

REPORT OF MARKET CONDUCT EXAMINATION

**AUTO CLUB OF MISSOURI GROUP
GROUP # 1148**

**AUTOMOBILE CLUB INTER-INSURANCE EXCHANGE
FEIN # 43-6029277
NAIC # 15512
NAIC ETS # KS057-M1**

**AUTO CLUB FAMILY INSURANCE COMPANY
FEIN # 43-1453212
NAIC # 27235
NAIC ETS # KS 057-M2**

12901 NORTH FORTY DRIVE

ST. LOUIS, MO 63141

AS OF

August 31, 2005

BY

KANSAS INSURANCE DEPARTMENT

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Honorable Sandy Praeger
Insurance Commissioner
Kansas Insurance Department
420 SW Ninth Street
Topeka, KS 66612

Dear Commissioner Praeger:

In accordance with your respective authorization, and pursuant to K.S.A. 40-222, a market conduct examination has been conducted on the business affairs of:

Automobile Club Inter-Insurance Exchange

and

Auto Club Family Insurance Company

12901 North Forty Drive

St. Louis, MO 63141

hereafter referred to as “the Auto Club ” or “the Company”, and the following report of such examination is respectfully submitted,

Lyle Behrens, CPCU, CIE, ARM
Market Conduct Supervisor
Examiner in Charge

EXECUTIVE SUMMARY

The Kansas Insurance Department (KID) performed a market conduct examination of the Auto Club. The period of examination was January 1, 2003 through August 31, 2005.

The examiners reviewed the company underwriting, claims, and rating manuals. The exam team reviewed underwriting, claim, and complaint files in company's Administrative office in St Louis, MO. A series of meetings were held with the Auto Club staff that focused on their current operations. To supplement and verify the understanding of how the company does business, a series of samples were selected for review to verify their procedures and practices in claims, underwriting and rating.

The company passed most tests; and in terms of delivering good service to its insureds, the examiners were impressed with the overall positive and very professional performance by the Auto Club staff and management to their policyholders. The exam team has made recommendations on several issues.

LIST OF RECOMMENDATIONS

Company Operations and Management

1. The exam team recommends that the Auto Club complete their formalizing an internal audit program for the claims department and look into developing similar programs for underwriting and policy processing.

Complaint Handling

1. The exam team recommends that the control and record keeping of the non-insurance department complaints be coordinated and maintained with the same unit that keeps department of insurance complaints.

Underwriting and Rating

1. The Company needs to re-file their ACFIC rating factor for PIP coverage. The Company revised their filing on 12/22/05.
2. The current ACIIE auto territory pages show Territory 24 comprising a single zip code. Given the small geographic size of one zip code and small population base of that area, it would appear that ACIIE may be in violation of K.S.A. 40-953. The exam team recommends that in the next rate filing, ACIIE look at this territory definition. This territory filing was approved twelve years ago. It wasn't until 1996 that KID began to look at territories closely to make sure that companies were not over segmenting.
3. The Auto Club should allow three days for mail time on all notices of cancellation and non-renewal in the interest of consistency.

The Company indicated that they are implementing a new procedure. The cancellation notice will be prepared far enough in advance that the policyholder will be given at least 10 days actual notice (3+ days for mailing and 10 days for the notice).

4. The Auto Club should review the “Kansas insurance score act” to make sure that their forms and underwriting activities conform to K.S.A. 40-5101 through 40-5114. The Company must present a plan to KID within 30 days from the issuance of the Final Order for this exam of how they are conforming to this recommendation.

5. The Company should review their underwriting cancellation and non-renewal procedures to insure that they are in compliance with K.S.A. 40-276, K.S.A. 276a and K.S.A. 40-277 and the “Kansas insurance score act”. The Auto Club must present a plan to KID within 30 days from the issuance of the Final Order for this exam of how they are conforming to this recommendation.

General Recommendation

1. The exam team recommends that a targeted follow up exam be completed in 15 months to insure that the Auto Club has taken the necessary steps to correct the problems cited in recommendations #4 and #5 of the Underwriting and Rating portion of this exam and are now complying with the Kansas Credit Scoring Act.

PURPOSE AND SCOPE OF REVIEW

A targeted market conduct examination of The Auto Club was conducted pursuant to, but not limited to, K.S.A. 40-222. The exam team reviewed underwriting files, claims and complaints to determine if the Company was in compliance with applicable statutes, regulations and bulletins of the state of Kansas.

The audit was conducted according to the guidelines and procedures recommended in the NAIC Market Conduct Examiners Handbook (Handbook). The exam team utilized the standards and tests recommended in the Handbook. An acceptable tolerance standard per the Handbook of 7% was used for claim procedures and 10% was used for all other categories. The examination report is a report written by test rather than a report written by exception. This means all standard tests are described and results indicated.

The testing and file review for the Company's underwriting, rating and claims practices consisted of several samplings from the Company's corporate headquarters in St. Louis, MO.

The examination included a review of the Company's underwriting, complaint and settled claim files from January 1, 2004 to August 31, 2005.

General topics were covered in Interrogatories submitted to the Company for their written response. Subjects covered were Complaints, Underwriting and Claims. The responses received addressed the issues presented.

The examination included, but was **not limited to the following:**

COMPANY OVERVIEW

- History and Profile
- Prior Market Conduct Examination Reports
- Fines and/or Penalties
- Company Operations and Management
- Certificates of Authority
- Internal Audit Procedures
- Privacy Procedures

COMPLAINT HANDLING

- Record Keeping
- Timely Response

UNDERWRITING & RATING

- Proper Rating
- Underwriting Acceptance/Termination
- Use of Appropriate Forms
- Promptness of Policy Issuance
- Proper Maintenance of Underwriting Files

CLAIMS

Claim Processing

Timeliness and Accuracy of Claim Payment

Proper Maintenance of Claim Files

DESK EXAMINATION/ON-SITE EXAMINATION

COMPANY OVERVIEW

History and Profile

History - ACIIE

The Automobile Club Inter-Insurance Exchange (ACIIE) commenced its automobile insurance business in Missouri on April 15, 1927. The ACIIE is organized as a reciprocal insurance company. The ACIIE is essentially an insurer of private passenger automobiles.

ACIIE expanded its operations into Illinois on April 27, 1934, and to Kansas (Johnson and Wyandotte Counties) on July 14, 1937. In 1962, ACIIE began issuing six-month policies with automatic billing for renewals.

In October 1972, the ACIIE began writing in the territory acquired by the Auto Club of Missouri (ACM) from the Auto Club of Egypt in southern Illinois, increasing its operations to cover thirty Illinois counties.

In August 1982, the ACIIE began writing in the territory acquired by the ACM from the Arkansas Automobile Club, expanding its operation to cover this additional state.

In 1984, the ACIIE entered into an agreement with the Kansas Auto Club to write in that area of the state that did not belong to AAA Missouri. In 1995, this agreement was terminated. A new agreement was entered into in 2001. This agreement was terminated in 2004 due to a change in ownership of the Kansas Auto Club. ACIIE continues to service existing business written through those agreements.

In June 1995, the ACIIE began writing in 3 additional counties in Kansas. This was possible through a merger with the Automobile Club of St. Joseph. The 3 counties include Atchison, Brown and Doniphan.

In August 1999, the ACIIE began writing in the state of Louisiana. This territory was acquired by the Auto Club of Missouri from the American Automobile Association. In December 1999, the ACIIE began writing in the state of Oklahoma through an agreement with AAA Oklahoma.

In February 2000, the ACIIE began writing in the state of Mississippi. This territory was acquired by the ACM from the American Automobile Association.

In November 2000, the ACIIE began writing in the territory acquired by the ACM from the Auto Club of Southern Indiana. This territory covers 12 counties in Indiana.

In January 2004, the ACIIE began writing in the state of Alabama through an agreement with AAA Alabama.

History - ACFIC

In January 1990 the ACIIE purchased the Alternative Insurance Company of North America, Inc. This Missouri domiciled, stock company was incorporated in June 1987 and was licensed to sell fire and casualty lines. Upon purchase, the name was changed to the Auto Club Family Insurance Company (ACFIC).

In February 1990, the ACFIC commenced writing homeowners insurance in Missouri. In 1990, application was made to the Illinois and Kansas Insurance Departments for licensing to sell fire and casualty lines. The ACFIC commenced writing homeowners insurance in March 1991 in Illinois and in January 1992 in Kansas.

In September 1992 the ACFIC commenced writing renters insurance in Missouri. In January 1993 it commenced writing renters insurance in Illinois and Kansas.

In 1993, application was made to the Arkansas Insurance Department for licensing to sell fire and casualty lines. The ACFIC commenced writing homeowners and renters insurance in September, 1994.

The ACFIC began writing automobile insurance to those consumers whose driving characteristics did not meet the eligibility requirements of the ACIIE in June 1995. In June 1995, the ACFIC also began writing in 3 additional counties in Kansas. This was possible through a merger with the Automobile Club of St. Joseph. The 3 counties include Atchison, Brown and Doniphan.

In August 1999, the ACFIC began writing in the state of Louisiana. This territory was acquired by the ACM from the American Automobile Association.

In December 1999, the ACFIC began writing in the state of Oklahoma through an agreement with AAA Oklahoma.

In February 2000, the ACFIC began writing in the state of Mississippi. This territory was acquired by the ACM from the American Automobile Association.

In November 2000, the ACFIC began writing in the territory acquired by the ACM from the Auto Club of Southern Indiana. This territory covers 12 counties in Indiana.

In March 2004, the ACFIC began writing in the state of Alabama through an agreement with AAA Alabama.

2004 Written Premium in Kansas:

ACIIE - 2004 – Line Of Ins.	Written Premium	Earned Premium
Other liability	47,754	46,463
Private passenger auto no-fault (PIP)	854,375	839,819
Other private passenger auto liability	6,732,259	6,729,343
Private passenger auto physical damage	8,654,535	8,559,872
Totals	\$16,288,923	\$16,175,497

ACFIC - 2004 – Line Of Ins.	Written Premium	Earned Premium
Homeowners multiple peril	7,933,108	7,235,365
Private passenger auto no-fault (PIP)	91,260	89,910
Other private passenger auto liability	1,210,653	1,252,161
Private passenger auto physical damage	1,036,854	1,062,602
Totals	\$10,271,875	\$9,640,038

Both ACIIE and ACFIC hold certificates of insurance to write fire and casualty business in the following states:

Alabama
Arkansas
Illinois
Indiana
Kansas
Louisiana
Mississippi
Missouri
Ohio
Oklahoma

Table 1 is an organizational chart showing the relationship of ACIIE & ACFIC and the other affiliates of the ACM.

Company Agreements

There is a service agreement between ACM and ACIIE & ACFIC. This document spells out the necessary business services that ACM provides to ACIIE and ACFIC. This is a standard service contract and the allocation of expenses for such services as sales, claims, underwriting, Actuarial, data processing, legal, accounting and general management and administration.

The Auto Club does not use an MGA.

Internal Audits

The Company indicated that their “Internal Audit Department is in the process of developing a formal Internal Audit program for claims. At this time, however, no formal Internal Audit programs exist for complaints, underwriting and claims.”

Prior Market Conduct Examination Report(s)

The Auto Club provided the examiners with the market examination report from the State of Missouri that was conducted on the Company in 2003. There were no recommendations in this exam that required a follow up by the market conduct unit.

Fines and/or Penalties

The NAIC I-Site database was reviewed. There was nothing noted that warranted follow-up by this exam team.

Tests for Company Operations/Management

Standard 1

The company has an up-to-date, valid internal or external audit program.

The Company indicated that at the time of the audit they had no formal internal audit program for complaints and underwriting. They were in the process of developing an audit program for claims.

Standard 7

Records are adequate, accessible, consistent and orderly and comply with state record retention requirements. K.S.A. 40-222 (a)(b)(c)(g)

The Company provided the exam team with the necessary records and documents in a timely fashion.

The Company passed Standard 7.

Standard 8

The company is licensed for the lines of business that are being written. K.S.A. 40-216

The Certificate of Authority was reviewed and found to be in order, and the company was in compliance.

The Company passed Standard 8.

Standard 9

The company cooperates on a timely basis with examiners performing the examinations. K.S.A. 40-222 (c)(g)

The Company was very cooperative and provided the exam team with the items requested within the time frames established for this exam.

The Company passed Standard 9.

Standard 12

The company has policies and procedures to protect the privacy of nonpublic personal information relating to its customers, former customers and consumers that are not customers. K.A.R. 40-1-46

The Company does maintain policies and procedures for the protection of consumer nonpublic information and are regularly scheduled for review and revision. Prospective and former customers are afforded the same protections as existing members with respect to the use of personal information.

The Company passed Standard 12.

Standard 13

The company provides privacy notices to its customers and, if applicable, to its consumers who are not customers regarding treatment of nonpublic personal financial information. K.A.R. 40-1-46

Generally, the Company distributes privacy notices to all new members, insureds and travel customers within 30 days of their first transaction. Insureds receive a Notice of Privacy Policy printed as a separate sheet with every declaration page.

All branch offices have copies of the Privacy Policy and additional copies can be ordered from the headquarters warehouse. This policy is also posted on the ACMO website and can be accessed from most pages.

The Company passed Standard 13.

Standard 14

If the company discloses information subject to an opt out right, the company has policies and procedures in place so that nonpublic personal financial information will not be disclosed when a consumer who is not a customer has opted out, and the company provides opt out notices to its customers and other affected consumers. K.A.R. 40-1-46

AAA Missouri employees who are responsible for conducting solicitations must obtain their prospect lists from the Marketing Services Department. These employees may not use any other prospect lists. Customers may submit an opt out form online at the website and a link has been added to the ACMO web site on the Privacy page. The company updates its membership file daily to reflect those whose personal information should not be shared.

The Company passed Standard 14.

Standard 15

The company's collection, use and disclosure of nonpublic personal financial information are in compliance with applicable statutes, rules and regulations. K.A.R. 40-1-46

The Company maintains and periodically reviews several procedures to limit the use and disclosure of nonpublic personal financial information as required under Kansas laws which encompass the NAIC 2000 Model Privacy Regulation."

The Company passed Standard 15.

Standard 16

In states promulgating the health information provisions of the NAIC model regulation, or providing equivalent protection through other substantially similar laws under the jurisdiction of the Department of Insurance, the company has policies and procedures in place so that nonpublic personal health information will not be disclosed except as permitted by law, unless a customer or a consumer who is not a customer has authorized the disclosure.

The Company maintains an opt-out list for those who do not want their information shared. However, the opt-out applies only to non-affiliated companies. The AAA family of companies may continue to share this information.

The Company passed Standard 16.

Company Operations/Management Recommendation:

1. The exam team recommends that the Auto Club complete their formalizing an internal audit program for the claims department and look into developing similar programs for underwriting and policy processing.

COMPLAINT HANDLING

The Auto Club defines a "complaint" as any written correspondence primarily expressing a grievance.

Division of Insurance complaint: A complaint from any State Department must be immediately forwarded to the Home Office to the attention of General Counsel/Secretary of AAA Missouri, for a response. Complaints are to be resolved within ten working days from date of receipt.

Claims Complaint: A complaint to a branch claims office is resolved by the branch claim manager or their designee. Copies of the complaint form are kept by the Director of Claims in a complaint handling log, and are imaged to the applicable claim file. Complaints from the Department of Insurance are handled by the Director of Legal Services or his designee.

A running “Kansas Complaint Record” is maintained by the secretary to the Director of Legal Services. They are reviewed by the Director of Claims and the Vice President of Insurance Administration.

Tests for Complaint Handling

Standard 1

All complaints are recorded in the required format on the company complaint register. KSA 40-2404 (10).

- The complaint log for claims in which all non-insurance department complaints are recorded was not set up in the format specified in K.S.A. 40-2404 (10).

K. S.A. 40-2404. The following are hereby defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance: (10) *Failure to maintain complaint handling procedures.* Failure of any person, who is an insurer on an insurance policy, to maintain a complete record of all the complaints which it has received since the date of its last examination under K.S.A. 40-222, and amendments thereto; but no such records shall be required for complaints received prior to the effective date of this act. The record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of the complaints, the date each complaint was originally received by the insurer and the date of final disposition of each complaint. For purposes of this subsection, "complaint" means any written communication primarily expressing a grievance related to the acts and practices set out in this section.

The Company failed this standard. The Company did present to the exam team prior to finishing the on-site review a revised format that meets the requirements of K.S.A. 40-2404 (10).

Standard 2

The company has adequate complaint handling procedures in place and communicates such procedures to policyholders. KAR 40-1-34, Sections 5(a) & 6.

- The Auto Club maintains 1 log for all Insurance Department complaints. There is a separate log maintained in the claims department for all non-insurance department complaints that are related to claims. There is a similar log in the marketing department for non-insurance department's complaints that are related to sales and marketing issues. A third log is maintained in the legal department for non insurance department grievances pertaining to underwriting and rating issues.

Standard 3

The company takes adequate steps to finalize and dispose of the complaint in accordance with applicable statutes, rules and regulations, and contract language. KAR 40-1-34, 6.

The Company passed this standard.

Standard 4

The time frame within which the company responds to complaints is in accordance with applicable statutes, rules and regulations. KAR 40-1-34, Sections 6 & 8(a)(c).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Insurance Dept. Complaints	33	0	100

The Company passed Standard 4.

Complaint Handling Recommendation:

1. The exam team recommends that the control and record keeping of the non-insurance department complaints be coordinated and maintained with the same unit that keeps department of insurance complaints.

UNDERWRITING AND RATING

The company's underwriting & rating process is described below:

New Business Processing – Auto

ACIIE

New business is processed through a point of sale program in offices of captive and independent agents. All information required to qualify and rate an applicant is entered on an online application.

An automatic underwriting system assigns the following rating components:

- territory based on zip code
- classification based on age, sex, marital status and vehicle usage
- symbol based on the vehicle identification number
- tier based on driving record, years licensed, type of vehicle, prior coverage and health of the driver
- merit rating based on the driving record information provided

Based on the information provided, a quote is provided with the coverages and limits available in Kansas.

If an applicant decides to purchase a policy, the agent submits the application and a policy number is assigned.

A Comprehensive Loss Underwriting Evaluation (CLUE) report is ordered with current carrier information. If additional activity or drivers are identified, the agent receives

messages to review the CLUE report, make any necessary updates and re-rate the application if necessary.

Those applications that have all the necessary information and have no rating issues are processed automatically without underwriting review.

The remaining policies are referred to the underwriter responsible for the submitting agent. When the underwriter reviews the referred applications, they may determine an MVR is needed and order it at that time. If additional information is needed, an email is sent to the agent. Once all the information is in place, the underwriter issues or rejects the application.

Driving records are verified by CLUE reports and MVR's. Prior coverage is verified by copies of declarations pages kept in an agent's file and forwarded to the underwriter upon their request as well as current carrier information available on the CLUE report.

ACFIC

New business is processed through a point of sale program in offices of captive and independent agents. All information required to qualify and rate an applicant is entered on an online application.

An automatic underwriting system assigns the following rating components:

- territory based on zip code
- classification based on age, sex, marital status and vehicle usage
- symbol based on the vehicle identification number
- merit rating based on the driving record information provided

Based on the information provided, a quotation is provided with the coverages and limits available in Kansas.

If an applicant decides to purchase a policy, the agent submits the application and a policy number is assigned.

A CLUE report with current carrier information and a MVR for all drivers are ordered. If additional activity or drivers are identified, the agent receives messages to review the reports, make any necessary updates and re-rate the application if necessary.

Those applications that have all the necessary information and have no rating issues are processed automatically without underwriting review. Automatic issues represent about 20% of the applications submitted.

The remainder are referred to the underwriter responsible for the submitting agent. The underwriter reviews the referred applications. If additional information is needed, an email is sent to the agent. Once all the information is in place, the underwriter issues or rejects the application.

Driving records are verified by CLUE reports and MVR's. Prior coverage is verified by copies of declarations pages kept in an agent's file and forwarded to the underwriter upon their request as well as current carrier information available on the CLUE report.

New Business Processing - Homeowners

New business is processed using paper applications. Captive and independent agents complete the application, a replacement cost estimator and any required forms and forward them to AAA headquarters. Pictures are also required.

Upon receipt, the information on the application and supporting documents are keyed into the mainframe system. When this process is completed, the application is forwarded to the underwriting department. CLUE and credit reports are automatically ordered for all named insureds.

Underwriters review each application making sure the correct policy has been written, that the dwelling and the insured qualify for the program, and that the dwelling is insured for the proper amount. In addition to the application, the replacement cost estimator, pictures and supporting documentation is reviewed. At the end of this process, the underwriter issues or rejects the application.

Tests for Underwriting and Rating

Standard 1: Rating Practices

The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the company rating plan. K.S.A. 40-955.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	10	80%
Homeowners New Business	50	0	100%

- The company did not file a deviation for their PIP coverage in ACFIC for certain type of vehicles. 10 out of 13 ACFIC policies received a lower premium than was filed. This was a violation of K.S.A. 40-955 (a)(f).

The Company failed Standard 1.

Standard 2: Rating Practices

Disclosures to insureds concerning rates and coverage are accurate and timely. K.S.A. 40-955.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	0	100%
Homeowners New Business	50	0	100%

The Company passed Standard 2.

Standard 3 Rating Practices

Company does not permit illegal rebating, commission cutting or inducements.

The exam team did not specifically test for this standard. In the normal review of the sample files, any indications of rebating, commission cutting or inducements would have been reviewed, and the examiner would have noted it. There were no issues with the files that were reviewed.

Standard 4: Rating Practices

Credits and deviations are consistently applied on a non-discriminatory basis. K.S.A. 40-953 & K.S.A. 40-954.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	3	94%
Homeowners New Business	50	0	100%

- Three accounts did not have the proper driving credit applied.

The Company passed Standard 3.

Standard 5: Rating Practices

Schedule rating or individual risk premium modification plans, where permitted, are based on objective criteria with usage supported by appropriate documentation. K.A.R. 40-3-32(d), K.A.R. 40-3-12, K.S.A. 40-953 & K.S.A. 40-954.

This standard was not applicable for this exam.

Standard 11: Underwriting Practices

The company underwriting practices are not unfairly discriminatory. The company adheres to applicable statutes, rules and regulations and company guidelines in the selection of risks. K.S.A. 40-953, K.S.A. 40-954, & K.S.A. 40-955.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	0	100%
Homeowners New Business	50	0	100%

- While the sample did not show any files where there was an underwriting practice of unfair discrimination, the current ACIIE auto territory pages show Territory 24 comprising of a single zip code. Given the small geographic size of one zip code and small population base of that area, it would appear that ACIIE may be in violation of:

K.S.A. 40 -953 Rates shall not be excessive, inadequate or unfairly discriminatory ...

One rate is unfairly discriminatory in relation to another in the same class if it clearly fails to reflect equitably the differences in expected losses and expenses. Rates are not unfairly discriminatory because different premiums result for policyholders with like loss exposures but different expense factors or like expense factors but different loss exposures, so long as the rates reflect the differences with reasonable accuracy.

The Club indicated that they will review this territory definition in their next rate filing. This territory definition has been approved twelve years ago. It wasn't until 1996 that KID began to look at territories closely to make sure that companies were not over segmenting.

The Company passed Standard 11.

Standard 12: Underwriting Practices

All forms and endorsements forming a part of the contract are listed on the declaration page and should be filed with the department of insurance (if applicable). K.S.A. 40-216.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	22	56%
Homeowners New Business	50	50	0%

- Auto:

ACIIE used an application that contained the following statement, "I warrant that the statements hereon are true and correct and I understand these statements will be relied upon by the Automobile Club Inter-Insurance Exchange in issuing the policy." The use of the term "warrant" or "warranty" is a violation of:

K.A.R. 40-3-16 (b) Companies writing fire or casualty insurance, or both, shall not require their Kansas insureds or applicants to make a ``warranty," either expressed or implied, of any fact or allegation, either in the application for an insurance policy or in the policy provisions.

The Company has since revised and filed a new version of their application. It was approved in June 2005. The current application has the correct language. A sample review of policies issued after the 6/2005 file date confirmed that ACIIE is currently using the correct wording.

- Homeowners:

The Homeowners application, Form #5901KS(4/2004), was approved by KID to be effective 4/14/2004. However the Company was utilizing an individual's credit

history as an underwriting tool in determining the eligibility of an account for their Homeowners program.

The Kansas Insurance Score Act., K.S.A. 40-5101 through 40-5114, defines:

K.S.A. 40-5103 (a) "Adverse action" means any of the following in connection with the underwriting of personal insurance:

- (1) A denial or cancellation of coverage;
- (2) anything other than the best possible rate; or
- (3) a reduction or other adverse or unfavorable change in the terms of coverage of any insurance regardless of whether such insurance is in existence or has been applied for.

K.S.A. 40-5106 requires that the Company disclose to the applicant that an internal appeal process exists as provided by paragraph (b) of K.S.A. 40-5107. Since the Auto Club was taking adverse action against individuals based solely or partially on their credit history, the Company was in violation of this statute. Until the Company re-filed their application to be effective October 17, 2005, the Auto Club was in violation of:

K.A.R. 40-5106 - If an insurer writing personal insurance uses credit information in underwriting or rating a consumer, the insurer or its agent shall disclose that it may obtain credit information in connection with such application. The insurer shall further notify such consumer that an internal appeal process exists as provided by paragraph (b) of K.S.A. 40-5107 and amendments thereto. The disclosure shall be made either on the insurance application or at the time the insurance application is taken. Such disclosure shall be either written or provided to an applicant in the same medium as the application for insurance.

The Company failed Standard 12.

Standard 14: Underwriting Practices

Underwriting, rating and classification are based on adequate information developed at or near inception of the coverage rather than near expiration, or following a claim. K.S.A. 40-953.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	0	100%
Homeowners New Business	50	0	100%

The Company passed Standard 14.

Standard 15: Underwriting Practices

File documentation adequately supports decisions made. K.S.A. 40-953 & K.S.A. 40-955.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	1	100%
Homeowners New Business	50	0	100%

The Company passed Standard 15.

Standard 16: Underwriting Practices

Policies and endorsements are issued or renewed accurately, timely and completely. K.S.A. 40-216, K.S.A. 40-953 & K.S.A. 40-955.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	0	100%
Homeowners New Business	50	0	100%

The Company passed Standard 16.

Standard 18: Underwriting Practices

Company verifies that VIN number submitted with application is valid and that the correct symbol is utilized. K.S.A. 40-953 & K.S.A. 40-954.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto New Business	50	0	100%

The Company passed Standard 18.

Standard 22: Rejections/Declinations

Rejections and declinations are not unfairly discriminatory. K.S.A. 40-954 (c) & K.A.R. 40-3-40.

The Company does not reject or decline a new submission. Bound applications are issued and then cancelled if the client does not meet the new business criteria.

Standard 23: Termination Practices

Cancellation/non-renewal notices comply with policy provisions and state laws, including the amount of advance notice provided to the insured and other parties to the contract. K.S.A. 40-276(a), K.S.A. 40-277, K.S.A. 40-278, K.S.A. 40-2,111, K.S.A. 40-2,112, K.S.A. 40-2,120, K.S.A. 40-2,121, K.S.A. 40-2,122, K.A.R. 40-3-15, K.A.R. 40-3-23, K.A.R. 40-3-28 & K.A.R. 40-3-31.

1. Mailing Time

- Out of a sample of 25 policies cancelled for reason of nonpayment, 22 did not allow sufficient mailing time for the cancellation notice to arrive at the insured's address with 10 days notice before cancellation. The Certified Mailing Lists were

prepared 1-3 days before the U. S. Post Office stamped them. The Company indicated that they are implementing a new procedure. The cancellation notice will be prepared far enough in advance that the policyholder will be given 10 days for the notice and 3+ days for mailing.

- Out of a sample of 56 policies cancelled for underwriting reasons, 5 did not allow sufficient mailing time for the cancellation notice to arrive at the insured's address with 30 days notice before cancellation. The Company needs to allow 30 days advance notice plus 3 days mailing time.

K.S.A. 40-276a. Automobile insurance; denial of renewal; conditions and exceptions

Any insurance company that denies renewal of an automobile liability insurance policy in this state shall give at least thirty (30) days written notice to the named insured, ...

K.S.A. 40-3118. Financial security requirement; termination

Except as otherwise provided in K.S.A. 40-276, K.S.A. 40-276a and K.S.A. 40-277, and amendments thereto, and except for termination of insurance resulting from nonpayment of premium or upon the request for cancellation by the insured, no motor vehicle liability insurance policy, or any renewal thereof, shall be terminated by cancellation or failure to renew by the insurer until at least 30 days after mailing a notice of termination, by certified or registered mail or United States post office certificate of mailing, to the named insured at the latest address filed with the insurer by or on behalf of the insured.

K.A.R. 40-3-15. Fire and casualty insurance contracts; cancellation at option of insurer; notice required

(a) Each policy or contract, that is issued by fire or casualty insurers within the state of Kansas, and that provides for cancellation at the option of the insurer, shall contain a provision within the policy, or at the discretion of the commissioner, within an amending rider, that the insured will be notified in writing at least 30 days in advance of the effective date of the cancellation.

2. Cancellation/Non Renewal activity

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Cancellations - Insd. Request/NSF	50	0	100%
Canc/Non-renewal - Underwriting	56	11	80%

- Six of the 56 policies canceled or non-renewed for underwriting reasons contain the following language in the notice letters:

In addition, applicants credit history represents a high risk for future loss. The major factors influencing our decision may have

included bankruptcy, overdue accounts, bad debts and collection items.

This language is vague and unclear. The insured cannot identify the specific reasons why the insurer took an adverse action. The use of the word “may” implies that there is a possibility that one or more of the factors existed, but is not clear and specific which ones are on an individual’s record. This is a violation of K.S.A. 40-5107(2) (b)(c) and K.S.A. 40-2,112.

K.S.A. 40-5107(2)(b)(c) Notice of adverse action

(2) explains the reason for such adverse action.

(b) Each reason must be provided in sufficiently clear and specific language so that a person can identify the basis for the insurer's decision to take such adverse action. An insurer shall provide a procedure whereby a consumer may review an adverse action based on credit information. Such procedure shall be consistent with the provisions of K.S.A. 40-2,112 and amendments thereto. The insurer and the insurer's agent shall be immune from any action arising from information provided to the insured through such process. The insurer shall not be found in violation of rate filings by adjusting an insured's rate in such a manner.

(c) The use of generalized terms such as "poor credit history," "poor credit rating," or "poor insurance score" shall be deemed not to comply with requirements of this section.

K.S.A. 40-2,112 Adverse underwriting decisions; furnishing reasons

(a) In the event of an adverse underwriting decision the insurance company, health maintenance organization or agent responsible for the decision shall either provide the applicant, policyholder or individual proposed for coverage with the specific reason or reasons for the adverse underwriting decision in writing or advise such persons that upon written request they may receive the specific reason or reasons in writing.

(b) Upon receipt of a written request within 60 business days from the date of the mailing of notice or other communication of an adverse underwriting decision to an applicant, policyholder or individual proposed for coverage, the insurance company, health maintenance organization or agent shall furnish to such person within 21 business days of the receipt of such written request:

(1) The specific reason or reasons for the adverse underwriting decision, in writing, if such information was not initially furnished in writing pursuant to subsection (a);

- One file used only credit as the sole reason to cancel. The only reason provided in the cancellation notice was adverse credit and specifically a bankruptcy in January 2002. This is a violation of K.S.A. 40-5104(b).

K.S.A. 40-5104 Prohibited practices

No insurer authorized to do business in the state of Kansas which uses credit information to underwrite or rate risks, shall:

(b) Without consideration of any other applicable underwriting factor independent of credit information and not expressly prohibited by subsection (a), refuse to quote, deny, cancel or refuse to renew any policy of personal insurance solely on the basis of credit information.

- Two policies were cancelled with the reason given “We are unable to continue this automobile insurance policy without the pertinent underwriting data. Please contact your agent for details.” Kansas law requires a cancellation notice to contain either a written explanation specifically detailing the reasons why the policy was canceled or the opportunity to request the reasons for cancellation from the company.

The reason cited in these two cancellation notices does not meet either requirement. “Pertinent underwriting data” is a general statement, not a specific reason. Also, the insureds are instructed to contact their agents for details, not the company and no mention is made of the 10 day response time required by the company.

This is a violation of K.S.A 40-2,122 and K.A.R. 40-3-31(b)(1).

K.S.A.40-2,122 Written explanation; liability for disclosure

Any insurance company doing business in this state shall provide to an insured a written explanation specifically detailing the reasons why such company canceled or denied renewal of an existing policy of insurance. There shall be no liability on the part of and no cause of action of any nature shall arise against any insurer, its authorized representative, its agents, its employees, or any firm, person or corporation furnishing to the insurer information as to reasons for cancellation or denial of renewal of an existing policy of insurance, for any statement made by any of them in any written notice of cancellation or denial of renewal of an existing policy of insurance, for the providing of information pertaining thereto, or for statements made or evidence submitted

at any hearings conducted in connection therewith, if such information was provided in good faith and without malice.

K.A.R. 40-3-31 Fire and casualty insurance; automobile liability policies; notices of cancellation or nonrenewal; requirements

(b) The notice of cancellation or nonrenewal, or accompanying forms, shall include words similar to the following statements:

(1) Within 10 days after receiving a written request, this company will furnish, the reason for the cancellation or nonrenewal in writing. This statement is required only when reasons for cancellation or nonrenewal are not sent with the cancellation or nonrenewal notice.

- One policy was non-renewed but did not show a substantial change in exposure to non-renew for claim activity. The comprehensive claim should not impact the decision, and the property damage was not major. Therefore with only one at-fault accident charged to this policy in three years, there was no substantial change in exposure, and the underwriting action was in violation of K.S.A. 40-276(a)(4):

K.S.A. 40-276(a)(4) Automobile insurance; denial of renewal; conditions and exceptions

(a) Any insurance company that denies renewal of an automobile liability insurance policy in this state shall give at least 30 days written notice to the named insured, at his last known address, or cause such notice to be given by a licensed agent of its intention not to renew such policy. No insurance company shall deny the renewal of an automobile liability insurance policy except in one or more of the following circumstances or as permitted in subsection (b):

(4) when unfavorable underwriting factors, pertinent to the risk, are existent, and of a substantial nature, which could not have reasonably been ascertained by the company at the initial issuance of the policy or the last renewal thereof;

- One policy was non-renewed and there was not a copy of the non-renewal notice in file. This is a violation of K.S.A. 40-276a and K.S.A. 40-3118:

K.S.A. 40-276a. Automobile insurance; denial of renewal; conditions and exceptions

Any insurance company that denies renewal of an automobile liability insurance policy in this state shall give at least thirty (30) days written notice to the named insured, ...

and

K.S.A. 40-3118. Financial security requirement; termination

Except as otherwise provided in K.S.A. 40-276, K.S.A. 40-276a and K.S.A. 40-277, and amendments thereto, and except for termination of insurance resulting from nonpayment of premium or upon the request for cancellation by the insured, no motor vehicle liability insurance policy, or any renewal thereof, shall be terminated by cancellation or failure to renew by the insurer until at least 30 days after mailing a notice of termination, by certified or registered mail or United States post office certificate of mailing, to the named insured at the latest address filed with the insurer by or on behalf of the insured.

The Company failed Standard 23.

Standard 25: Termination Practices

Unearned premiums are correctly calculated and returned to appropriate party in a timely manner and in accordance with applicable statutes, rules and regulations. K.S.A. 40-2,112 (d)(1).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Cancellation/Decline	50	0	100%

The Company passed Standard 25.

Standard 26: Terminations

Rescissions are not made for non-material misrepresentation.

The exam team did not specifically test for this standard. In the regular file review, there were no rescissions taken in the 50 underwriting cancellation/non-renewal files reviewed.

Underwriting and Rating Recommendations

1. The Company needs to re-file their ACFIC rating factor for PIP coverage. The company revised their filing on 12/22/05.
2. The current ACIIE auto territory pages show Territory24 comprising a single zip code. Given the small geographic size of one zip code and small population base of that area, it would appear that ACIIE may be in violation of K.S.A. 40-953. The exam team recommends that in the next rate filing, ACIIE look at this territory definition. This territory filing was approved twelve years ago. It wasn't until 1996 that KID began to look at territories closely to make sure that companies were not over segmenting.

3. The Company should allow three days for mail time on all notices of cancellation and non-renewal in the interest of consistency.

The Company indicated that they are implementing a new procedure. The cancellation notice will be prepared far enough in advance that the policyholder will be given at least 10 days actual notice (3+ days for mailing and 10 days for the notice).

4. The Auto Club should review the “Kansas insurance score act” to make sure that their forms and underwriting activities conform to K.S.A. 40-5101 through 40-5114. The Company must present a plan to KID within 30 days from the issuance of the Final Order for this exam of how they are conforming to this recommendation.
5. The Company should review their underwriting cancellation and non-renewal procedures to insure that they are in compliance with K.S.A. 40-276, K.S.A. 276a and K.S.A. 40-277 and the “Kansas insurance score act”. The Auto Club must present a plan to KID within 30 days from the issuance of the Final Order for this exam of how they are conforming to this recommendation.

CLAIM HANDLING

Company Claim Handling Procedures:

The claim is reported to the Auto Club’s call center where the claim information is captured. This information is input into an electronic claim file which is called Claims Work Station or (CWS). The file is then assigned an adjuster based on the complexity of the claim. The adjuster then receives the new claim on their work manager and proceeds to make contact with the appropriate parties. When an adjuster makes first contact with the customer we explain all benefits available that would be applicable for that claim. Once a claim is investigated the adjuster proceeds to settle all aspects of the claim based on the provisions of the insurance contract. Both fast track and regular claims are handled in the same manner.

Adjusters have authority levels in which they can settle claims; above their assigned authority level they must get authority from their supervisor to settle claims.

All of Auto Club claim files are controlled by an in house (AAA staff) adjuster. They utilize outside independent adjusters and appraisers for field work on both homeowner and auto on an as needed basis.

The Auto Club utilizes a direct repair network of body shops. There is a Direct Repair Coordinator that oversees this program.

Tests for Claims (See Appendix I for the wording of the appropriate statute or regulation)

Standard 1

The initial contact by the company with the claimant is within the required time frame. K.A.R. 40-1-34, 6(a)(d).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Auto Claims	50	1	98%
Paid Homeowners Claims	50	2	96%
No Pay Claims	50	1	98%

- There were 4 cases where initial contact with the insured or claimant was not made within 10 working days per K.A.R. 40-1-34, 6(a).

The Company passed Standard 1.

Standard 2

Timely investigations are conducted. K.A.R. 40-1-34, Sections 7 & 8(c).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Auto Claims	50	0	100%
Paid Homeowners Claims	50	0	100%
No Pay Claims	50	1	98%

The Company passed Standard 2.

Standard 3

Claims are resolved in a timely manner. K.A.R. 40-1-34, 8(a)(c).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Auto Claims	50	0	100%
Paid Homeowners Claims	50	1	98%
No Pay Claims	50	1	98%

The Company passed Standard 3.

Standard 4

The company responds to claim correspondence in a timely manner. K.A.R. 40-1-34, 6(a)(d).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Auto Claims	50	0	100%
Paid Homeowners Claims	50	0	100%
No Pay Claims	50	1	98%

The Company passed Standard 4.

Standard 5

Claim files are adequately documented. K.A.R.40-1-34, Sections 4, 6(a) & 8(b).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Auto Claims	50	1	98%
Paid Homeowners Claims	50	2	96%
No Pay Claims	50	0	100%

- One auto paid claim and two homeowners paid claims lacked adequate documentation per K.A.R. 40-1-34, 4.

The Company passed Standard 5.

Standard 6

Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations. K.A.R. 40 -1-34, Sections 5(a), 8, & 9, K.S.A. 40-3110, K.S.A. 40-2-126.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Auto Claims	50	1	100%
Paid Homeowners Claims	50	1	98%
No Pay Claims	50	2	96%
Claim Complaints	33	2	94%

- One auto paid claim did not have an add order paid per K.S.A. 40-2404, (9)(f).
- One paid homeowners claim did not have payment for two personal items of the insured per K.A.R. 40-1-34, 5(a).
- Two complaint violations did not have follow up written communication with the insured per K.A.R 40-1-34, Sections 7, & 8(b)(c).
- Two no pay violations lacked complete investigation per K.A.R. 40-1-34, 6(a) and K.S.A. 40-2404, (9)(d).

The Company passed Standard 6.

Standard 7

Company uses the reservation of rights and excess of loss letters, when appropriate.

The exam team did not specifically test for this standard. In the normal review of the sample claim files, any reservation of rights and excess of loss letter activity would have been reviewed, and the examiner would have noted it. There were no issues with the files that were reviewed.

Standard 8

Deductible reimbursement to insureds upon subrogation recovery is made in a timely and accurate manner. K.A.R. 40-1-34, 9(d).

The exam team did not specifically test for this standard. In the normal review of the sample claim files, any subrogation activity would have been reviewed, and the

examiner would have noted it. There were no issues with the files that were reviewed.

Standard 9

Company claim forms are appropriate for the type of product.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Auto Claims	50	0	100%
Paid Homeowners Claims	50	0	100%
No Pay Claims	50	0	100%

The Company passed Standard 9.

Standard 11

Denied and closed-without-payment claims are handled in accordance with policy provisions and state law. K.A.R. 40- 1-34, 8(a)(b)(c).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
No Pay Claims	50	0	100%

The Company passed Standard 11.

Standard 12

Cancelled benefit checks and drafts reflect appropriate claim handling practices.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Canceled Checks	16	0	100%

The Company passed Standard 12.

Standard 13

Claim handling practices do not compel claimants to institute litigation, in cases of clear liability and coverage, to recover amounts due under policies by offering substantially less than is due under the policy. K.S.A. 40-2404, 9(f)(g).

The exam team did not specifically test for this standard. In the normal review of the sample claim files, any attempts to not settle a claim fair and promptly would have been reviewed, and the examiner would have noted it. There were no issues with the files that were reviewed.

GENERAL COMMENTS

Company Operations and Management

1. The exam team recommends that the Auto Club complete their formalizing an internal audit program for the claims department and look into developing similar programs for underwriting and policy processing.

Complaint Handling

1. The exam team recommends that the control and record keeping of the non-insurance department complaints be coordinated and maintained with the same unit that keeps department of insurance complaints.

Underwriting and Rating

1. The Company needs to re-file their ACFIC rating factor for PIP coverage. The company revised their filing on 12/22/05.
2. The current ACIE auto territory pages show Territory24 comprising a single zip code. Given the small geographic size of one zip code and small population base of that area, it would appear that ACIE may be in violation of K.S.A. 40-953. The exam team recommends that in the next rate filing, ACIE look at this territory definition. This territory filing was approved twelve years ago. It wasn't until 1996 that KID began to look at territories closely to make sure that companies were not over segmenting.
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The Company indicated that they are implementing a new procedure. The cancellation notice will be prepared far enough in advance that the policyholder will be given at least 10 days actual notice (3+ days for mailing and 10 days for the notice).

4. The Auto Club should review the “Kansas insurance score act” to make sure that their forms and underwriting activities conform to K.S.A. 40-5101 through 40-5114. The Company must present a plan to KID within 30 days from the issuance of the Final Order for this exam of how they are conforming to this recommendation.
5. The Company should review their underwriting cancellation and non-renewal procedures to insure that they are in compliance with K.S.A. 40-276, K.S.A. 276a and K.S.A. 40-277 and the “Kansas insurance score act”. The Auto Club must present a plan to KID within 30 days from the issuance of the Final Order for this exam of how they are conforming to this recommendation.

General Recommendation

1. The exam team recommends that a targeted follow up exam be completed in 15 months to insure that the Auto Club has taken the necessary steps to correct the problems cited in recommendations #4 and #5 of the Underwriting and Rating portion of this exam and are now complying with the Kansas Credit Scoring Act.

CONCLUSION

I would like to acknowledge the cooperation and courtesy extended to the examination team by Deborah Miller and the staff of the Auto Club.

The following examiners of the Office of the Commissioner of Insurance in the State of Kansas participated in the review:

Market Conduct Division

Lyle Behrens
Supervisor

Mary Lou Maritt
Market Conduct Examiner

Tate Flott
Market Conduct Examiner

Respectfully submitted,

Lyle Behrens, CPCU, CIE, ARM