

# **MARKET CONDUCT EXAMINATION REPORT**

## **FARMERS INSURANCE COMPANY, INC.**

NAIC # 21628; Group #212

17000 W. 119<sup>th</sup> Street

Olathe, KS 66061

ETS # KS057-M12

As of

June 30, 2012



**KANSAS INSURANCE DEPARTMENT**

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The 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:

Farmers Insurance Company, Inc.  
NAIC # 21628  
17000 W. 119<sup>th</sup> Street  
Olathe, KS 66061

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

Stacy Rinehart, FLMI, MCM, CIE, AIRC  
Market Conduct Manager  
Examiner-in-Charge

## **PURPOSE AND SCOPE OF REVIEW**

A market conduct examination of Farmers Insurance Company, Inc. also referred to as the “Company”, was conducted pursuant to, but not limited to K.S.A. 40-222.

The Kansas Insurance Department (KID) reviewed the Company’s operations and management, complaint handling, claims processing, underwriting and rating practices. The examination was done in part to review the Company’s business practices after the Department was made aware of rating errors. The review was performed at KID on electronic files provided by the Company. The review was conducted according to the guidelines and procedures recommended in the 2012 NAIC Market Regulation Handbook (MRH). The exam team utilized the standards and tests recommended in the Handbook which allows an error tolerance of 7% for claims procedures and 10% for all other categories. This examination report is written by test rather than by exception, which means all standards that were used are described and the results indicated. Silence on any NAIC standard or Company practice does not imply KID acceptance or endorsement of such practices. Applicable statutes and regulations cited throughout the report may be found in Appendix A.

The examination included a review of files for the exam period of July 1, 2010 through June 30, 2012. Interrogatories were submitted to the Company prior to the file review segment of the examination, and written responses were provided. The examination included, but was not limited to, company operations and management, history and profile, prior market conduct examination reports, fines and penalties, Certificates of Authority, internal audit procedures, complaint handling, claim processing, underwriting and rating.

## **EXECUTIVE SUMMARY**

A market conduct examination of Farmers Insurance Company, Inc. also referred to as the “Company”, was conducted pursuant to, but not limited to K.S.A. 40-222. The examination period was from July 1, 2010 through June 30, 2012. The focus of the exam was operations and management, complaint handling, claim processing, underwriting and rating related to both private passenger automobile and homeowners insurance.

There were some issues noted in the handling of complaints and claim files. The main issue for both of these areas is the inconsistency of date stamping and being able to recreate the files to determine when correspondence is received by the Company. There were also delays in responding to consumers on complaints, though many of these are not violations of Kansas law, but rather beyond Company guidelines. Prior to the review of claim files the company disclosed an error they had discovered with a fee that was inadvertently being left out in total loss settlements. With regards to underwriting, violations were discovered in the nonrenewals of a large number of auto policies for reasons not allowed by Kansas law.

The significant issues to note are the many inconsistencies found in the Company’s rating practices. The Company had filed a new auto rating system in the fall of 2010 and there were several areas that the Company failed to use the rates and rules as filed or failed to put all rating elements into the new filings until brought to their attention by the exam team. Other issues of concern included applications being used that were not on file with the Kansas Insurance Department as required. Some of the issues were with filing errors and some were other business practices that had been addressed prior to the examination, while other issues have been updated during the course of the examination. The Company had disclosed to the Kansas Insurance Department in the fall of 2012 that they had implemented a rate filing prior to approval. This affected a large number of policyholders and refunds for most of those overcharged have been processed, while the Company is continuing to complete the refund process. There have been many updated rate and rules filed, especially on the automobile line of insurance over the past few years. With the number of errors noted in the implementation of new auto rate filings, a follow-up examination is recommended to ensure compliance in this area.

The exam team has made several recommendations based on the violations found during the examination, regardless of whether the standard was passed or failed. Additional details on each standard including percentages of compliance are found within the individual sections of this report.

### **Recommendations**

#### **OPERATIONS AND MANAGEMENT**

1. The Company should review their audit procedures to ensure future compliance with Kansas statutes and regulations as well as ensure consistencies in following business practices set by the company.

## **COMPLAINT HANDLING**

1. The Company should ensure all incoming correspondence is date stamped on the day received in order to have adequate documentation of the files. The Company should also put procedures in place to ensure the dates received on the complaint log are accurate.
2. The Company should take steps to ensure all complaints are responded to within the timeframes specified by Kansas regulations or within Company guidelines when legal requirements are not applicable.

## **CLAIM HANDLING**

1. The Company should maintain procedures to ensure documents are scanned into the system on the day they are received. When this is not possible, it should be clear to the examiners when the documents were received in order to recreate the claim files.
2. It was noted on the homeowner claims review that there were instances in which claim payments were made using a debit card. While we have no laws in Kansas prohibiting this practice, there are fees and requirements associated with the use of the cards that are not presented until after issuance. It appears if a person refuses the card the Company will send a check, however it is not clear if both options are discussed. The Company should disclose stipulations involved in using the card and should give the option of receiving payment by check along with the offer of receiving payment by debit card.

## **UNDERWRITING AND RATING**

1. The Company must do a thorough review of their rating practices to ensure they coincide with the rules and rates filed and approved with the Kansas Insurance Department prior to and during implementation of each new rate and rule filing.
2. The Company must ensure procedures are in place to file all required forms with the Kansas Insurance Department.
3. The Company must review the allowable reasons to cancel and nonrenew policies as indicated by Kansas statute and ensure the Company's procedures comply.

## DESK EXAMINATION

### OPERATIONS AND MANAGEMENT

#### **I. History and Profile**

[Based on Company response to interrogatories:]

Farmers Insurance Company Inc. was originally incorporated as Midland Empire Insurance Company, Inc. (Midland), on June 6, 1955, as a capital stock company to make contracts of insurance or to cede or receive reinsurance thereon. The Articles of Incorporation provide for 100 years of existence. The Articles of Incorporation were amended, effective December 9, 1969, changing the name of Midland to Farmers Insurance Company, Inc. ("FICO"). A subsequent merger occurred in 1984. Farmers Insurance Company of Arkansas merged into FICO, effective as of March 31, 1984. The company received its Certificate of Authority from the Kansas Department of Insurance on April 25, 1969. The authorized lines of business are: Fire, Windstorm & Hail, Extended Coverage, Sprinkler Leakage, Business Interruption, Earthquake, Inland Marine, Automobile Physical Damage, Homeowners Policies, Accident & Health, Automobile Liability, General Liability, Glass, Burglary, Theft & Robbery, Reinsurance Only: Workers' Compensation, Fidelity, Surety & Forgery Bonds, Boiler & Machinery.

#### **II. Prior Market Conduct Examination Reports**

The KID examination team requested all market conduct exams completed within the last three years prior to the exam. There were no exams completed within that time frame.

#### **III. Fines and/or Penalties**

The KID examination team reviewed the actions from other states regarding fines and penalties from the five year period prior to the exam and found nothing that warranted additional inspection beyond the scope of this targeted examination.

#### **IV. Tests for Company Operations and Management**

##### **Standard 1**

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

[Based on Company response to interrogatories:]

Internal audits are selected based on quarterly risk assessments conducted by management. Audits are performed on identified areas by Farmers Internal Audit, and are conducted at a national level, crossing numerous states and underwriting companies. The Company did not have a specific audit for Kansas or for Farmers Insurance Company, Inc. to report.

Recommendation: The Company should review their audit procedures to ensure future compliance with Kansas statutes and regulations as well as ensure consistencies in following business practices set by the company.

**Standard 7**

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

The Company maintained adequate records as required and provided items to the exam team as requested with a few exceptions.

Recommendation: None

**Standard 8**

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

The Kansas Certificates of Authority were reviewed and were in compliance with Kansas law.

Recommendation: None

**Standard 9**

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

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

Recommendation: None

**COMPLAINT HANDLING**

The examiners reviewed the Company’s procedures for handling various types of complaints. Also, the examiners reviewed a sample which contained 100 files submitted to the Company from the Kansas Insurance Department (DOI Complaints) and 40 files submitted directly to the Company (Consumer Complaints). The “Number of Errors” included in the samples below are defined as the total number of complaints in the sample which contained errors.

**Standard 1**

All complaints are recorded in the required format on the regulated entity’s complaint register.

<b>Sample Type</b>	<b>Sample Size</b>	<b>Number of Errors</b>	<b>Percent Compliance</b>
DOI Complaints	100	0	100%
Consumer Complaints	40	0	100%

Result: Pass

Recommendation: None

**Standard 2**

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

Sample Type	Sample Size	Number of Errors	Percent Compliance
DOI Complaints	100	0	100%
Consumer Complaints	40	0	100%

Result: Pass

Recommendation: None

**Standard 3**

The regulated entity takes adequate steps to finalize and dispose of the complaint in accordance with applicable statutes, rules and regulations, and contract language.

Sample Type	Sample Size	Number of Errors	Percent Compliance
DOI Complaints	100	23	77%
Consumer Complaints	40	1	98%

There were twenty-three (23) claim-related complaint files from the DOI and one consumer complaint that had incoming correspondence without date stamps. The complaint logs indicate a date received on all files, but there were differences in some records between date stamps and the date entered on the complaint log. Therefore, without the date stamp we are unable to determine when these files were actually received by the company and recreate the pertinent events in the file. This is a violation of K.A.R. 40-1-34, Section 4. Two additional complaint files from the DOI that were not claim related also did not contain date stamps, though the above regulation does not apply.

Result: Fail (DOI Complaints)

Recommendation: The Company should ensure all incoming correspondence is date stamped on the day received in order to have adequate documentation of the files. The Company should also put procedures in place to ensure the dates received on the complaint log are accurate.

**Standard 4**

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

Sample Type	Sample Size	Number of Errors	Percent Compliance
DOI Complaints	100	0	100%
Consumer Complaints	40	1	98%

There was one consumer complaint file related to a claim that was not responded to within ten working days. This is a violation of K.A.R. 40-1-34, Section 6(c). There were seven other consumer complaint files that did not contain a response within ten working days, however they were not claim related and Kansas does not have any laws requiring response. The Company procedures indicate a goal of responding to all complaints within ten (10) business days.

Result: Pass

Recommendation: The Company should take steps to ensure all complaints are responded to within the timeframes specified by Kansas regulations or within Company guidelines when legal requirements are not applicable.

## CLAIM HANDLING

The examiners reviewed the Company's claims procedures in addition to a review of actual claim files. The file review consisted of 109 private passenger auto claims and 109 homeowner claims processed during the exam period. The "Number of Errors" included in the samples below are defined as the total number of claims in the sample which contained errors.

### General Claim Standards

#### Standard 1

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

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	0	100%
Homeowner Claims	109	0	100%

Result: Pass

Recommendation: None

#### Standard 2

Timely investigations are conducted.

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	0	100%
Homeowner Claims	109	0	100%

Result: Pass

Recommendation: None

**Standard 3**

Claims are resolved in a timely manner.

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	1	99%
Homeowner Claims	109	0	100%

There was one auto claim file where multiple claims were submitted on a PIP claim file, and the company did not pay, deny, or acknowledge the claims for over two months. This is a violation of K.A.R. 40-1-34, Section 8(a)&(c).

Result: Pass

Recommendation: None

**Standard 4**

The regulated entity responds to claim correspondence in a timely manner.

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	0	100%
Homeowner Claims	109	0	100%

Result: Pass

Recommendation: None

**Standard 5**

Claim files are adequately documented.

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	*see below	
Homeowner Claims	109	*see below	

The Company has a National Document Center in Oklahoma City, OK where incoming mail is received. There are no day or time stamps placed on the documents to indicate when the correspondence is received. The Company indicates that documents are usually scanned the day they are received, and if not they are hand stamped. With the times that certain documents are scanned, some are likely to have been received on the day prior. Faxed documents are also scanned in a way it is unclear the day and time of receipt.

\*Not all claim files contain documents that go to the National Document Center. Several files in the auto sample were identified with one or more documents where it is unclear the exact date received and we are not able to fully reconstruct the claim files. This is a violation of K.A.R. 40-1-34, Section 4. The homeowner claims also use the Document Center to receive some correspondence, however in our claim sample there were not as many files noted with documents that went through the National Document Center. The Company passes the standard since the actual documents in the sample are not specifically being identified and not all claims will have documents submitted in this manner. It should be noted, however, as a business practice that should be reviewed and updated to ensure received dates are clear.

Result: Pass

Recommendation: The Company should maintain procedures to ensure documents are scanned into the system on the day they received. When this is not possible, it should be clear to the examiners when the documents were received in order to recreate the claim files.

**Standard 6**

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

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	8	93%
Homeowner Claims	109	0	100%

There were eight claim files in which the company failed to pay the vehicle registration fee required on total loss settlements per K.A.R. 40-1-34, Section 9(a)(2). One of those files also had a third party total loss claim that failed to pay the applicable fee as required by K.A.R. 40-1-34, Section 9(h). The Company notified the examiners of this issue prior to the review of the claim files. This issue had been discovered by the company during an internal review which began in April 2012 (during our exam period), and reimbursements were made to affected consumers. Per the Company, 8,135 reimbursements were completed in September 2012 for a total amount of \$44,680.

Result: Pass

Recommendation: None

**Standard 8**

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

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	0	100%
Homeowner Claims	109	0	100%

Result: Pass

Recommendation: None

**Standard 9**

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

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	0	100%
Homeowner Claims	109	0	100%

Result: Pass

Recommendation: None

**Standard 11**

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.

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Claims	109	0	100%
Homeowner Claims	109	0	100%

Result: Pass

Recommendation: None

General Claims Recommendation: It was noted on the homeowner claims review that there were instances in which claim payments were made using a debit card. While we have no laws in Kansas prohibiting this practice, there are fees and requirements associated with the use of the cards that are not presented until after issuance. It appears if a person refuses the card the Company will send a check, however it is not clear if both options are discussed. The Company should disclose stipulations involved in using the card and should give the option of receiving payment by check along with the offer of receiving payment by debit card.

## UNDERWRITING AND RATING

### General Underwriting and Rating Standards

#### Standard 1

The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the regulated entity's rating plan.

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Policies	94	*see below	
Homeowner Policies	108	1	99%

There were inconsistencies during the exam period between how policies were rated and the filed rating rules with regards to policies with multiple vehicles that had been converted from the Legacy system to the FA2 system. The Legacy filings prior to the end of 2009 allowed for only one vehicle per policy, thus when converted into the FA2 system they were converted into multiple policies as previously written. New business written into FA2 allowed for up to four vehicles on a policy. The FA2 filing indicated multi-car discounts would be applied if there were more than one vehicle on a policy, however the company provided the discount to the households with multiple policies, even if those had only one vehicle on each policy. Also, the UM/UIM rate order of calculation in the approved FA2 rating manual indicated the UM factors were determined by average factors of each vehicle on the policy, when actually this was being averaged at the household level with those that had multiple policies rather than multiple vehicles on one policy (from the conversion mentioned above). Since the company was not following their approved rating rules, many policies during the exam period were not issued in accordance with approved rates and rules, and are in violation of K.S.A. 40-955(g). After our review, the company has updated the filing to match how the company was actually performing the rating with regards to multiple policies and vehicles.

When converting from the Legacy system to FA2, the company did not include a complete PIP symbol filing. On the vehicle symbol pages, there were five columns (BI, PD, UM/MED, CM, CL), while the auto symbol rating factors contained six categories (BI, PD, PIP, UM, COMP, COLL). The Company acknowledged this oversight and has re-filed updated symbol pages after this was brought to their attention during the examination in 2013. The rates being used were not completely filed, which is a violation of K.S.A. 40-955(a). The policies written or renewed on the FA2 system during the exam period were rated not in accordance to the rates on file, in violation of K.S.A. 40-955(g).

Two auto policies were issued with work loss coverage that was not in accordance with the rates on file. This is a violation of K.S.A. 40-955(g). The work loss had been in the Company's Legacy filing, but they failed to insert it into the FA2 filings when they converted in late 2010. This was not discovered until the exam team's review. The Company indicates since the launch of FA2 there have been 6,704 policies with this work loss coverage, most of which originally had

the coverage through a Legacy policy. The rates for work loss have now been filed with the Kansas Insurance Department.

Four policies in our sample were rated with a rate filing that had been filed, but not yet approved. This is a violation of K.S.A. 40-955(g). The Company had disclosed to the Kansas Insurance Department in fall 2012 that they had discovered the early implementation of a rate filing on the initial proposed effective date of 4/9/2012 (new business) and 5/22/2012 (renewals), though the filing was not approved until 7/16/2012 (new business) and 8/14/2012 (renewals). The Company indicated to the examiners in May 2012 that 31,984 customers had received refunds in the amount of \$764,052 and there were still approximately 5,000 policies still being processed. As our exam period ended June 30, 2012, there were many policies during our exam period that were affected by this error, and many policies written and renewed outside of our exam period that were also impacted.

One policy in our sample was written with customization coverage indicated on the Declarations page, though it did not meet the criteria for the coverage. The company indicated a system oversight allowed the coverage to be presented. The policy did not have the required comprehensive or collision coverage. The policy was not charged for the coverage, and a claim was not filed against the coverage, though the company indicates they would have honored the claim if presented. The Company indicated they were working with IT to get the issue corrected, and identified 125 policies that also showed as having the coverage though not rated with this coverage. This is a violation of K.S.A. 40-955(g).

One Homeowner Renewal policy included a Condominium Product Type Factor that did not match the information in the filed and approved rates. This is a violation of K.S.A. 40-955(g). The Company had decreased the factor they were using, but failed to file the decrease with the rate filing. The Company estimates approximately 950 Condo customers were impacted by the undercharge due to this factor.

\*The specific files from our sample affected by the work loss, customization, and early rate implementation are noted above. There were many policies in our exam period issued with rating violations due to the early implementation of the rate filing noted above, but the exact number during that time period was unidentified by the examiners (total number described above). The exact number of households in our sample with multiple policies after conversion being rated according to the filed rules that pertained to multiple vehicles on the same policy was not isolated by the examiners. All policies rated on the FA2 system during the exam period were not in accordance with the filing in regards to the vehicle symbols as the filing was not complete, though the exact number written during the period was not identified by the examiners. The numbers of affected policies for each of these issues are listed above where identified in the sample. Due to the fact that many issues noted above were business practices and affected a large number of policyholders (as noted), the Company fails this standard.

Result: Fail (Auto Policies)

Recommendation: The Company must do a thorough review of their rating practices to ensure they coincide with the rules and rates filed and approved with the Kansas Insurance Department prior to and during implementation of each new rate and rule filing.

#### **Standard 4**

The regulated entity's underwriting practices are not unfairly discriminatory. The regulated entity adheres to applicable statutes, rules and regulations and regulated entity guidelines in the selection of risks.

While rating errors were noted, there is no evidence of discrimination in the Company's rating practices.

Recommendation: None

#### **Standard 5**

All forms, including contracts, riders, endorsement forms and certificates are filed with the insurance department, if applicable.

Both the private passenger auto and homeowner lines had binding applications being used during the exam period that were not filed with the Kansas Insurance Department. This is a violation of K.A.R. 40-3-23. Both lines have had had new applications filed after the end of the exam period.

An auto policy being issued during the exam period contained language not in accordance with Bulletin 2004-1 regarding proper language for Arbitration/Appraisal Clauses. This was updated by the company prior to the exam, effective 6/16/2012.

Recommendation: The Company must ensure procedures are in place to file all required forms with the Kansas Insurance Department.

#### **Standard 6**

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

There was one file noted in the auto rating portion of the exam that was a motorcycle policy with no PIP coverage, but without written refusal of the coverage. This is a violation of K.S.A. 40-3107(f).

Recommendation: None

#### **Standard 8**

Cancellation/nonrenewal, discontinuance and declination notices comply with policy provisions, state laws, and the regulated entity's guidelines.

Sample Type	Sample Size	Number of Errors	Percent Compliance
Auto Policies	80	42	48%
Homeowner Policies	80	0	100%

Forty-one (41) policies were non-renewed for reasons contrary to those allowed in K.S.A. 40-276a. Of those, forty (40) were for similar reasons, lack of information on a possible driver in the household without a full investigation being conducted by the Company. The company had changed their procedures after the exam period, but prior to the exam review of the files. One policy contained a cancellation notice that was sent one day after the actual cancellation date. This is a violation of K.S.A. 40-3118(b) which requires a 30 day notice prior to cancellation.

Result: Fail (Auto Policies)

Recommendation: The Company must review the allowable reasons to cancel and nonrenew policies as indicated by Kansas statute and ensure their procedures comply.

### **SUMMARIZATION**

This examination was conducted to review the operations and management, complaint handling, claim handling, and underwriting and rating practices of the Company. On complaint handling there were issues noted with regards to inconsistent date-stamping practices as well as timely responses to consumers. With regards to claim handling, it was unclear exactly when some of the claim documentation was received by the company, and a recommendation is being made to ensure consistency. The Company had identified a system error leading to the omission of a \$4.00 fee being paid on total loss settlement claims. The Company identified all policies affected by this and had issued payment to affected claimants. Other isolated violations were noted on these two areas, but are not perceived as business practices.

The company had a large number of auto policies cancelled for reasons not allowed by Kansas statutes. Many of these were due to lack of information on an added driver in the household. This is one area that the Company had already changed their procedures in a manner that allows for policies to be re-rated for the additional driver rather than cancelled or non-renewed due to lack of information. Also of concern was the use of un-filed binding applications by the Company both on the auto and homeowner lines of business. These have now been filed by the Company.

Most of the issues noted during the examination were related to auto rating. There have been numerous changes to the rates and rules over the exam period, and there were several areas where the filings were not complete or not being followed as written. The Company did disclose to the Kansas Insurance Department in the fall of 2012 the use of a filing prior to approval, and indicated to the exam team in May 2012 that 31,984 customers had received refunds in the amount of \$764,052 and a small number of refunds were still to be calculated. Other problems with the filings noted in the exam report were not discovered until the examination, and have now been filed with our Department. A large number of policyholders were charged rates not in

accordance to what was filed, though many of those were rated less than they should have been with the exception of the early rate implementation noted above. Some of the errors were from previously filed and approved rates, so even though they weren't being charged what was approved for that time period it had previously been approved. The issue noted above where the Company averaged on the household basis rather than per policy as described in the rating manual and provided the discount in that manner was a benefit to the consumer. The Company needs to do a thorough review of their rating practices and their rate and rule filings to ensure they are being used properly. When finding rating issues, the Company should report these to the Kansas Insurance Department and clearly indicate all changes on submitted filings.

### **CONCLUSION**

I would like to acknowledge the cooperation and courtesy extended to the examination team by the Farmers Insurance Company staff. The following examiners from the Office of the Commissioner of Insurance in the State of Kansas participated in the review:

#### Market Conduct Division

Stacy Rinehart  
Market Conduct Manager

LeAnn Crow  
Market Conduct Examiner

Tate Flott  
Market Conduct Examiner

Claudia Perney  
Market Conduct Examiner

Respectfully submitted,



Stacy Rinehart, FLMI, MCM, CIE, AIRC  
Market Conduct Manager  
Examiner-In-Charge

## APPENDIX A

### Related Kansas Insurance Statutes and Administrative Regulations

#### **K.S.A. 40-222. Examinations**

(a) Whenever the commissioner of insurance deems it necessary but at least once every five years, the commissioner may make, or direct to be made, a financial examination of any insurance company in the process of organization, or applying for admission or doing business in this state. In addition, at the commissioner's discretion the commissioner may make, or direct to be made, a market regulation examination of any insurance company doing business in this state.

(b) In scheduling and determining the nature, scope and frequency of examinations of financial condition, the commissioner shall consider such matters as the results of financial statement analyses and ratios, changes in management or ownership, actuarial opinions, reports of independent certified public accountants and other criteria as set forth in the examiner's handbook adopted by the national association of insurance commissioners and in effect when the commissioner exercises discretion under this subsection.

(c) For the purpose of such examination, the commissioner of insurance or the persons appointed by the commissioner, for the purpose of making such examination shall have free access to the books and papers of any such company that relate to its business and to the books and papers kept by any of its agents and may examine under oath, which the commissioner or the persons appointed by the commissioner are empowered to administer, the directors, officers, agents or employees of any such company in relation to its affairs, transactions and condition.

...

(g) The refusal of any company, by its officers, directors, employees or agents, to submit to examination or to comply with any reasonable written request of the examiners shall be grounds for suspension or refusal of, or nonrenewal of any license or authority held by the company to engage in an insurance or other business subject to the commissioner's jurisdiction. Any such proceedings for suspension, revocation or refusal of any license or authority shall be conducted in accordance with the provisions of the Kansas administrative procedures act.

...

#### **K.S.A. 40-276a. Automobile liability insurance policies; denial of renewal; notice; conditions; 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):

(1) When such insurance company is required or has been permitted by the commissioner of insurance, in writing, to reduce its premium volume in order to preserve the financial integrity of such insurer;

(2) when such insurance company ceases to transact such business in this state;

(3) when such insurance company is able to show competent medical evidence that the insured has a physical or mental disablement that impairs his ability to drive in a safe and reasonable manner;

(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;

(5) when the policy has been continuously in effect for a period of five years. Such five-year period shall begin at the first policy anniversary date following the effective date of the policy, except that if such policy is renewed or continued in force after the expiration of such period or any subsequent five-year period, the provisions of this subsection shall apply in any such subsequent period; or

(6) when any of the reasons specified as reasons for cancellation in K.S.A. 40-277 are existent, except that (A) when failure to renew is based upon termination of agency contract, obligation to renew will be satisfied if the insurer has manifested its willingness to renew, and (B) obligation to renew is terminated on the effective date of any other automobile liability insurance procured by the named insured with respect to any automobile designated in both policies.

Renewal of a policy shall not constitute a waiver or estoppel with respect to grounds for cancellation which existed before the effective date of such renewal. Nothing in this section shall require an insurance company to renew an automobile liability insurance policy if such renewal would be contrary to restrictions of membership in the company which are contained in the articles of incorporation or the bylaws of such company.

(b) (1) No insurance company shall refuse to renew a policy until after June 30, 2002, based on an insured's failure to maintain membership in a bona fide association, until both the insurance company and bona fide association have complied with the requirements of this subsection. No insurance company shall refuse to renew any coverage continuously in effect before July 1, 2002, unless:

(A) The application for insurance and the insurance policy shall clearly disclose that both the payment of dues and current membership in the bona fide association are prerequisites to obtaining or renewing the insurance;

(B) the bona fide association has filed a certification with the commissioner of insurance verifying the eligibility of the insurance company to refuse to renew an insurance policy based on the membership in the bona fide association; and

(C) any money paid to the bona fide association as a membership fee:

(i) Shall not be used by the insurance company directly or indirectly to defray any costs or expenses in connection with the sale or purchase of the insurance; and

(ii) shall be set independently of any factor used by the insurance company to make any judgment or determination about the eligibility of any individual to purchase or renew such insurance. For the purposes of this provision, the individual may be a member of the bona fide organization or an employee or dependent of such a member.

(2) (A) Upon request the bona fide association shall file a statement with the commissioner of insurance verifying that the bona fide association meets the requirements of this paragraph.

(B) For the purposes of this subsection, "bona fide association" means an association which:

(i) Has been in active existence for at least five consecutive years immediately preceding the date the statement is filed;

(ii) has been formed and maintained in good faith for purposes other than obtaining or providing insurance and does not condition membership in the association on the purchase of insurance;

(iii) has articles of incorporation and bylaws or other similar governing documents;

(iv) has a relationship with one or more specific insurance companies and identifies each such insurance company; and

(v) and does not condition membership in the association or set membership fees on the eligibility of any individual to purchase or renew the insurance or on any factor that the insurance company could not lawfully consider when setting rates. For the purposes of this provision, the individual may be a member of the bona fide organization or an employee or dependent of such a member.

(3) Membership fees collected by the bona fide association shall not be deemed to be premiums of the insurance company that issued the coverage unless the bona fide association:

(A) Uses any portion of such membership fees directly or indirectly to defray any costs or expenses in connection with the sale or purchase of the insurance; or

(B) sets or adjusts membership fees for any member of the bona fide association based on any factor used by the insurance company that issues the insurance to make any judgment or determination about the eligibility of any individual to purchase or renew the insurance. For the purposes of this provision, the individual may be a member of the bona fide organization or an employee or dependent of such a member.

(4) If the membership fees are determined to constitute premiums pursuant to paragraph (3) of this subsection, the insurance company shall not refuse to renew a policy as otherwise permitted by this subsection.

**K.S.A. 40-955. Same; rate filings; review and approval of certain lines; effective dates; exemptions from filing; certain workers compensation policies; rules and regulations.**

(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. Every such filing shall indicate the proposed effective date and the character and extent of the coverage contemplated and shall be accompanied by the information upon which the insurer supports the filings. A filing and any supporting information shall be open to public inspection after it is filed with the commissioner, except that disclosure shall not be required for any information contained in a filing or in any supporting documentation for the filing when such information is either a trade secret or copyrighted. For the purposes of this section, the term "trade secret" shall have the meaning ascribed to it in K.S.A. 60-3320, and amendments thereto. An insurer may satisfy its obligations to make such filings by authorizing the commissioner to accept on its behalf the filings made by a licensed rating organization or another insurer. Nothing contained in this act shall be construed to require any insurer to become a member or subscriber of any rating organization.

...

(g) No insurer shall make or issue a contract or policy except in accordance with filings which have been filed or approved for such insurer as provided in this act.

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**K.S.A. 40-3107. Motor vehicle liability insurance policies; required contents; exclusions of coverage.** Every policy of motor vehicle liability insurance issued by an insurer to an owner residing in this state shall:

...

(f) include personal injury protection benefits to the named insured, relatives residing in the same household, persons operating the insured motor vehicle, passengers in such motor vehicle and other persons struck by such motor vehicle and suffering bodily injury while not an occupant of a motor vehicle, not exceeding the limits prescribed for each of such benefits, for loss sustained by any such person as a result of injury. The owner of a motorcycle, as defined by K.S.A. 8-1438 and amendments thereto or motor-driven cycle, defined by K.S.A. 8-1439 and amendments thereto, who is the named insured, shall have the right to reject in writing insurance coverage including such benefits for injury to a person which occurs while the named insured is operating or is a passenger on such motorcycle or motor-driven cycle; and unless the named insured requests such coverage in writing, such coverage need not be provided in or supplemental to a renewal policy when the named insured has rejected the coverage in connection with a policy previously issued by the same insurer. The fact that the insured has rejected such coverage shall not cause such motorcycle or motor-driven cycle to be an uninsured motor vehicle;

...

Unfair claims settlement practices regulation, January 1981 edition, adopted by reference in K.A.R. 40-1-34, subject to exceptions. Unofficial compilation of K.A.R. 40-1-34 with the Model Regulation is referenced in report.

#### **K.A.R. 40-1-34, Section 4. File and Record Documentation**

The insurer's claim files shall be subject to examination by the (Commissioner) or by his duly appointed designees. Such files shall contain all notes and work papers pertaining to the claim in such detail that pertinent events and the dates of such events can be reconstructed.

#### **K.A.R. 40-1-34, Section 6. Failure to Acknowledge Pertinent Communications**

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(c) An appropriate reply shall be made within ten working days on all other pertinent communications from a claimant which reasonably suggest that a response is expected.

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**K.A.R. 40-1-34, Section 8. Standards for Prompt, Fair and Equitable Settlements Applicable to All Insurers**

(a) Within fifteen working days after receipt by the insurer of properly executed proofs of loss, the first party claimant shall be advised of the acceptance or denial of the claim by the insurer. 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.

...

(c) If the insurer 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. If the investigation remains incomplete, the insurer shall, forty-five days from the date of the initial notification and every forty-five days thereafter, send to such claimant a letter setting forth the reasons additional time is needed for investigation.

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**K.A.R. 40-1-34, Section 9. Standards for Prompt, Fair and Equitable Settlements Applicable to Automobile Insurance**

(a) When the insurance policy provides, for the adjustment and settlement of automobile total losses on the basis of actual cash value or replacement with another of like kind and quality, one of the following methods must apply:

(1) The insurer may elect to offer a replacement automobile which is a specific comparable automobile available to the claimant, with all applicable taxes, license fees and other fees incident to transfer of evidence of ownership of the automobile paid, at no cost other than any deductible provided in the policy. The offer and any rejection thereof must be documented in the claim file.

(2) The insurer may elect to pay a cash settlement, based upon the actual cost, less any deductible provided in the policy, to purchase a comparable automobile including all applicable taxes, license fees and other fees incident to transfer of evidence of ownership of a comparable automobile. Such cost shall be determined by any source or method for determining statistically valid fair market value that meets both of the following criteria:

(A) The source or method's database, including nationally recognized automobile evaluation publications, shall provide values for at least eighty-five percent (85%) of all makes and models of private passenger vehicles for the last fifteen (15) model years taking into account the values for all major options for such vehicles; and

(B) The source, method, or publication shall provide fair market values for a comparable automobile based on current data available for the local market area as defined in subsection (j)(2).

...

(h) Insurers shall include consideration of applicable taxes, license fees, and other fees incident to transfer of evidence of ownership in third party automobile total losses and shall have sufficient documentation relative to how the settlement was obtained in the claim file. A measure of damages shall be applied which will compensate third party claimants for the reasonable loss sustained as the proximate result of the insured's negligence.

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**K.A.R. 40-3-23 Fire and casualty insurance except accident and health; binder forms required to be filed.**

Binders or other temporary contracts of insurance are subject to K.S.A. 40- 216. These forms shall be filed with and approved by the commissioner in accordance with applicable statutory provisions.

**Bulletin 2004-1**

TO: All Companies Writing Business in Kansas and Rating Organizations  
FROM: Sandy Praeger Commissioner of Insurance  
DATE: March 3, 2004  
RE: Arbitration/ Appraisal Clauses

Please refer to our bulletin 1998-3 that was mailed on February 3, 1998.

On page one of such bulletin, we made the following comments relative to arbitration/ appraisal provisions in insurance contracts:

"The Kansas Insurance Department has reviewed the use of arbitration clauses in insurance contracts based on the decision of the Kansas Supreme Court in *Friday v. Trinity Universal of Kansas*, (22 Kan App. 2d 935, 924, P.2d 1284 1996). Based on our review, the Department believes that the use of voluntary arbitration clauses in insurance contracts is permissible."

The Department has subsequently reviewed the decision reached by the Kansas Supreme Court in *Friday*, 262 Kan. 347, 939 P.2d 869 (1997). Based on our subsequent review of this case and the court's interpretation of K.S.A. 5-401, the Department now believes that the use of arbitration/ appraisal of insurance claims is permissible only when resolving disputes that have already arisen and when both parties volunteer.

K.S.A. 5-401 states, "Validity of arbitration agreement. (a) A written agreement to submit any existing controversy to arbitration is valid, enforceable and irrevocable except upon such

grounds as exist at law or in equity for the revocation of any contract... (b) Except as provided in subsection (c), a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable except upon such grounds as exist at law or in equity for the revocation of any contract. (c) The provisions of subsection (b) shall not apply to: (1) Contracts of insurance, except for those contracts between insurance companies, including reinsurance contracts; (2) contracts between an employer and employees, or their respective representatives; or (3) any provision of a contract providing for arbitration of a claim in tort.”

The court has interpreted this statute in Friday as meaning that an insurer and insured can agree to arbitrate a controversy or conduct appraisals only after a dispute has arisen. This decision means that any contractual agreement to arbitrate future disputes is unenforceable.

In view of the foregoing, we hereby revoke the opinion in our bulletin 1998-3 relative to the permissibility of all arbitration and appraisal clauses in insurance contracts. In lieu thereof, you are directed to advise your personnel in charge of your Kansas operations of this decision. Companies are, therefore, advised that arbitration and appraisal conditions in any filing with this office, including bylaws of fraternal benefit societies, are unenforceable if they provide for arbitration or appraisal of future disputes. In addition, provisions that do not inform consumers that arbitration or appraisal are voluntary and must be agreed upon by both parties are unenforceable.

A mandatory endorsement is a necessary filing and shall be submitted to the appropriate division of this Department by July 1, 2004. Suggested endorsement language is as follows:

**After a dispute has arisen, an appraisal or arbitration may take place if you and we fail to agree on the amount of the loss. However, an appraisal or arbitration will take place only if both you and we agree, voluntarily, to have the loss appraised or arbitrated.**

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