by a downturn in general economic conditions and other forces beyond the Company s control. In addition, other risks and uncertainties not presently known or that the Company currently believes to be immaterial may also adversely affect the Company s business. If any such risks or uncertainties, or any of the following risks or uncertainties, develop into actual events, there could be a materially adverse effect on the Company s business, financial condition, results of operations, or liquidity.

The information discussed below should be considered carefully with the other information contained in this Annual Report on Form 10-K and the other documents and materials filed by the Company with the SEC, as well as news releases and other information publicly disseminated by the Company from time to time.

Risks Related to the Company s Business

The Company remains highly dependent upon California and several other key states to produce revenues and operating profits.

For the year ended December 31, 2010, the Company generated approximately 76.6% of its direct automobile insurance premiums written in California, 7.8% in Florida, 3.9% in New Jersey, and 3.2% in Texas. The Company s financial results are subject to prevailing regulatory, legal, economic, demographic, competitive, and other conditions in these states and changes in any of these conditions could negatively impact the Company s results of operations.

Mercury General is a holding company that relies on regulated subsidiaries for cash operating profits to satisfy its obligations.

As a holding company, Mercury General maintains no operations that generate revenue sufficient to pay operating expenses, shareholders dividends, or principal or interest on its indebtedness. Consequently, Mercury General relies on the ability of the Insurance Companies, particularly the California Companies, to pay dividends for Mercury General to meet its debt payment and other obligations. The ability of the Insurance Companies to pay dividends is regulated by state insurance laws, which limit the amount of, and in certain circumstances may prohibit the payment of, cash dividends. Generally, these insurance regulations permit the payment of dividends only out of earned surplus in any year which, together with other dividends or distributions made within the preceding 12 months, do not exceed the greater of 10% of statutory surplus as of the end of the preceding year or the net income for the preceding year, with larger dividends payable only after receipt of prior regulatory approval. The inability of the Insurance Companies to pay dividends in an amount sufficient to enable the Company to meet its cash requirements at the holding company level could have a material adverse effect on the Company s results of operations, financial condition, and its ability to pay dividends to its shareholders. On December 16, 2010, the California DOI notified the Company that MCC was authorized to pay a $270 million extraordinary dividend to Mercury General in 2011. Mercury General intends to use the proceeds from the dividend to repay the $125 million senior notes and to fund shareholder dividends.

The Company s insurance subsidiaries are subject to minimum capital and surplus requirements, and any failure to meet these requirements could subject the Company s insurance subsidiaries to regulatory action.

The Company s insurance subsidiaries are subject to risk-based capital standards and other minimum capital and surplus requirements imposed under applicable laws of their state of domicile. The risk-based capital standards, based upon the Risk-Based Capital Model Act adopted by the NAIC, require the Company s insurance subsidiaries to report their results of RBC calculations to state departments of insurance and the NAIC. If any of the Company s insurance subsidiaries fails to meet these standards and requirements, the DOI regulating such subsidiary may require specified actions by the subsidiary.

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The Company s success depends on its ability to accurately underwrite risks and to charge adequate premiums to policyholders.

The Company s financial condition, results of operations, and liquidity, depend on its ability to underwrite and set premiums accurately for the risks it assumes. Premium rate adequacy is necessary to generate sufficient premium to offset losses, loss adjustment expenses, and underwriting expenses and to earn a profit. In order to price its products accurately, the Company must collect and properly analyze a substantial volume of data; develop, test, and apply appropriate rating formulae; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. The Company s ability to undertake these efforts successfully, and as a result, price accurately, is subject to a number of risks and uncertainties, including, but not limited to:

- availability of sufficient reliable data;
- incorrect or incomplete analysis of available data;
- uncertainties inherent in estimates and assumptions, generally;
- selection and application of appropriate rating formulae or other pricing methodologies;
- successful innovation of new pricing strategies;
- recognition of changes in trends and in the projected severity and frequency of losses;
- the Company s ability to forecast renewals of existing policies accurately;
- unanticipated court decisions, legislation or regulatory action;
- ongoing changes in the Company s claim settlement practices;
- changes in operating expenses;
- changing driving patterns;
- extra-contractual liability arising from bad faith claims;
- weather catastrophes;
- losses from sinkhole claims;

- unexpected medical inflation; and

- unanticipated inflation in auto repair costs, auto parts prices, and used car prices.

Such risks may result in the Company s pricing being based on outdated, inadequate or inaccurate data or inappropriate analyses, assumptions or methodologies, and may cause the Company to estimate incorrectly future changes in the frequency or severity of claims. As a result, the Company could underprice risks, which would negatively affect the Company s margins, or it could overprice risks, which could reduce the Company s volume and competitiveness. In either event, the Company s financial condition, results of operations, and liquidity could be materially adversely affected.

The effects of emerging claim and coverage issues on the Company s business are uncertain and may have an adverse effect on the Company s business.

As industry practices and legal, judicial, social, and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect the Company s business by either extending coverage beyond its underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until sometime after the Company has issued insurance policies that are affected by the changes. As a result, the full extent of liability under the Company s insurance policies may not be known for many years after a policy is issued.

The Company s insurance rates are subject to prior approval by the departments of insurance in most of the states in which the Company operates, and to political influences.

In most of the states in which the Company operates, it must obtain prior approval from the state department of insurance of insurance rates charged to its customers, including any increases in those rates. If the Company is unable to receive approval of the rate changes it requests, the Company s ability to operate its business in a profitable manner may be limited and its financial condition, results of operations, and liquidity may be adversely affected.

From time to time, the auto insurance industry comes under pressure from state regulators, legislators, and special interest groups to reduce, freeze, or set rates at levels that do not correspond with underlying costs, in the opinion of the Company s management. The homeowners insurance business faces similar pressure, particularly as regulators in catastrophe-prone states seek an acceptable methodology to price for catastrophe exposure. In addition, various insurance underwriting and pricing criteria regularly come under attack by regulators, legislators, and special interest groups. The result could be legislation, regulations, or new interpretations of existing regulations that would adversely affect the Company s business, financial condition, and results of operations.

The Company may be unable to refinance its outstanding debt obligations or obtain sufficient capital to repay the obligations on acceptable terms, or at all.

The Company has an aggregate of $263 million in the following long-term debt obligations:

- $125 million senior notes, which mature in August 2011;
- $120 million secured credit facility, which matures in January 2012, incurred in connection with the AIS acquisition; and
- $18 million secured bank loan, which matures in March 2013, incurred in connection with the Folsom, California building acquisition.

The Company s ability to generate cash depends on many factors beyond its control, and the Company may not generate sufficient cash flow to repay the debt at maturity. The Company s ability to repay or refinance its long term debt at maturity also creates financial risk, particularly if the Company s business or prevailing financial market conditions are not conducive to refinancing the outstanding debt obligations or obtaining new financing. If the Company is unable to generate sufficient cash flow to repay the debt obligations at maturity or to refinance the obligations on commercially reasonable terms, the Company s business, financial condition, and results of operations may be harmed.

On December 16, 2010, the California DOI notified the Company that MCC was authorized to pay a $270 million extraordinary dividend to Mercury General in 2011. Mercury General intends to use a portion of the proceeds from the dividend to repay the $125 million senior notes that mature on August 15, 2011.

If the Company cannot maintain its A.M. Best ratings, it may not be able to maintain premium volume in its insurance operations sufficient to attain the Company s financial performance goals.

The Company s ability to retain its existing business or to attract new business in its insurance operations is affected by its rating by A.M. Best Company. A.M. Best Company currently rates all of the Company s insurance subsidiaries with sufficient operating history to be rated as either A+ (Superior) or A- (Excellent). If the Company is unable to maintain its A.M. Best ratings, the Company may not be able to grow its premium volume sufficiently to attain its financial performance goals, and if A.M. Best were to downgrade the Company s ratings, the result may adversely affect the Company s business, financial condition, and results of operations.

The Company s ability to access capital markets, its financing arrangements, and its business operations are dependent on favorable evaluations and ratings by credit and other rating agencies.

Financial strength and claims-paying ability ratings issued by firms such as Standard & Poor s, Fitch, and Moody s have become an increasingly important factor in the ability for the Company to access capital markets. Rating agencies assign ratings based upon their evaluations of an insurance company s ability to meet its financial obligations. The Company s financial strength ratings with Fitch and Moody s are A+ and Aa3, respectively; its respective debt ratings are A and A3. On January 21, 2011, the Company terminated its rating service with Standard & Poor s. On January 25, 2011, Standard & Poor s released a closing rating of BBB+, and has informed the Company that it will continue the rating on an unsolicited basis until the senior notes mature on August 15, 2011**.** A lowering of the existing ratings could limit the Company s access to the capital markets or adversely affect pricing of new debt sought in the capital markets in the future. These events, in turn, could have a material adverse effect on the Company s financial condition, results of operations, and liquidity.

The Company received approval from the California DOI for an extraordinary dividend, of which a portion of the proceeds will be used to repay the $125 million senior notes maturing on August 15, 2011. Once the notes are repaid, the Company will not have public debt and has no intention of raising public debt in the foreseeable future. Consequently, the Company is reducing the number of its paid rating services.

Changes in market interest rates or defaults may have an adverse effect on the Company s investment portfolio, which may adversely affect the Company s financial results.

The Company s results are affected, in part, by the performance of its investment portfolio. The Company s investment portfolio contains interest rate sensitive-investments, such as municipal and corporate bonds. Increases in market interest rates may have an adverse impact on the value of the investment portfolio by decreasing realized capital gains on fixed income securities. Declining market interest rates could have an adverse impact on the Company s investment income as it invests positive cash flows from operations and as it reinvests proceeds from maturing and called investments in new investments that could yield lower rates than the Company s investments have historically generated. Defaults in the Company s investment portfolio may produce operating losses and negatively impact the Company s results of operations.

Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions, and other factors beyond the Company s control. Although the Company takes measures to manage the risks of investing in a changing interest rate environment, it may not be able to mitigate interest rate sensitivity effectively. The Company s mitigation efforts include maintaining a high quality portfolio and managing the duration of the portfolio to reduce the effect of interest rate changes. Despite its mitigation efforts, a significant increase in interest rates could have a material adverse effect on the Company s financial condition and results of operations.

The Company s valuation of financial instruments may include methodologies, estimations, and assumptions that are subject to differing interpretations and could result in changes to valuations that may materially adversely affect the Company s financial condition or results of operations.

The Company employs a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date using the exit price. Accordingly, when market observable data is not readily available, the Company s own assumptions are set to reflect those that market participants would be presumed to use in pricing the asset or liability at the measurement date. Assets and liabilities recorded on the consolidated balance sheets at fair value are categorized based on the level of judgment associated with the input used to measure their fair value and the level of market price observability.

During periods of market disruption, including periods of significantly changing interest rates, rapidly widening credit spreads, inactivity or illiquidity, it may be difficult to value certain of the Company s securities if trading becomes less frequent and/or market data becomes less observable. There may be certain asset classes in historically active markets with significant observable data that become illiquid due to changes in the financial environment. In such cases, the valuations associated with such securities may rely more on management judgment and include inputs and assumptions that are less observable or require greater estimation as well as valuation methods, which are more sophisticated or require greater estimation. The valuations generated by such methods may be different from the value at which the investments ultimately may be sold. Further, rapidly changing and unprecedented credit and equity market conditions could materially impact the valuation of securities as reported within the Company s financial statements, and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on the Company s financial condition or results of operations.

Changes in the financial strength ratings of financial guaranty insurers issuing policies on bonds held in the Company s investment portfolio may have an adverse effect on the Company s investment results.

In an effort to enhance the bond rating applicable to certain bond issues, some bond issuers purchase municipal bond insurance policies from private insurers. The insurance generally guarantees the payment of principal and interest on a bond issue if the issuer defaults. By purchasing the insurance, the financial strength ratings applicable to the bonds are based on the credit worthiness of the insurer rather than the underlying credit of the bond issuer. Several financial guaranty insurers that have issued insurance policies covering bonds held by the Company have experienced financial strength rating downgrades due to risk exposures on insurance policies that guarantee mortgage debt and related structured products. These financial guaranty insurers are subject to DOI oversight. As the financial strength ratings of these insurers are reduced, the ratings of the insured bond issues correspondingly decrease. Although the Company has determined that the financial strength rating of the underlying bond issues in its investment portfolio are within the Company s investment policy without the enhancement provided by the insurance policies, any further downgrades in the financial strength ratings of these insurance companies or any defaults on the insurance policies written by these insurance companies may reduce the fair value of the underlying bond issues and the Company s investment portfolio or may reduce the investment results generated by the Company s investment portfolio, which could have a material adverse effect on the Company s financial condition, results of operations, and liquidity.

Deterioration of the municipal bond market in general or of specific municipal bonds held by the Company may result in a material adverse effect on the Company s financial condition, results of operations, and liquidity.

At December 31, 2010, 77.0% of the Company s total investment portfolio at fair value and 91.6% of its total fixed maturity investments at fair value were invested in tax-exempt municipal bonds. With such a large percentage of the Company s investment portfolio invested in municipal bonds, the performance of the Company s investment portfolio, including the cash flows generated by the investment portfolio is significantly dependent on the performance of municipal bonds. If the value of municipal bond markets in general or any of the Company s municipal bond holdings deteriorate, the performance of the Company s investment portfolio, financial condition, results of operations, and liquidity may be materially and adversely affected.

If the Company s loss reserves are inadequate, its business and financial position could be harmed.

The process of establishing property and liability loss reserves is inherently uncertain due to a number of factors, including underwriting quality, the frequency and amount of covered losses, variations in claims settlement practices, the costs and uncertainty of litigation, and expanding theories of liability. While the Company believes that improved actuarial techniques and databases have assisted in estimating loss reserves, the Company s methods may prove to be inadequate. If any of these contingencies, many of which are beyond the Company s control, results in loss reserves that are not sufficient to cover its actual losses, the Company s financial condition, results of operations, and liquidity may be materially adversely affected.

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There is uncertainty involved in the availability of reinsurance and the collectability of reinsurance recoverable.

The Company reinsures a portion of its potential losses on the policies it issues to mitigate the volatility of the losses on its financial condition and results of operations. The availability and cost of reinsurance is subject to market conditions, which are outside of the Company s control. From time to time, market conditions have limited, and in some cases prevented, insurers from obtaining the types and amounts of reinsurance that they consider adequate for their business needs. As a result, the Company may not be able to successfully purchase reinsurance and transfer a portion of the Company s risk through reinsurance arrangements. In addition, as is customary, the Company initially pays all claims and seeks to recover the reinsured losses from its reinsurers. Although the Company reports as assets the amount of claims paid which the Company expects to recover from reinsurers, no assurance can be given that the Company will be able to collect from its reinsurers. If the amounts actually recoverable under the Company s reinsurance treaties are ultimately determined to be less than the amount it has reported as recoverable, the Company may incur a loss during the period in which that determination is made.

The failure of any of the loss limitation methods employed by the Company could have a material adverse effect on its financial condition or results of operations.

Various provisions of the Company s policies, such as limitations or exclusions from coverage which are intended to limit the Company s risks, may not be enforceable in the manner the Company intends. In addition, the Company s policies contain conditions requiring the prompt reporting of claims and the Company s right to decline coverage in the event of a violation of that condition. While the Company s insurance product exclusions and limitations reduce the Company s loss exposure and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or legislation could be enacted modifying or barring the use of such endorsements and limitations in a way that would adversely affect the Company s loss experience, which could have a material adverse effect on its financial condition or results of operations.

The Company s business is vulnerable to significant catastrophic property loss, which could have an adverse effect on its financial condition and results of operations.

The Company faces a significant risk of loss in the ordinary course of its business for property damage resulting from natural disasters, man-made catastrophes and other catastrophic events, particularly hurricanes, earthquakes, hail storms, explosions, tropical storms, fires, sinkholes, war, acts of terrorism, severe winter weather and other natural and man-made disasters. Such events typically increase the frequency and severity of automobile and other property claims. Because catastrophic loss events are by their nature unpredictable, historical results of operations may not be indicative of future results of operations, and the occurrence of claims from catastrophic events is likely to result in substantial volatility in the Company s financial condition and results of operations from period to period. Although the Company attempts to manage its exposure to such events, the occurrence of one or more major catastrophes in any given period could have a material and adverse impact on the Company s financial condition and results of operations and could result in substantial outflows of cash as losses are paid.

The Company depends on independent agents and brokers who may discontinue sales of its policies at any time.

The Company sells its insurance policies through approximately 5,700 independent agents and brokers. The Company must compete with other insurance carriers for these agents and brokers business. Some competitors offer a larger variety of products, lower prices for insurance coverage, higher commissions, or more attractive non-cash incentives. To maintain its relationship with these independent agents, the Company must pay competitive commissions, be able to respond to their needs quickly and adequately, and create a consistently high level of customer satisfaction. If these independent agents find it preferable to do business with the Company s competitors, it would be difficult to renew the Company s existing business or attract new business. State regulations may also limit the manner in which the Company s producers are compensated or incentivized. Such developments could negatively impact the Company s relationship with these parties and ultimately reduce revenues.

The Company s expansion plans may adversely affect its future profitability.

The Company intends to continue to expand its operations in several of the states in which the Company has operations and into states in which it has not yet begun operations. The intended expansion will necessitate increased expenditures. The Company expects to fund these expenditures out of cash flow from operations. The expansion may not occur, or if it does occur may not be successful in providing increased revenues or profitability. If the Company s cash flow from operations is insufficient to cover the increased costs of the expansion, or if the expansion does not provide the benefits anticipated, the Company s financial condition, results of operations, and ability to grow its business may be harmed.

The Company may require additional capital in the future, which may not be available or may only be available on unfavorable terms.

The Company s future capital requirements depend on many factors, including its ability to write new business successfully, its ability to establish premium rates and reserves at levels sufficient to cover losses, the success of its current expansion plans and the performance of its investment portfolio. The Company may need to raise additional funds through equity or debt financing, sales of all or a portion of its investment portfolio or curtail its growth and reduce its assets. Any equity or debt financing, if available at all, may not be available on terms that are favorable to the Company. In the case of equity financing, the Company s shareholders could experience dilution. In addition, such securities may have rights, preferences, and privileges that are senior to those of the Company s current shareholders. If the Company cannot obtain adequate capital on favorable terms or at all, its business, financial condition, and results of operations could be adversely affected.

Funding for the Company s future growth may depend upon obtaining new financing, which may be difficult to obtain given prevalent economic conditions.

To accommodate the Company s expected future growth, the Company may require funding in addition to cash provided from current operations. The Company s ability to obtain financing may be constrained by current economic conditions affecting global financial markets. Specifically, with the recent trends affecting the banking industry, many lenders and institutional investors have ceased funding even the most credit-worthy borrowers. If the Company is unable to obtain necessary financing, it may be unable to take advantage of opportunities with potential business partners or new products or to otherwise expand its business as planned.

Any inability of the Company to realize its deferred tax assets may have a material adverse effect on the Company s financial condition and results of operations.

The Company recognizes deferred tax assets and liabilities for the future tax consequences related to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for tax credits. The Company evaluates its deferred tax assets for recoverability based on available evidence, including assumptions about future profitability and capital gain generation. Although management believes that it is more likely than not that the deferred tax assets will be realized, some or all of the Company s deferred tax assets could expire unused if the Company is unable to generate taxable income of a sufficient nature in the future sufficient to utilize them.

If the Company determines that it would not be able to realize all or a portion of its deferred tax assets in the future, the Company would reduce the deferred tax asset through a charge to earnings in the period in which the determination is made. This charge could have a material adverse effect on the Company s results of operations and financial condition. In addition, the assumptions used to make this determination are subject to change from

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period to period based on changes in tax laws or variances between the Company s projected operating performance and actual results. As a result, significant management judgment is required in assessing the possible need for a deferred tax asset valuation allowance. For these reasons and because changes in these assumptions and estimates can materially affect the Company s results of operations and financial condition, management has included the assessment of a deferred tax asset valuation allowance as a critical accounting estimate.

The carrying value of the Company s goodwill and other intangible assets could be subject to an impairment write-down.

At December 31, 2010, the Company s consolidated balance sheet reflected $43 million of goodwill and $60 million of other intangible assets. The Company continually evaluates whether events or circumstances have occurred that suggest that the fair value of its intangible assets are below their respective carrying values. The determination that the fair value of the Company s intangible assets is less than its carrying value may result in an impairment write-down. The impairment write-down would be reflected as expense and could have a material adverse effect on the Company s results of operations during the period in which it recognizes the expense. In the future, the Company may incur impairment charges related to the goodwill and other intangible assets already recorded or arising out of future acquisitions.

The Company relies on its information technology systems to manage many aspects of its business, and any failure of these systems to function properly or any interruption in their operation could result in a material adverse effect on the Company s business, financial condition, and results of operations.

The Company depends on the accuracy, reliability, and proper functioning of its information technology systems. The Company relies on these information technology systems to effectively manage many aspects of its business, including underwriting, policy acquisition, claims processing and handling, accounting, reserving and actuarial processes and policies, and to maintain its policyholder data. The Company is developing and deploying new information technology systems that are designed to manage many of these functions across all of the states in which it operates and all of the lines of insurance it offers. See Overview Technology in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. The failure of hardware or software that supports the Company s information technology systems, the loss of data contained in the systems, or any delay or failure in the full deployment of the Company s new information technology systems could disrupt its business and could result in decreased premiums, increased overhead costs, and inaccurate reporting, all of which could have a material adverse effect on the Company s business, financial condition, and results of operations.

In addition, despite system redundancy, the implementation of security measures, and the existence of a disaster recovery plan for the Company s information technology systems, these systems are vulnerable to damage or interruption from:

- earthquake, fire, flood and other natural disasters;
- terrorist attacks and attacks by computer viruses or hackers;
- power loss;
- unauthorized access; and
- computer systems, Internet, telecommunications or data network failure.

It is possible that a system failure, accident, or security breach could result in a material disruption to the Company s business. In addition, substantial costs may be incurred to remedy the damages caused by these disruptions. Following implementation of its new information technology systems, the Company may from time to time install new or upgraded business management systems. To the extent that a critical system fails or is not properly implemented and the failure cannot be corrected in a timely manner, the Company may experience disruptions to the business that could have a material adverse effect on the Company s results of operations.

Changes in accounting standards issued by the Financial Accounting Standards Board (FASB) or other standard-setting bodies may adversely affect the Company s consolidated financial statements.

The Company s consolidated financial statements are subject to the application of GAAP, which is periodically revised and/or expanded. Accordingly, the Company is required to adopt new or revised accounting standards from time to time issued by recognized authoritative bodies, including the FASB. It is possible that future changes the Company is required to adopt could change the current accounting treatment that the Company applies to its consolidated financial statements and that such changes could have a material adverse effect on the Company s financial condition and results of operations. See Note 1 of Notes to Consolidated Financial Statements.

The Company may be required to adopt International Financial Reporting Standards (IFRS). The ultimate adoption of such standards could negatively impact its financial condition or results of operations.

Although not yet required, the Company could be required to adopt IFRS, which differs from GAAP, for the Company s accounting and reporting standards. The ultimate implementation and adoption of new standards could favorably or unfavorably impact the Company s financial condition or results of operations.

The Company s disclosure controls and procedures may not prevent or detect acts of fraud.

The Company s disclosure controls and procedures are designed to reasonably assure that information required to be disclosed in reports filed or submitted under the Securities Exchange Act is accumulated and communicated to management and is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. The Company s management, including its Chief Executive Officer and Chief Financial Officer, believe that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, the Company cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by an unauthorized override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and the Company cannot assure that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

Failure to maintain an effective system of internal control over financial reporting may have an adverse effect on the Company s stock price.

Section 404 of the Sarbanes-Oxley Act of 2002, as amended, and the related rules and regulations promulgated by the SEC require the Company to include in its Annual Report on Form 10-K a report by its management regarding the effectiveness of the Company s internal control over financial reporting. The report includes, among other things, an assessment of the effectiveness of the Company s internal control over financial reporting as of the end of its fiscal year, including a statement as to whether or not the Company s internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in the Company s internal control over financial reporting identified by management. Areas of the Company s internal control over financial reporting may require improvement from time to time. If management is unable to assert that the Company s internal control over financial reporting is effective now or in any future period, or if the Company s independent auditors are unable to express an opinion on the effectiveness of those internal controls, investors may lose confidence in the accuracy and completeness of the Company s financial reports, which could have an adverse effect on its stock price.

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The ability of the Company to attract, develop and retain talented employees, managers and executives, and to maintain appropriate staffing levels, is critical to the Company s success.

As the Company expands its operations, it hires and trains new employees and retains current employees to handle the resulting increase in new inquiries, policies, customers, and claims. The failure to successfully hire and retain a sufficient number of skilled employees could result in the Company having to slow the growth of its business. In addition, the failure of adequate staffing of claims and underwriting departments could result in decreased quality of the Company s operations.

The Company s success also depends upon the continued contributions of its executive officers, both individually and as a group. The Company s future performance will be substantially dependent on its ability to retain and motivate its management team. The loss of the services of any of the Company s executive officers could prevent the Company from successfully implementing its business strategy, which could have a material adverse effect on the Company s business, financial condition, and results of operations.

Continuing negative economic conditions may negatively affect the Company s business and operating results.

Continuing negative economic conditions could adversely affect the Company in the form of consumer behavior and pressure on its investment portfolio. Consumer behavior could include policy cancellations, modifications, or non-renewals, which may reduce cash flows from operations and investments, may harm the Company s financial position, and may reduce the Insurance Companies statutory surplus. Challenging economic conditions also may impair the ability of the Company s customers to pay premiums as they fall due, and as a result, the Company s bad debt reserves and write-offs could increase. It is also possible that claims fraud may increase. The Company s investment portfolios could be adversely affected as a result of deteriorating financial and business conditions affecting the issuers of the securities in the Company s investment portfolio. In addition, declines in the Company s profitability could result in a charge to earnings for the impairment of goodwill, which would not affect the Company s cash flow but could decrease its earnings, and its stock price could be adversely affected.

Many economists believe that the severe economic recession is over but they expect the recovery to be slow with many businesses feeling the effects of the downturn for years to come. The Company is unable to predict the duration and severity of the current disruption in the financial markets in the United States, and in California, where the majority of the Company s business is produced. If economic conditions do not show significant improvement, the adverse impact on the Company s financial condition, results of operations, and liquidity may continue.

The presence of defective Chinese-made drywall in homes subject to our homeowner policies may lead to additional losses and expenses.

Some homeowners in southern Florida have experienced unpleasant odors and unusual air-conditioning problems, which have been linked to the use of defective Chinese-made drywall. It is difficult to accurately estimate any covered losses that may develop as a result of these problems. However, if and to the extent the scope of the Chinese-made drywall problems proves to be significant, the Company could incur costs or liabilities related to this issue that could have a material adverse effect on its financial condition, results of operations, and liquidity.

The Company s business is vulnerable to significant losses related to sinkhole claims, which could have an adverse effect on its results of operations.

In December 2010, the Florida Senate issued a 47-page report entitled Issues Relating to Sinkhole Insurance. The report states that the Florida Insurance Commissioner has identified sinkhole claims as a major cost driver and has expressed concern that such claims could threaten the solvency of domestic insurers and have a destabilizing effect on an already fragile market. While the Company, with approximately 8,000 homeowners

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policies in-force in Florida, does not believe that the sinkhole issue creates solvency concerns, it does impair profitability. The Company is in the process of withdrawing from the Florida homeowners market and expects to complete the withdrawal in 2012. The Company expects that it will continue to experience losses and claims frequency could increase through the completion of the withdrawal.

Risks Related to the Company s Industry

The private passenger automobile insurance industry is highly competitive, and the Company may not be able to compete effectively against larger, better-capitalized companies.

The Company competes with many property and casualty insurance companies selling private passenger automobile insurance in the states in which the Company operates. Many of these competitors are better capitalized than the Company and have higher A.M. Best ratings. The superior capitalization of the competitors may enable them to offer lower rates, to withstand larger losses, and to more effectively take advantage of new marketing opportunities. The Company s competition may also become increasingly better capitalized in the future as the traditional barriers between insurance companies and banks and other financial institutions erode and as the property and casualty industry continues to consolidate. The Company s ability to compete against these larger, better-capitalized competitors depends on its ability to deliver superior service and its strong relationships with independent agents.

The Company may undertake strategic marketing and operating initiatives to improve its competitive position and drive growth. If the Company is unable to successfully implement new strategic initiatives or if the Company s marketing campaigns do not attract new customers, the Company s competitive position may be harmed, which could adversely affect the Company s business and results of operations. Additionally, in the event of a failure of any competitor, the Company and other insurance companies would likely be required by state law to absorb the losses of the failed insurer and would be faced with an unexpected surge in new business from the failed insurer s former policyholders.

The Company may be adversely affected by changes in the private passenger automobile insurance industry.

Approximately 82.7% of the Company s direct written premiums for the year ended December 31, 2010 were generated from private passenger automobile insurance policies. Adverse developments in the market for personal automobile insurance or the personal automobile insurance industry in general, whether related to changes in competition, pricing or regulations, could cause the Company s results of operations to suffer. The property-casualty insurance industry is also exposed to the risks of severe weather conditions, such as rainstorms, snowstorms, hail and ice storms, hurricanes, tornadoes, wild fires, sinkholes, earthquakes and, to a lesser degree, explosions, terrorist attacks and riots. The automobile insurance business is also affected by cost trends that impact profitability. Factors which negatively affect cost trends include inflation in automobile repair costs, automobile parts costs, used car prices, and medical care.

The insurance industry is subject to extensive regulation, which may affect the Company s ability to execute its business plan and grow its business.

The Company is subject to comprehensive regulation and supervision by government agencies in each of the states in which its insurance subsidiaries are domiciled, sell insurance products, issue policies, or handle claims. Some states impose restrictions or require prior regulatory approval of specific corporate actions, which may adversely affect the Company s ability to operate, innovate, obtain necessary rate adjustments in a timely manner or grow its business profitably. These regulations provide safeguards for policyholders and are not intended to protect the interests of shareholders. The Company s ability to comply with these laws and regulations, and to obtain necessary regulatory action in a timely manner, is and will continue to be, critical to its success. Some of these regulations include:

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Required Licensing. The Company operates under licenses issued by the DOI in the states in which the Company sells insurance. If a regulatory authority denies or delays granting a new license, the Company s ability to enter that market quickly or offer new insurance products in that market may be substantially impaired. Also, if the DOI in any state in which the Company currently operates suspends, non-renews, or revokes an existing license, the Company would not be able to offer affected products in the state.

Transactions Between Insurance Companies and Their Affiliates. Transactions between the Insurance Companies and their affiliates (including the Company) generally must be disclosed to state regulators, and prior approval of the applicable regulator is required before any material or extraordinary transaction may be consummated. State regulators may refuse to approve or delay approval of some transactions, which may adversely affect the Company s ability to innovate or operate efficiently.

Regulation of Insurance Rates and Approval of Policy Forms. The insurance laws of most states in which the Company conducts business require insurance companies to file insurance rate schedules and insurance policy forms for review and approval. If, as permitted in some states, the Company begins using new rates before they are approved, it may be required to issue refunds or credits to the Company s policyholders if the new rates are ultimately deemed excessive or unfair and disapproved by the applicable state regulator. In other states, prior approval of rate changes is required and there may be long delays in the approval process or the rates may not be approved. Accordingly, the Company s ability to respond to market developments or increased costs in that state can be adversely affected.

Restrictions on Cancellation, Non-Renewal or Withdrawal. Most of the states in which the Company operates have laws and regulations that limit its ability to exit a market. For example, these states may limit a private passenger auto insurer s ability to cancel and non-renew policies or they may prohibit the Company from withdrawing one or more lines of insurance business from the state unless prior approval is received from the state insurance department. In some states, these regulations extend to significant reductions in the amount of insurance written, not just to a complete withdrawal. Laws and regulations that limit the Company s ability to cancel and non-renew policies in some states or locations and that subject withdrawal plans to prior approval requirements may restrict the Company s ability to exit unprofitable markets, which may harm its business and results of operations.

Other Regulations. The Company must also comply with regulations involving, among other matters:

- the use of non-public consumer information and related privacy issues;
- the use of credit history in underwriting and rating;
- limitations on the ability to charge policy fees;
- limitations on types and amounts of investments;
- the payment of dividends;
- the acquisition or disposition of an insurance company or of any company controlling an insurance company;
- involuntary assignments of high-risk policies, participation in reinsurance facilities and underwriting associations, assessments and other governmental charges;
- reporting with respect to financial condition;

- periodic financial and market conduct examinations performed by state insurance department examiners; and

- the other regulations discussed in this Annual Report on Form 10-K.

The failure to comply with these laws and regulations may also result in regulatory actions, fines and penalties, and in extreme cases, revocation of the Company s ability to do business in that jurisdiction. In addition, the Company may face individual and class action lawsuits by insured and other parties for alleged violations of certain of these laws or regulations.

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In addition, from time to time, the Company may support or oppose legislation or other amendments to insurance regulations in California or other states in which it operates. Consequently, the Company may receive negative publicity related to its support or opposition of legislative or regulatory changes that may have a material adverse effect on the Company s financial condition, results of operations, and liquidity.

Regulation may become more extensive in the future, which may adversely affect the Company s business, financial condition, and results of operations.

No assurance can be given that states will not make existing insurance-related laws and regulations more restrictive in the future or enact new restrictive laws. New or more restrictive regulation in any state in which the Company conducts business could make it more expensive for it to continue to conduct business in these states, restrict the premiums the Company is able to charge or otherwise change the way the Company does business. In such events, the Company may seek to reduce its writings in or to withdraw entirely from these states. In addition, from time to time, the United States Congress and certain federal agencies investigate the current condition of the insurance industry to determine whether federal regulation is necessary. The Company cannot predict whether and to what extent new laws and regulations that would affect its business will be adopted, the timing of any such adoption and what effects, if any, they may have on the Company s business, financial condition, and results of operations.

Assessments and other surcharges for guaranty funds, second-injury funds, catastrophe funds, and other mandatory pooling arrangements may reduce the Company s profitability.

Virtually all states require insurers licensed to do business in their state to bear a portion of the loss suffered by some insured parties as the result of impaired or insolvent insurance companies. Many states also have laws that established second-injury funds to provide compensation to injured employees for aggravation of a prior condition or injury which are funded by either assessments based on paid losses or premium surcharge mechanisms. In addition, as a condition to the ability to conduct business in various states, the insurance subsidiaries must participate in mandatory property and casualty shared market mechanisms or pooling arrangements, which provide various types of insurance coverage to individuals or other entities that otherwise are unable to purchase that coverage from private insurers. The effect of these assessments and mandatory shared-market mechanisms or changes in them could reduce the Company s profitability in any given period or limit its ability to grow its business.

The insurance industry faces risks related to litigation, which, if resolved unfavorably, could result in substantial penalties and/or monetary damages, including punitive damages. In addition, insurance companies incur material expenses in the defense of litigation and their results of operations or financial condition could be adversely affected if they fail to accurately project litigation expenses.

Insurance companies are subject to a variety of legal actions including employee benefit claims, wage and hour claims, breach of contract actions, tort claims, and fraud and misrepresentation claims. In addition, insurance companies incur and likely will continue to incur potential liability for claims related to the insurance industry in general and the Company s business in particular, such as claims by policyholders alleging failure to pay for, termination or non-renewal of coverage, sales practices, claims related to reinsurance matters, and other matters. Such actions can also include allegations of fraud, misrepresentation, and unfair or improper business practices and can include claims for punitive damages.

Court decisions and legislative activity may increase exposures for any of the types of claims insurance companies face. There is a risk that insurance companies could incur substantial legal fees and expenses, including discovery expenses, in any of the actions companies defend in excess of amounts budgeted for defense.

The Company and its insurance subsidiaries are named as defendants in a number of lawsuits. These lawsuits are described more fully at Overview B. Regulatory and Legal Matters in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 17 of Notes to Consolidated Financial Statements. Litigation, by its very nature, is unpredictable and the outcome of these cases is uncertain. The precise nature of the relief that may be sought or granted in any lawsuits is uncertain and may negatively impact the manner in which the Company conducts its business and results of operations, which could materially increase the Company s legal expenses. In addition, potential litigation involving new claim, coverage, and business practice issues could adversely affect the Company s business by changing the way policies are priced, extending coverage beyond its underwriting intent, or increasing the size of claims.

Loss or significant restriction of the use of credit scoring in the pricing and underwriting of personal lines products could reduce the Company s future profitability.

The Company uses credit scoring as a factor in pricing decisions where allowed by state law. Some consumer groups and regulators have questioned whether the use of credit scoring unfairly discriminates against some groups of people and are calling for the prohibition or restriction on the use of credit scoring in underwriting and pricing. Laws or regulations that significantly curtail the use of credit scoring, if enacted in a large number of states, could impact the Company s future results of operations.

Risks Related to the Company s Stock

The Company is controlled by small number of shareholders who will be able to exert significant influence over matters requiring shareholder approval, including change of control transactions.

George Joseph and Gloria Joseph collectively own more than 50% of the Company s common stock. Accordingly, George Joseph and Gloria Joseph have the ability to exert significant influence on the actions the Company may take in the future, including change of control transactions. This concentration of ownership may conflict with the interests of the Company s other shareholders and the holders of its debt securities.

Future sales of common stock may affect the market price of the Company s common stock and the future exercise of options and warrants will result in dilution to the Company s shareholders.

The Company may raise capital in the future through the issuance and sale of shares of its common stock. The Company cannot predict what effect, if any, such future sales will have on the market price of its common stock. Sales of substantial amounts of its common stock in the public market could adversely affect the market price of the Company s outstanding common stock, and may make it more difficult for shareholders to sell common stock at a time and price that the shareholder deems appropriate. In addition, the Company has issued options to purchase shares of its common stock. In the event that any options to purchase common stock are exercised, shareholders will suffer dilution in their investment.

Applicable insurance laws may make it difficult to effect a change of control of the Company or the sale of any of its insurance subsidiaries.

Before a person can acquire control of a U.S. insurance company or any holding company of a U.S. insurance company, prior written approval must be obtained from the DOI of the state where the insurer is domiciled. Prior to granting approval of an application to acquire control of the insurer or holding company, the state DOI will consider a number of factors relating to the acquirer and the transaction. These laws and regulations may discourage potential acquisition proposals and may delay, deter or prevent a change of control of the Company or the sale by the Company of any of its insurance subsidiaries, including transactions that some or all of the Company s shareholders might consider to be desirable.

Although the Company has consistently paid cash dividends in the past, it may not be able to pay cash dividends in the future.

The Company has paid cash dividends on a consistent basis since the public offering of its common stock in November 1985. However, future cash dividends will depend upon a variety of factors, including the Company s profitability, financial condition, capital needs, future prospects and other factors deemed relevant by the Board of Directors. The Company s ability to pay dividends may also be limited by the ability of the Insurance

Companies to make distributions to the Company, which may be restricted by financial, regulatory or tax constraints, and by the terms of the Company s debt instruments. In addition, there can be no assurance that the Company will continue to pay dividends even if the necessary financial and regulatory conditions are met and if sufficient cash is available for distribution.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company owns the following buildings which are mostly occupied by the Company s employees. Space not occupied by the Company is leased to independent third party tenants. In addition, the Company owns a 4.2 acre parcel of land in Brea, California for future expansion. The Company leases all of its other office space for operations. Office location is not crucial to the Company s operations, and the Company anticipates no difficulty in extending these leases or obtaining comparable office space. The Company s properties are well maintained, adequately meet its needs, and are being utilized for their intended purposes.

Location	Purpose	Size in square feet	Percent occupied by the Company at December 31, 2010
Brea, CA	Home office and I.T. facilities (2 buildings)	236,000	100%
Folsom, CA	Administrative and Data Center	88,000	100%
Los Angeles, CA	Executive offices	41,000	95%
Rancho Cucamonga, CA	Administrative	127,000	100%
St. Petersburg, FL	Administrative	157,000	74%
Oklahoma, OK	Administrative	100,000	77%

Item 3. Legal Proceedings

The Company is, from time to time, named as a defendant in various lawsuits incidental to its insurance business. In most of these actions, plaintiffs assert claims for punitive damages, which are not insurable under judicial decisions. The Company has established reserves for lawsuits in which the Company can estimate potential exposure and that the likelihood that the court will rule against the Company is probable. Additionally, from time to time, regulators may take actions to challenge the Company s business practices. The Company vigorously defends actions, unless a reasonable settlement appears appropriate. An unfavorable ruling against the Company in the actions currently pending may have a material impact on the Company s results of operations in the period of such ruling; however, none is expected to be material to the Company s financial condition. For a discussion of legal matters, see Overview B. Regulatory and Legal Matters in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 17 of Notes to Consolidated Financial Statements, which is incorporated herein by reference.

There are no environmental proceedings arising under federal, state, or local laws or regulations to be discussed.

Item 4. Removed and Reserved

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Market Information

The following table presents the high and low sales price per share on the New York Stock Exchange (symbol: MCY) since January, 2009.

2010	**High**	**Low**
1st Quarter	$ 44.19	$ 37.38
2nd Quarter	$ 46.66	$ 41.13
3rd Quarter	$ 44.40	$ 37.90
4th Quarter	$ 45.08	$ 40.51

2009	**High**	**Low**
1st Quarter	$ 46.09	$ 22.45
2nd Quarter	$ 35.74	$ 28.90
3rd Quarter	$ 37.82	$ 31.00
4th Quarter	$ 40.12	$ 35.43

The closing price of the Company s common stock on February 4, 2011 was $42.94.

Holders

As of February 4, 2011, there were approximately 149 holders of record of the Company s common stock.

Dividends

Since the public offering of its common stock in November 1985, the Company has paid regular quarterly dividends on its common stock. During 2010 and 2009, the Company paid dividends on its common stock of $2.37 and $2.33 per share, respectively. On February 4, 2011, the Board of Directors declared a $0.60 quarterly dividend payable on March 31, 2011 to shareholders of record on March 16, 2011.

For financial statement purposes, the Company records dividends on the declaration date. The Company expects to continue the payment of quarterly dividends; however, the continued payment and amount of cash dividends will depend upon the Company s operating results, overall financial condition, capital requirements, and general business conditions.

Holding Company Act

The California Companies are subject to California DOI regulation pursuant to the provisions of the Holding Company Act. The Holding Company Act requires disclosure of any material transactions among affiliates within a Holding Company System. Certain transactions and dividends defined to be of an extraordinary type may not be affected if the California DOI disapproves the transaction within 30 days after notice. An extraordinary dividend is a dividend which, together with other dividends or distributions made within the preceding 12 months, exceeds the greater of 10% of the insurance company s statutory policyholders surplus as of the preceding December 31 or the insurance company s statutory net income for the preceding calendar year.

Insurance companies are required to notify the California DOI of any dividend after declaration, but prior to payment. There are similar limitations imposed by other states on the Insurance Companies ability to pay dividends. On December 16, 2010, the California DOI notified the Company that MCC was authorized to pay a

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$270 million extraordinary dividend to Mercury General in 2011. Mercury General intends to use the proceeds from the dividend to repay the $125 million senior notes and to fund shareholder dividends. As of December 31, 2010, the Insurance Companies are permitted to pay, without extraordinary DOI approval, $31.9 million in dividends to Mercury General, of which $14.0 million is payable from the California Companies.

For a discussion of certain restrictions on the payment of dividends to Mercury General by some of its insurance subsidiaries, see Note 12 of Notes to Consolidated Financial Statements.

Performance Graph

The following graph compares the cumulative total shareholder returns on the Company s Common Stock (Symbol: MCY) with the cumulative total returns on the Standard and Poor s 500 Composite Stock Price Index (S&P 500 Index) and the Company s industry peer group over the last five years. The graph assumes that $100 was invested on December 31, 2005 in each of the Company s Common Stock, the S&P 500 Index and the industry peer group and the reinvestment of all dividends.

Comparative Five-Year Cumulative Total Returns

Stock Price Plus Reinvested Dividends

	2005	2006	2007	2008	2009	2010
Mercury General	$ 100.00	$ 93.90	$ 92.24	$ 89.44	$ 81.99	$ 94.99
Industry Peer Group	100.00	118.20	127.66	91.14	95.86	114.87
S&P 500 Index	100.00	115.79	122.16	76.96	97.33	111.99

The industry peer group consists of Ace Limited, Alleghany Corporation, Allstate Corporation, American Financial Group, Berkshire Hathaway, Chubb Corporation, Cincinnati Financial Corporation, CNA Financial Corporation, Erie Indemnity Company, Hanover Insurance Group, HCC Insurance Holdings, Markel Corporation, Old Republic International, PMI Group, Inc., Progressive Corporation, RLI Corporation, Selective Insurance Group, Travelers Companies, Inc., W.R. Berkley Corporation and XL Capital, Ltd.

Recent Sales of Unregistered Securities

None.

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Share Repurchases

The Company has had a stock repurchase program since 1998. The Company s Board of Directors authorized a $200 million stock repurchase program on July 30, 2010, and the authorization will expire in June 2011. The Company may repurchase shares of its common stock under the program in open market transactions at the discretion of management. The Company will use dividends received from the Insurance Companies to fund the share repurchases. Since the inception of the program, the Company has purchased 1,266,100 shares of common stock at an average price of $31.36. The purchased shares were retired, and no stock has been purchased since 2000.