

**REPORT OF MARKET CONDUCT EXAMINATION**

**ARMED FORCES INSURANCE EXCHANGE**

**550 EISENHOWER ROAD**

**LEAVENWORTH, KS 66048**

**AS OF**

**DECEMBER 31, 2001**

**BY**

**KANSAS INSURANCE DEPARTMENT**

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June 28, 2002

Honorable Kathleen Sebelius  
Insurance Commissioner  
Kansas Insurance Department  
420 SW Ninth Street  
Topeka, Ks. 66612

Dear Commissioner Sebelius:

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:

Armed Forces Insurance Exchange  
550 Eisenhower Rd.  
Leavenworth, Ks. 66048

Hereafter referred to as “AFIE” or the “Company”, and the following report as such examination is respectfully submitted,

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

## **SCOPE OF REVIEW**

A Market Conduct Examination of AFIE's operation was completed to determine compliance with applicable statutes, regulations and bulletins of the state of Kansas. The examination was conducted according to the guidelines and procedures recommended in the NAIC Market Conduct Examiners Handbook.

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

### **COMPANY OVERVIEW**

History and Profile  
Territory and Plan of Operation  
Prior Market Conduct Examination Report  
Reinsurance  
Fines and/or Penalties  
Company Operations and Management  
Certificates of Authority  
Internal Audit Procedures  
Computer Systems  
Anti-Fraud Program  
Disaster Recovery Procedures

### **COMPLAINT HANDLING**

Record Keeping  
Timely Response

### **MARKETING AND SALES**

Advertising  
Training  
Communication

### **AGENT LICENSING**

Appointment/Termination  
Training  
Communication

### **POLICYHOLDER SERVICE**

Processing  
Communication

### **UNDERWRITING & RATING**

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

## **CLAIMS**

Claim Processing  
Use of Outside Pricing Entities  
Timeliness and Accuracy of Claim Payment  
Proper Maintenance of Claim Files

## **SUMMARY OF REVIEW**

The Market Conduct Examination focused on AFIE. The testing and file review consisted of sampling from the Company's underwriting and processing center in Leavenworth, Ks. The claim processing for AFIE is also handled out of their office in Leavenworth, Ks. The examination included a review of the Company's underwriting and settled claim files from January 1, 2000 to December 12, 31,2001.

General topics were covered in Interrogatories submitted to AFIE for their written response. Subjects covered were Policyholder Service and Complaints, Sales and Marketing, Underwriting and Claims. The response received adequately addressed the issues presented.

## **DESK EXAMINATION/ON-SITE EXAMINATION**

### **COMPANY OVERVIEW**

#### **History**

Armed Forces Insurance Exchange (AFIE) was established as a reciprocal exchange under Article 16 of Chapter 40 of the Kansas Statutes Annotated and commenced business on August 1, 1982. It was organized to provide for the exchange of insurance contracts for the benefit of its subscribers, being commissioned officers of the U.S. Uniformed Services, and to provide a company to continue writing the insurance that was written by the Armed Forces Cooperative Insuring Association (Association) as a reciprocal.

AFIE was formed to assume the business of the Association. As the Exchange's Attorney-In-Fact became authorized to transact business in each state, and the Association members' policies in that state came due for renewal, the members policies and accounts with the Association were transferred from the Association to the Exchange. In 1991 the Association and Armed Forces Insurance Exchange merged.

The Association was originally named the Army Co-operative Fire Association and was organized on February 7, 1887, for the sole purpose of insuring personal property for loss by fire. After World War II, catastrophic coverage was offered, as many members were serving in areas that suffered from typhoons, floods or earthquakes. In 1954, insurance against loss by theft and other perils was offered. In 1960, the Association started to market homeowner's coverage in the United States, as well as liability throughout the world.

Before the formation of the Exchange, the Association was not licensed as an insurance entity in any state. The expansion of homeowners insurance and the increased emphasis on state regulation of insuring organizations required the Association to become licensed by state insurance departments. To accomplish this, the Exchange was formed to assume the Association's business. As the Exchange was licensed in each new state, policies in force in that state were transferred to the Exchange. On July 1, 1992, the remaining assets and liabilities of the Association were merged into the Exchange, with the Exchange being the surviving entity. In conjunction with the merger, Armed Forces Insurance Corporation (AFIC), a wholly-owned subsidiary of the Association, became a wholly owned subsidiary of the Exchange.

The subscribers own AFIE. AFIC manages the affairs of AFIE as an Attorney-In-Fact. AFIC is granted such authority through power-of-attorney statements executed by each subscriber. The Attorney-In-Fact makes arrangements for work to be carried out by employees of the AFIE.

### Territory and Operation

AFIE is licensed in the State of Kansas as a multiple line insurer and is authorized for the following lines of insurance: Fire, Windstorm and Hail, Extended Coverage, Inland Marine, Automobile Physical Damage, Homeowners, Automobile Liability, General Liability and Workers' Compensation. Kansas agents are employed by AFIE as salaried employees market the products. No commissions are paid.

When AFIE was formed in 1982 lines of business marketed were Inland Marine, Personal Liability, Personal Umbrella, Homeowners, Dwelling Fire and Farmowners. Farmowners policies were subsequently dropped and in 1993 Personal Auto was added.

The Exchange provides property and casualty insurance to the military marketplace. Over 40% of the direct premiums written came from risks located in California, Florida, Texas and Virginia. The Exchange markets automobile insurance in the following ten (10) states: Alaska, Arkansas, Colorado, Illinois, Kansas, Maryland, Missouri, Ohio, Virginia and Washington.

The Exchange uses Armed Forces Insurance Agency (AFIA) to place insurance on additional risks, unacceptable exposures and flood insurance for the Exchange's subscribers. Although property risks are geographically distributed, the Exchange has a sizable exposure to catastrophe losses. Management has taken initiatives to minimize property exposures, including rate increases, new business restrictions in catastrophe prone areas, more stringent underwriting of new property risks and a new catastrophe aggregate reinsurance program.

Company Operations and Management

AFIE is controlled by its subscribers and managed by a Subscribers Advisory Committee (SAC). AFIE's bylaws stipulate that the SAC shall be composed of nine individuals, eight of whom are member subscribers elected by the member subscribers of AFIE, plus ex-officio, the President of the Attorney -in-Fact. The following members served on the SAC in December 2001:

<u>NAME</u>	<u>POSITION HELD</u>	<u>TERM</u>
Norman D. Greczyn	Chairman	2003
Deborah Gregoire	Vice Chairman	2004
Stephen J. Kempf	Member	Ex-Officio
Stanley F. Cherrie	Member	2003
George Michael Beshenich	Member	2004
Lawyn C. Edwards	Member	2003
Myron J. Griswold	Member	2003
Craig M. Kennedy	Member	2003
Donald Olson	Member	2003

The affairs of the Exchange are under the direction Of the Attorney-in-Fact as authorized by the power of attorney submitted by each subscriber

The board of directors directing the Attorney-in-Fact at 2001 was as follows:

<u>NAME AND RESIDENCE</u>	<u>PRINCIPAL OCCUPATION</u>	<u>TERM EXPIRES</u>
James T. Pittman Lansing, KS	KS-Site Leader Mitre Corporation	2002
Deborah D. Gregoire Fort Leavenworth, KS	Senior Military Analyst SY Technology	Ex-Officio
Edward W. Geiger III Leavenworth, KS	President Geiger Ready-Mix Co., Inc.	2002
Stephen J. Kempf Leavenworth, KS	President & Chairman of the Board Armed Forces Insurance Corporation	Ex-Officio
Norman D. Greczyn Fort Leavenworth, KS	Operations Officer United States Army	Ex-Officio
Robert H. Longmire Lenexa, KS	President Longmire & Co., Inc	2002
Terry D. Tiede Topeka, KS	VP Compliance & Internal Audit American Investors Life Insurance Co.	2004

David A. Hanson	President	2003
Topeka, Ks	Glen, Cornish, Hanson & Karns	
Ronald L. Romig	President & CEO	2004
Leavenworth, KS	Citizens Savings & Loan Association	
James C. Schroeder	President	6-30-01
Leavenworth, KS	Western Manufacturing Company	
Jack E. Walker	Executive Assistant to Garrison	2004
Leavenworth, Ks	Fort Leavenworth, Ks	

The following officers of the Attorney-in-Fact were appointed, and serving in that capacity in 2001.

<b>Name</b>	<b>Position</b>
Stephen J. Kempf	President & Chairman of the Board
Joyce M. Jordan	Vice President & secretary
Carroll D. Haverkamp	Vice President & treasurer
Thomas A. Dials	Vice President
Gerald R. Frietchen	Vice President
Gary L. Maulfair	Vice President
William I James Sr.	Vice President
Arlen Lloyd Briggs	Asst. Vice-President

Membership to AFIE is spelled out in Article of the Bylaws of the Armed Forces Insurance Exchange:

**ARTICLE II - SECTION I (Eligibility)**

The following are eligible to be member subscribers of AFIE and thereby entitled to its benefits:

- a. any active or retired commissioned officer or warrant officer of the regular service, the reserve components, the retired reserve list, or the retired reserve components of the U.S. Army, Air Force, Navy, Marine Corps, or Coast Guard;
- b. any active or retired commissioned officer of the Public Health Service;
- c. any active or retired commissioned officer of the National Oceanic and Atmospheric Administration;
- d. any cadet or midshipman of the Armed Forces Academies and any midshipman of the U.S. Merchant Marine Academy;
- e. any ROTC cadet or midshipman in an advanced ROTC program who has accepted a contractual service obligation
- f. any unremarried surviving spouse of any of the above.

On November 28, 2000, the Exchange's bylaws were changed to expand the current definition of non-members to include the following:

### Section 3 (Exceptions)

AFIE may insure persons and organizations who are not eligible for membership in AFIE who shall be termed nonmember subscribers as follows;

- a. the spouses, former spouses, and children of current or former member subscribers;
- b. active or retired person in those enlisted grades of the regular service, the reserve components, the retired reserve list or the retired reserve components, and the spouses, former spouses, and children of these persons, as authorized by the Attorney-in-Fact;
- c. any employee of AFIE, the Armed Forces Insurance Corporation, or any other affiliate of the aforementioned organizations and any person who has retired directly from the employment of any of these organizations or affiliates and the spouse, former spouse, and children of these persons as authorized by the Attorney-in-Fact;
- d. former commissioned, warrant, and non-commissioned officers of the U.S. Army, Marines, Navy, Air force, Coast Guard, Public Health Service and National Oceanic and Atmospheric Administration and their spouses, former spouses, and children as authorized by the Attorney-in-Fact;
- e. when required by the laws or regulations of federal state or other governmental bodies;
- f. when title to insured real property is transferred to a person not eligible for subscribership, policies may be kept in full force and effect until the normal expiration of the policy as required by regulatory authorities or under rules established by the Attorney-in-Fact;
- g. through participation in reinsurance policies or reinsurance pools as authorized by the Attorney-in-Fact.

### Prior Market Conduct Examination Report(s)

The Kansas Insurance Department was finalizing a financial examination at the same time as this Market Conduct Examination. The last Market Conduct Examination complete by Kansas was done in 1993. That report did not indicate any areas where corrective action was needed to be followed up on during this examination.

### Reinsurance

The financial examination team reviewed the reinsurance treaties.

### Fines and/or Penalties

Regulatory Information Retrieval System indicated that there were 2 regulatory actions during the examination period and 5 for the past 5 years.

### **Tests for Company Operations/Management**

#### Standard 1

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

The financial exam team reviewed their audit program.

#### Standard 2

The company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

The financial exam team reviewed their computer system.

#### Standard 3

The company has an antifraud plan in place.

The financial exam team tested their antifraud program

#### Standard 4

The company has a valid disaster recovery plan.

This comprehensive business resumption plan was developed in 1996 through an outside consultant utilizing a software package and includes the protection of life, information and equipment at three locations--Ft. Leavenworth, Leavenworth and Kansas City, MO. Computer tapes are stored off-site according to a rotation plan established to preserve data on a daily, weekly, monthly and yearly basis. Copies of all procedures manuals are stored off-site as well as a complete set of forms and manuals.

Additionally, employees are assigned to various teams with responsibilities ranging from emergency response, executive management, notifications to employees and vendors, establishment of alternative work sites, replacement of equipment, recovery of business operations and data and personal contact with policyholders.

One revision was completed during September 1996. A total review of the plan, an annual report of this review, a test exercise and a summary of the exercise are required each year by the plan but have not been accomplished since 1996. Further, employee names and vendor agreements have not been reviewed annually. A company Senior Vice President has responded to this inquiry with an explanation and immediate action to begin the review process.

While Kansas law does not require these timelines, the business resumption plan was developed by their own staff and deemed appropriate to protect employees, records and policyholders. It appears the company will renew the mandates in their plan.

#### Standard 5

The company adequately monitors the activities of the MGA.

This standard was not applicable since AFIE does not use MGA's.

#### Standard 6

Company contracts with MGA's comply with applicable statutes, rules and regulations.

This standard was not applicable sic AFIE does not use MGA's.

#### Standard 7

Records are adequate, accessible, consistent and orderly and comply with state record retention requirements.

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

#### Standard 8

The company is licensed for the lines of business that are being written.

The Certificate of Authority was reviewed and found to be in order. The company was complying with it.

#### Standard 9

The company cooperates on a timely basis with examiners performing the examinations.

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

#### Standard 10

The company has procedures for the collection, use and disclosure of information gathered in connection with insurance transactions so as to minimize any improper intrusion into the privacy of applicants and policyholders.

See Standards 1 & 2.

#### Standard 11

The company had developed and implemented written policies, standards and procedures for the management of insurance information.

See Standards 1 & 2.

#### Recommendation for Company Operations/Management

Review the Disaster Recovery Program annually.

### **COMPLAINTS**

The company's complaint procedures are spelled out in the memo that AFIE provided the exam team:

The Unfair Trade Practices Acts in most states require companies to maintain records of complaints in the form of a register or log. The required retention

periods range from 3 years to permanently, with the most common requirement being to retain the record for the period since the last market conduct exam.

Currently there are no states that require the complaint register to be filed, but it must be available upon request or at the time of a market conduct exam. A proper record of complaints serves a dual purpose. It meets the requirements of the various State Insurance Departments and serves as a management tool to determine how well we are dealing with our policyholders.

While the most common definition of "complaint" in the various statutes is "any written communication expressing a grievance," not every contact by a policyholder or a claimant questioning some action by AFIE constitutes a complaint. Reasonable judgment must be applied. The distinction usually lies in the language used in the letter and in a reasonable interpretation of that language.

The format for the complaint register is the same one that AFIE has used for the past several years. This procedure attempts to consolidate the records currently kept by the Vice-Presidents of Risk Management, Claims and Administration. It is also an attempt to record complaints more completely.

A folder named "Complaint Register" has been placed on the Public drive. Everyone can view the file but only Directors in Risk Management, Claims, Insurance Operations and all Vice-Presidents can make changes or additions. The folder contains the complaint register in Excel spreadsheet format. The instructions for completing the form are also in the folder.

Each written communication that is judged to be a complaint should be entered on the spreadsheet when it is assigned for response and the entry completed when the complaint is resolved. Copies of the correspondence and the response will continue to be sent to the 201 file or claim file as appropriate. Copies of the complaint are no longer required to be sent to the Vice-President, Administration and Compliance.

## **Tests for Complaint Handling**

### **Standard 1**

All complaints are recorded in the required format on the company complaint register.

Passed - Complaints are maintained in both paper files and electronically in a separate complaint register. Three (3) complaints filed with the Kansas Insurance Department during the exam period were reviewed and complied with the requirements set forth in KSA 40-2404 (10).

Two complaints filed directly with the company appeared on a separate register but upon further review neither were Kansas policyholders.

#### Standard 2

The company has adequate complaint handling procedures in place and communicates such procedures to policyholders.

Letters are sent to policyholders whose claims are denied and are advised to contact the Kansas Insurance Department if they disagree with the resolution of their claim.

Passed - Complainants who file directly with the company are advised to send a written rebuttal with any supporting evidence or documentation to support the request for coverage. The complaint is forwarded to upper management who reviews the request and makes the final decision. A letter is written to the complainant explaining the final outcome. There is very little structure to this policy other than responses seem to occur in a timely manner as mandated by KAR 40-1-34 (5a)(6) even though a written explanation of the procedure was not found in the materials supplied to the examiners.

#### 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.

Passed - Complaints filed with the Kansas Insurance Department and directly with the company were answered within the mandates outlined in KAR 40-1-34 (6).

#### Standard 4

The time frame within which the company responds to complaints is in accordance with applicable statutes, rules and regulations.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
2000 & 2001 Complaints	3	0	100%

Passed

### **MARKETING AND SALES**

AFIE is perhaps unique in that the market is restricted to military personal and their families, which certainly narrows their market approach. They rely heavily on direct mailings to existing members and consumers inquiring about coverage. They do have an excellent web site with links for military personnel for information outside of insurance.

#### **Tests for Marketing and Sales**

##### Standard 1

All advertising and sales materials are in compliance with applicable statutes, rules and regulations.

Passed

#### Standard 2

Company internal producer training materials are in compliance with applicable statutes, rules and regulations.

Passed

#### Standard 3

Company communications to producers are in compliance with applicable statutes, rules and regulations.

Passed

#### Standard 4 – Mass Marketing

Company mass marketing of property and casualty insurance is in compliance with applicable statutes, rules and regulations.

Passed

### **AGENT LICENSING**

The company uses licensed salaried employees to act as agents and advise their customers on coverages and quote prices. The following is a brief summary of the procedures that AFIE goes through to appoint and terminate an employee who is to act as an agent for the company.

The Human Resources (HR) Department performs all resident agent appointment and termination activities centrally. HR also performs all function related to resident agent licensing, scheduling of agent continuing education classes, and submission of continuing education compliance forms for all appointed Kansas agents. HR's involvement in the processing of all new hires, transfers, or terminations provides assurance that agent appointment/termination activities will be completed on a timely basis.

Effective October 1, 2001, all new hires must successfully pass a criminal background screening. This policy assists the organization in maintaining compliance with the federal Violent Crime Control and Law Enforcement Act and with Kansas agent licensing regulations.

The following procedures are followed for all appointments and terminations of agents by the HR department:

1. When an individual is hired into a position requiring the incumbent to be licensed, HR verifies the individual's current license status.
2. If the individual is not licensed, HR schedules pre-licensing training through an area vendor. Immediately upon completion of the training, the individual is

scheduled for the KS agent examination. Upon notification of successful completion of the exam, HR submits the required forms and fees to certify the agent as a representative of AFIE. The entire process is completed prior to the individual assuming any responsibilities for the negotiation of insurance contracts.

3. If the individual is licensed, HR completes and submits the required forms/fees to appoint that agent as a representative of AFIE.
4. When an appointed agent moves to a position no longer requiring an agent license, or terminates employment with AFIE, HR completes and submits the required form to terminate that agent's appointment.

### **Tests for Agent Licensing**

#### Standard 1

Company records of licensed and appointed (if applicable) producers agree with department of insurance records.

Passed

#### Standard 2

The producers are properly licensed and appointed (if required by state law) in the jurisdiction where the application was taken.

Passed - All agents are salaried employees of the company rather than independent agents. The company tracks licensing, appointment and continuing education for their employee agents and files proper documentation with Kansas Insurance Department. The company self-funds Error & Omissions coverage for their employee agents as they are not classified as agents under KSA 40-2,106.

#### Standard 3

Termination of producers complies with statutes regarding notification to the producer and notification to the state if applicable.

Passed - There were no terminations for cause in the 38 agent files sampled.

#### Standard 4

The company's policy of producer appointments and terminations does not result in unfair discrimination against policyholders.

N/A - As all agents are salaried company employees.

#### Standard 5

Records of terminated producers adequately document reasons for terminations.

N/A

Standard 6

Producer accounts current (account balances) are in accordance with the producer's contract with the insurer.

N/A

**POLICY HOLDER SERVICE**

**Tests for Policyholder Service**

Standard 1

Premium notices and billing notices are sent out with an adequate amount of advance notice.

Passed

Standard 2

Policy issuance and insured-requested cancellations are timely.

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

Passed

Standard 3

All correspondence directed to the company is answered in a timely and responsive manner by the appropriate department.

Passed – While this was not specifically tested for. Any correspondence in a file that was being reviewed by exam team was examined for timely handling.

Standard 4 – Primarily Commercial Lines

Claims history and loss information is provided to insured in timely manner.

N/A

Standard 5

Whenever the company transfers the obligation of its contracts to another company pursuant to an assumption reinsurance agreement, the company has gained prior approval of the insurance department and the company has sent the required notices to its' affected policyholders.

N/A

**UNDERWRITING AND RATING**

The company's underwriting process is described below:

New and renewal business processing:

The company separates "new" business into two categories 1) new applications who are not insured under any other policies, and 2) applications from existing insureds for additional coverages.

The underwriting guidelines for insuring a structure to be insured are the same for new insureds as existing insureds. But, for new insureds, AFIE also employs the use of credit reports as a part of our evaluation. They do not use these reports on existing insureds nor on renewals as the insured's loss history and premium payment records provide the necessary data to evaluate the risk.

Applications from eligible accounts who have good credit and clean loss histories can be processed automatically without underwriting intervention.

However, all new business that does not adhere to company guidelines must be reviewed by underwriting, which include the review of credit and "CLUE " reports. Applications for new business from existing insureds need not be reviewed by underwriting if the risk meets company guidelines.

Renewal business is not subject to review by underwriting, unless the loss performance of the property is in question which reflect a substantially higher than average loss frequency or severity.

Declination of new business:

When an application is declined because of information obtained from an outside source, AFIE sends a written declination in accordance with the FCRA guidelines. If company declines for other reasons, the applicant is either notified by phone or in writing. In either case, the applicant is advised why the application is being declined.

### **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.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Inland Marine	50	0	100%
Auto	48	1	98%
Homeowners	50	3	94%

K.S.A. 40-955, Rate Filings; Disapproval of Filings, requires:

(a) Every insurer shall file with the commissioner, except as to inland marine risks where general custom of the industry is not to use manual rates or rating plans, every manual of classifications, rules and rates, every rating plan, policy form and every modification of any of the foregoing which it proposes to use.

Passed

#### Standard 2: Rating Practices

Disclosures to insureds concerning rates and coverage are accurate and timely.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Inland Marine	50	0	100%
Auto	48	0	100%
Homeowners	50	0	100%

Passed

#### Standard 3: Rating Practices

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

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Inland Marine	50	0	100%
Auto	48	0	100%
Homeowners	50	0	100%

Passed

#### Standard 4: Rating Practices

Credits and deviations are consistently applied on a non-discriminatory basis.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Inland Marine	50	0	100%
Auto	48	0	100%
Homeowners	50	2	96%

KSA 40-953, same; excessive, inadequate or unfairly discriminatory rates or rates resulting in destruction of competition, standards

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. Rates are not unfairly discriminatory if they

are averaged broadly among persons insured under a group, franchise, mass marketed plan or blanket policy.

K.S.A. 40-955, Rate Filings; Disapproval of Filings, requires:

(a) Every insurer shall file with the commissioner, except as to inland marine risks where general custom of the industry is not to use manual rates or rating plans, every manual of classifications, rules and rates, every rating plan, policy form and every modification of any of the foregoing which it proposes to use.

Passed

#### 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.

Passed - There was only one homeowner's account written during the period with a limiting coverage endorsement. It was handled properly.

#### Standard 6: Rating Practices - WC

Verification of use of the filed expense multipliers; the company should be using a combination of loss costs and expense multipliers filed with the Division.

N/A – AFIE does not write work comp policies.

#### Standard 7: Rating Practices - WC

Verification of premium audit accuracy and the proper application of rating factors.

N/A – AFIE does not write work comp policies.

#### Standard 8: Rating Practices - WC

Verification of experience modification factors.

N/A – AFIE does not write work comp policies.

#### Standard 9: Rating Practices - WC

Verification of loss reporting.

N/A – AFIE does not write work comp policies.

#### Standard 10: Rating Practices - WC

Verification of company data provided in response to the NCCI call on deductibles.

N/A – AFIE does not write work comp policies.

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.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Inland Marine	50	0	100%
Auto	48	0	100%
Homeowners	50	0	100%
Declines	53	0	100%

Passed

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).

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Inland Marine	50	0	100%
Auto	48	0	100%
Homeowners	50	0	100%

Passed

Standard 13: Underwriting Practices

The producers are properly licensed and appointed (if required) in the jurisdiction where the application was taken.

Passed

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.

Passed - This standard was not specifically tested for. In the regular file review for the other standards any activity of this nature would have been observed. There were no deficiencies noted.

Standard 15: Underwriting Practices

File documentation adequately supports decisions made.

Passed - This standard was not specifically tested for. In the regular file review for the other standards file documentation would have been observed. There were no deficiencies noted.

Standard 16: Underwriting Practices

Policies and endorsements are issued or renewed accurately, timely and completely.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Inland Marine	50	0	100%
Auto	48	0	100%
Homeowners	50	0	100%

Passed

Standard 17: Underwriting Practices – Commercial Lines

Audits when required are conducted accurately and timely.

N/A. – AFIE Does not write commercial lines.

Standard 18: Underwriting Practices

Company verifies that VIN number submitted with application is valid and that the correct symbol is utilized.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Auto	48	0	100%

Passed

Standard 19: Underwriting Practices

The company does not engage in collusive or anti-competitive underwriting practices.

Passed - This standard was not specifically tested for. In the regular file review for the other standards any activity of this nature would have been observed. There was not any collusive or anti-competitive underwriting practices noted.

Standard: 20 Underwriting Practices – Mass Market auto

The company underwriting practices are not unfairly discriminatory. The company adheres to applicable statutes, rules and regulations in application of mass marketing plans.

N/A. AFIE does not write any mass marketing auto programs.

Standard 21: Underwriting Practices – group accounts

All group personal lines property and casualty policies and programs meet minimum requirements.

N/A. AFIE does not write any group accounts.

Standard 22: Rejections/Declinations

Rejections and declinations are not unfairly discriminatory.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Declinations	53	0	100

In discussions with AFIE management, they indicated that they did not use credit scoring as the sole reason to decline a new business account. However there were 12 individuals who were declined for credit where there was no documentation in the file that any other adverse underwriting factors were considered.

Standard 23: Termination Practices

Cancellation/non-renewal and Declination notices comply with policy provisions and state laws and company guidelines.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Cancellations/NR & Declinations	53	0	100%

Passed

Standard 24: 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.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Cancellations/NR & Declinations	53	0	100%

Passed

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.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Cancellations/NR & Declinations	53	0	100%

Passed

Standard 26: Termination

Rescissions are not made for non-material misrepresentation.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Cancellations/NR & Declinations	53	0	100%

Passed - This standard was not specifically tested for. In the regular file review, there were no policies rescinded the 53 files declined/cancelled.

Standard 27: Statistical Coding  
All policies are correctly coded.

Passed - This standard was not specifically tested for. In the regular file review for the other standards, the information on the data runs matched the daily records.

Recommendation for Underwriting and Rating:

While this was not a problem since AFIE passed the homeowners rating tests, the examination team recommends the company insure that proper rating rules be followed, including the use of credits and appropriate protection classification. Per KSA 40-953 & KAR 40-955.

## **CLAIM PROCESSING**

The company's claims procedure guidelines are spelled out as follows:

Timeliness: Must contact pertinent parties within 24 hours of assignment of claim.

Coverage items to be resolved: Does the party seeking coverage qualify as an insured? Did the loss occur within the policy period? Does the loss come within the scope of the insuring agreement? Do any of the policy exclusions apply? Has there been a breach of any policy conditions? Opinion on any coverage issues, which would indicate the need for a reservation of rights letter, a Declination of coverage, or a non-waiver agreement. Is there any other coverage, which would apply in any way to this loss?

Investigation: Within 30 days the file should reflect: Evidence of interviews. Detailed description of accident/incident site. Actions or events leading up to and through the loss. Physical facts of accident and circumstances. Recovery opportunities. Police reports or other reports. Specific cause of accident. Necessary statements/information. Medical documentation. Is additional investigation needed?

Loss Determination: Was the scope and value determined timely and properly? Complete estimate within 5 business days, signed dated appraisal showing location of inspection; adequate photographs. If applicable, have co-defendants or joint tortfeasors been identified and advised of their involvement.

Evaluation/Reserving: Is the initial reserve for both indemnity and expense realistic? Within 21 days? Are reserves established or changed properly and timely? Are the evaluations proper? Is there a clear explanation of the damage value, percent of insured's liability, and estimated settlement value either on the bodily injury worksheet or in detail within the file?

Subrogation/Salvage: Was subrogation properly considered? Was salvage properly handled?

Reporting/Documentation: Are running notes properly recorded? Does the file contain required supplemental documentation? Are independent adjuster reports completed properly and in a timely manner? Are running notes, BIW and reports adequate for claim management purposes? Is file property organized for easy reference?

Disposition: Are we aggressively pursuing disposition? Did we develop the claim and follow up in a manner that enabled us to provide quality service and minimize loss? Did we pay what we owed? Was solid investigation, proper evaluation, and utilization of innovative settlement techniques supports dispositions, proper assessment/application of legal principles and well-planned negotiation strategy applied?

Expense Control: Are claims managed to control expense costs?

Litigation Management: Is the highest quality of legal defense being provided to our insureds as a result of proper claims handling procedures? Are legal costs being minimized as a result of litigation management? Are expense reserves reflecting accurate estimates for defense work?

Within 24 hours; T/C to insured immediately after CMR to advise of position, denial letter due out within 20 days after CMR is completed, KCIL screens need to be completed.

The exam team pointed out where their claim procedures manual referenced proof of loss acceptance or denial notification that was not in compliance with KAR 40-1-34 (8a). This did not appear to be problem. In the samples reviewed, the company meet our standards for both paid and denied claims.

## Tests for Claims

### Standard 1

The initial contact by the company with the claimant is within the required time frame.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid claims	50	0	100%
Denied Claims	50	0	100%

Passed

### Standard 2

Timely investigations are conducted.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Claims	50	0	100%
Denied Claims	50	8	84%

There were 8 denied claims that the investigation was not completed in 30 days per KAR 40-1-34 (7) “Every insurer shall complete investigation of a claim within thirty days after notification of claim, unless such investigation cannot reasonably be completed within such time.”

Over all the company’s average was 92%.

Standard 3

Claims are resolved in a timely manner.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Claims	50	0	100%
Denied Claims	50	0	100%

Passed

Standard 4

The company responds to claim correspondence in a timely manner.

Passed – While this was not specifically tested for. Any correspondence in a file that was being reviewed by exam team was examined for timely handling.

Standard 5

Claim files are adequately documented.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Claims	50	0	100%
Denied Claims	50	0	100%

Passed

Standard 6

Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Paid Claims	50	1	98%
Denied Claims	50	1	98%

In one file, the company used NADA as the only source to calculate the loss settlement cost. This is a violation of KAR 40-1-34, 9(a)(2)(B) which requires the settlement cost to be determined by “one of two or more quotations obtained by the insurer from two or more qualified dealers located within the local market area when a comparable automobile is not available in the local market area.”

On one denied claim, no letter of denial was sent. This is a violation of K.A.R. 40-1-34 8 which requires "... No insurer shall deny a claim on the grounds of a specific policy provision, condition, or exclusion unless reference to such provision, condition, or exclusion is included in the denial. The denial must be given to the claimant in writing and the claim file of the insurer shall contain a copy of the denial.'

Over all the company passed this test with an average of 98%.

Standard 7

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

Passed - There were no claims in the sample that fell into these 2 classes. The forms were reviewed as part of the exam team's review of the company's standard form letters.

Standard 8

Deductible reimbursement to insureds upon subrogation recovery is made in a timely and accurate manner.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Recovery/Subrogation	39	0	100%

Passed

Standard 9

Company claim forms are appropriate for the type of product

Passed - This standard was not specifically tested for. In the regular file review for the other standards any forms were reviewed. The exam team reviewed all of the company's standard form letters.

Standard 10

Claim files are reserved in accordance with the company's established procedures.

Passed - This standard was not specifically tested for. In the regular file review for the other standards, the reserving was reviewed as part of the exam team's review of the company's claim files.

Standard 11

Denied and closed-without-payment claims are handled in accordance with policy provisions and state law.

<u>Type</u>	<u>Sample</u>	<u>Errors</u>	<u>%Pass</u>
Denied	50	1	98%

On one claim, there was no denial letter sent to the Insured. Required by KAR 40-1-34 8

Passed

Standard 12

Canceled benefit checks and drafts reflect appropriate claim handling practices.

Twelve cancelled checks were requested from a sample of 50 paid claims for the year 2001 to test the number of days between the date the check was written and the date it was cashed. The number of days ranged from 0-63. All sampled checks appear to have been issued within the timelines specified by KAR 40-1-34(5)(f), (8)(a) and (8)(c) and KSA 40-3110.

Passed

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.

Passed

Standard 14

Loss statistical coding is complete and accurate

While no specific test was run, the reviewed files that showed paid amounts and closed with no payment matched the figures on the samples.

Passed

Recommendations for Claim Processing:

1. Claim investigations should be completed within 30 days per KAR 40-1-34 (7). When the company needs more time to determine whether a first party claim should be accepted or denied, it shall so notify the first party claimant within fifteen working days after receipt of the proofs of loss, giving the reasons more time is needed. And every forty-five days thereafter, the company should send to such claimant a letter setting forth the reasons additional time is needed for investigation. Per KAR 40-1-34 (8) (c). Letters should be sent on all denied claims per K.A.R. 40-1-34 (8a).
2. While not a problem the company should remind adjusters that they can not use NADA as the only source to calculate the loss settlement cost. Per KAR 40-1-34 (9)(a)(2)(B).

**GENERAL COMMENTS**

The following summarizes those areas that the examiners feel that AFIE needs to improve on:

#### Underwriting and Rating

While this was not a problem since AFIE passed the homeowners rating tests, the examination team recommends the company insure that proper rating rules be followed, including the use of credits and appropriate protection classification. Per KSA 40-953 & KAR 40-955.

#### Company Operations/Management

Review the Disaster Recovery Program annually.

#### Claim Processing

1. Claim investigations should be completed within 30 days per KAR 40-1-34 (7). When the company needs more time to determine whether a first party claim should be accepted or denied, it shall so notify the first party claimant within fifteen working days after receipt of the proofs of loss, giving the reasons more time is needed. And every forty-five days thereafter, the company should send to such claimant a letter setting forth the reasons additional time is needed for investigation. Per KAR 40-1-34 (8) (c). Letters should be sent on all denied claims per K.A.R. 40-1-34 (8a)

2. While not a problem, the company should remind adjusters that they couldn't use NADA as the only source to calculate the loss settlement cost. Per KAR 40-1-34 (9)(a)(2)(B).

### **CONCLUSION**

I would like to acknowledge the cooperation and courtesy extended to the examination team by the Personal Lines Operations Manager and employees of the Company. 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

Michael Grover  
Market Conduct Examiner

Mary Lou Maritt  
Market Conduct Examiner

#### **Fire And Casualty Division**

Jim Newins  
Casualty Supervisor

Respectfully submitted,

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Lyle Behrens, CPCU, CIE, ARM