

# **MARKET CONDUCT EXAMINATION REPORT**

## **LIBERTY MUTUAL FIRE INSURANCE COMPANY**

NAIC # 23035; Group #111

## **LM GENERAL INSURANCE COMPANY**

NAIC # 36447; Group #111

## **LM INSURANCE CORPORATION**

NAIC # 33600; Group #111

## **THE FIRST LIBERTY INSURANCE CORPORATION**

NAIC # 33588; Group #111

## **LIBERTY INSURANCE CORPORATION**

NAIC # 42404; Group #111

175 Berkeley Street  
Boston, MA 02116

ETS # KS057-M19

As of

December 31, 2014



**KANSAS INSURANCE DEPARTMENT**

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The Honorable Ken Selzer  
Insurance Commissioner  
Kansas Insurance Department  
420 SW Ninth Street  
Topeka, KS 66612

Dear Commissioner Selzer:

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:

Liberty Mutual Fire Insurance Company (NAIC #23035)  
LM General Insurance Company (NAIC #36447)  
LM Insurance Corporation (NAIC #33600)  
First Liberty Insurance Corporation (NAIC #33588)  
Liberty Insurance Corporation (NAIC #42404)

175 Berkeley Street  
Boston, MA 02116

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

Stacy Rinehart, FLMI, MCM, CIE, AIRC, ACS  
Assistant Director, Market Regulation  
Examiner-in-Charge

## **PURPOSE AND SCOPE OF REVIEW**

A market conduct examination of Liberty Mutual Fire Insurance Company (LMFIC), LM General Insurance Company (LMGIC), LM Insurance Corporation (LMIC), First Liberty Insurance Corporation (TFLIC), and Liberty Insurance Corporation (LIC), also collectively 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 rating practices with a limited review of operations and management. 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 2016 NAIC Market Regulation Handbook (MRH). The exam team utilized the standards and tests recommended in the Handbook, which allows an error tolerance of 10% for sample categories enclosed in this report. 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 January 1, 2012 through December 31, 2014. Interrogatories were submitted to the Company prior to the file review segment of the examination and written responses were provided to the examiners. The examination included, but was not limited to, a review of company operations and management, history and profile, prior market conduct examination reports, fines and penalties, Certificates of Authority, internal audit procedures, and rating.

## **EXECUTIVE SUMMARY**

A market conduct examination of Liberty Mutual Fire Insurance Company, LM General Insurance Company, LM Insurance Corporation, First Liberty Insurance Corporation, and Liberty Insurance Corporation, also referred to as the “Company,” was conducted pursuant to, but not limited to, K.S.A. 40-222. The examination period was from January 1, 2012 through December 31, 2014. The focus of the exam was operations and management and policy rating of both private passenger automobile and homeowners insurance.

There were several areas where the rates and rules filed with our Department were vague or not submitted with the filing. There were other items noted as violations where the rates and rules being used did not match what was filed with our Department. In addition, there was a time period in which one company did not have an appropriate Certificate of Authority. This was promptly corrected by the Company during the examination.

Following are some of the general recommendations made by the examiners. In addition, more detailed recommendations specific to automobile and homeowner rating issues were also provided to the Company during the course of the examination and upon receipt of the examination report. Some of the rating violations noted resulted in an overcharge to consumers, while some resulted in an undercharge. With the complexity of the filings and encrypted nature of some of the auto rating plans, we are unable to fully recreate the accurate rates according to the filings.

### **Recommendations**

**Recommendation 1:** The Company should ensure rating audits include and test whether the rates and rules being used correlate with those on file with our Department.

**Recommendation 2:** The Company must put procedures into place to ensure the certificates of authority adequately cover business prior to writing business.

**Recommendation 3:**

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. The Company was given a list of items found by the examiners that will need to be revised in the rate and rule manual, or change the rating process to match what was filed. The Company should not limit its review to these items.

**Recommendation 4:**

The Company should be able to provide evidence to KID that they can recreate rates as charged to policyholders, and are using rates and rules as filed with our Department.

**Recommendation 5:**

The Company should ensure clear definitions and calculation instructions are provided in the Manual on future filings.

Recommendation 6:

The encrypted nature of some previous filings specifically caused several violations as noted in the auto rating section. One other such issue that we noticed, specifically regarding the encrypted nature of the rating program, is that when future rating program updates were filed, they were filed in an unencrypted manner. While it is our ultimate recommendation to not submit encrypted filings in the future, it would be our secondary recommendation to submit consistent filings when updating the rating programs and to provide consistent handraters when being examined.

Recommendation 7:

When filing rates in SERFF, the requested effective dates should refer to when the rates would be actually in operation or in force. If there is a separate renewal processing period, that should be accounted for when requesting the “effective” date.

**DESK EXAMINATION**

**OPERATIONS AND MANAGEMENT**

**I. History and Profile**

LMIC was incorporated in Iowa in 1989, and transferred its domicile from Iowa to Illinois in 2009.

LMFIC was incorporated in MA in 1908 as United Druggists Mutual Fire Insurance Company. Its current name was adopted in 1949. The Company reorganized from a mutual to stock insurance company as part of a mutual holding company structure in 2002, and transferred domicile from MA to WI in 2005.

LIC was incorporated in VT in 1988, but transferred its domicile from VT to IL. In 1988, it merged with Liberty Insurance Corp (a Delaware corporation, incorporated in 1983) and assumed all of its business.

LMGIC was incorporated in DE in 1978 as “Prudential General Insurance Company”, and was wholly owned by Prudential Property and Casualty Insurance Company. Both the Company and Prudential Property and Casualty Insurance Company were acquired by Liberty Mutual Insurance Group in 2003. The company changed its name from Prudential General to LMGIC in 2004, and transferred domicile from DE to IL in 2009, becoming an IL stock insurance company.

TFLIC was incorporated in IA in 1989 and transferred its domicile to IL in 2009.

All five companies share in one another’s business under an inter-company reinsurance arrangement, and have an AM Best FSR of A (Excellent).

[The above profile information is based on the Company response to exam interrogatories.]

## **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 findings of concern that require review relative to the scope of our exam.

## **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 one issue regarding rating of concern. The Company indicated their internal procedures were adjusted and subsequent audits were performed. The issue was not noted in our file review.

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

### **Standard 1**

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

The Company provided a copy of their audit procedures related to rating, as requested by the examiners. They have a quality control process in place with rate revisions, and also conduct targeted reviews to ensure the accuracy of the rating processes.

### **Standard 7**

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

The Company was cooperative, but on some of the files had to be prompted several times to provide adequate records necessary to properly rate each sample policy.

### **Standard 8**

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

The Kansas Certificates of Authority were reviewed. One of the Companies, LM Insurance Corporation (NAIC #33600) did not have proper authority to write homeowners business in Kansas, but began writing homeowners coverage in 2012. This is a violation of K.S.A. 40-214 requiring proper authority to transact business.

[Note: This particular error was discovered during the examination and the Company has taken steps to update the COA for this Company.]

### **Standard 9**

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

The Company was cooperative, but at times took an extensive amount of time being able to adequately explain how some rates were being used. For the most part, they were forthcoming in identifying issues uncovered during the examination.

## UNDERWRITING AND RATING

The examiners reviewed the rate and rule manuals and policy rating for both private passenger automobile and homeowner policies. Samples of 39 auto policies and 36 homeowner policies, each including both new business and renewals, were reviewed for rating accuracy. The “Number of Errors” included in the samples below are defined as the total number of policies in the sample which contained errors.

### 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	39	39	0%
Homeowner Policies	36	17	53%

#### Auto Policies

The thirty-nine private passenger auto policies rated by the examiners consisted of a sample of both a legacy rating program (17 policies) for Liberty Mutual Fire and Liberty Insurance Corporation and a newer “Gears” rating program (22 policies) for LM Insurance Corporation and LM General Insurance Company. First Liberty Insurance Corporation also wrote business under the legacy auto rating program, however none of these policies appeared in our random sample.

In the legacy rating program, there were three (3) different violations noted during the examination.

- The symbol and identification section referenced in the rating manual was not filed. During the examination, the Company provided the missing symbol and identification section published by ISO. However, since these were not filed prior to use, this is a violation of K.S.A. 40-955 (a). All policies in the exam period with Collision or Comprehensive coverage were affected by this error.
- The Premium Determination Rule used by the Company was different than the Rule that was on file for Liability, PIP, Comprehensive and Collision premium determinations. This is a violation of K.S.A. 40-955 (a) and (g). All policies during the exam period were affected by this error.
- The Company provides an affinity affiliation discount called “Group Savings Plus Discount”. The rules filed indicate there is a 5% discount available, and to qualify the



group must have at least 500 members/employees. The filing also indicates a 10% discount available, though no specific or verifiable criteria was filed indicating how the additional discount was determined. The Company subsequently described the justification to the examiners for the increased discount, including lower acquisition costs for groups receiving a larger discount, but no evidence was provided that the rates were not applied in an unfairly discriminatory manner. The Company did not file the rules that were using. These are violations of K.S.A. 40-953 and K.S.A. 40-955 (a)

In the gears rating program, there were nineteen separate (19) violations noted during the examination which affected multiple policies. All of the policies sampled had at least one rating violation. Some of the rating violations that were identified did not affect any policies in our sample, but were still noted by the examiner.

- The Company used different Territory rates than what were filed. This affected all policies during the examination period. This is a violation of K.S.A. 40-955 (a) and (g).
- The Company used different Cycle Guard rates than what were filed. This affected all policies that were issued or renewed after 6/18/2013. This is a violation of K.S.A. 40-955 (a) and (g).
- The Company failed to file min and max tables for Tier factors (above 10 and below 0.4). There were no policies in our sample affected by this error, and a minimal percentage of new business applicants would be affected. In this instance, the Company did not file the rule or rates they used. This is a violation of K.S.A. 40-955 (a).
- The Company filed an ambiguous rule for the calculation of age-related factors but also used obscure rounding rules when calculating these age-related factors. Therefore, the Company did not file the rules that they used. The Company did not use the rates as filed. This is a violation of K.S.A. 40-955 (a)
- The Company did not file the rule or the consistent rates they used nor did they use the rates that they filed with regard to calculation of rating for vehicles aged 1981 or older. The rating manual does not specify when they use vendor-provided vehicle class data versus customer provided vehicle class data. In addition, a portion of the rates used for older vehicles was filed unencrypted, and could not interact with the encrypted tables to recreate the same calculation for the final vehicle factor. This is a violation of K.S.A. 40-955 (a) and (g).
- The Company used different Tier rates than what were filed. This affected policies issued after 12/16/2013. There was a variable within the Tier rate being used by the company, but not filed. This is a violation of K.S.A. 40-955 (a) and (g).
- The Company improperly applied “multi-car” discounts to policies that only had single vehicles on the policies. The Company did not file the rate or rule that they used nor did they use the rule as they filed it. This is a violation of K.S.A. 40-955 (a) and (g).
- There were twelve discounts being applied to policies in a manner that was not exactly as filed. Although each of these discounts were proportionally rolled off of the policies, the filings did not indicate how the roll-offs were being applied in Kansas. These are all violations of K.S.A. 40-955 (a). These discounts include:
  - New-to-Liberty Discount
  - New Graduate Discount

- Newly Retired Discount
- Military Discount
- Paid-in-Full Discount
- Newlywed Discount
- New Teen Driver Discount
- Newly Independent Discount
- Payroll Discount
- EFT Discount
- Early Shopper Discount
- Longevity Discount

### Homeowner Policies

The thirty-six homeowner policies rated by the examiners consisted of a sample of both a legacy rating program (21 policies) for Liberty Mutual Fire Insurance and LM Insurance Corporation and a newer “Elements” rating program (15 policies) for Liberty Insurance Corporation.

Two policies in the sample were found to be in violation of K.S.A. 40-955 (a)(g) for using a formula for the calculation of premium regarding Increased Additions and Alternations that was different than the calculation method filed. The Company indicates 165 total policies were issued or renewed during the exam period with this coverage.

One policy in the sample contained Unit Owners A Special coverage, while the table that included rates for this coverage was omitted from the manual and not filed, in violation of K.S.A. 40-955(a). The Company indicates a total of 118 policies with this coverage were issued or renewed during the exam period.

One policy in the sample used a factor different than what was filed and approved with regards to “no prior loss”. This is a violation of K.S.A. 40-955(g). The factor used had been approved in a previous filing. The Company indicates there were 2,595 policies with no prior losses issued or renewed during the exam period using the incorrect factor. The previously filed factor that was used was lower than what was filed in error.

Two policies in the sample were in violation of K.S.A. 40-955(g) due to tier algorithms used for renters and condo policies not being filed in part or whole between 12/17/2012 and 4/22/2013. The Company indicates a total of 250 policies were issued or renewed during the exam period in which the appropriate tier algorithm had not been previously filed.

One policy in the same used a Peril B Residency Type factor for long term rentals that was not the same factor that was filed and approved, in violation of K.S.A. 40-955(g). The Company indicates a total of 851 policies were issued or renewed during the exam period using the incorrect factor.

Tiers for new and renewal business between 4/23/2012 and 12/19/2013 used Financial Stability Score/Prior Theft Loss factors that were not filed and approved, thus in violation of K.S.A. 40-955(g). There were 14 policies in the sample affected by this error. The Company indicates a

total of 14,892 policies issued or renewed during the exam period which had tiers determined by factors other than what was approved.

In addition to the specific issues noted above, the Company was presented with a list of items that should be filed with our Department within the rate and rule manual. These are not considered to be specific violations of using incorrect rates or rules, but rather to ensure completeness of the filings so examiners are more able to re-create rates.

**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.

Rating practices with possible discriminatory effects were noted in rating Standard 1 (auto).

**CONCLUSION**

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  
Examiner-In-Charge

Nicole Boyd  
Actuarial Examiner

Shannon Lloyd  
Market Conduct Examiner

Respectfully submitted,



Stacy Rinehart, FLMI, MCM, CIE, AIRC, ACS  
Assistant Director, Market Regulation  
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. 40-214. Conditions under which insurance may be written; certificate of authority; revocation, when; unlawful acts.**

It shall be unlawful for any person, company, corporation or fraternal benefit society to transact the business of insurance, indemnity or suretyship, or do any act toward transacting such business, unless such person, company, corporation or fraternal benefit society shall have been duly authorized under the laws of this state to transact such business and shall have received proper written authority from the commissioner of insurance in conformity with the provisions of

the laws of this state relative to insurance, indemnity and suretyship, and further, it shall be unlawful for any insurance company to effect contracts of insurance in this state on the life or person of residents of this state or on property located in this state except through persons duly licensed and certified in accordance with the insurance laws of this state and subject to the provisions of K.S.A. 40-245, and amendments thereto. Neither the enrollment of individuals under a group policy nor the inclusion of insurance in a credit transaction under an arrangement for its purchase by the creditor in compliance with the applicable provisions of the uniform consumer credit code shall constitute the effecting of a contract of insurance.

...

**K.S.A. 40-953. Same; excessive, inadequate or unfairly discriminatory rates or rates resulting in destruction of competition, standards.**

Rates shall not be excessive, inadequate or unfairly discriminatory, nor shall an insurer charge any rate which if continued will have or tend to have the effect of destroying competition or creating a monopoly. Rates are presumed not to be excessive if a reasonable degree of market competition exists at the consumer level with respect to the class of business to which they apply. Rates in a noncompetitive market are excessive if they are producing or are likely to produce unreasonably high profits for the insurance provided or if expenses are unreasonably high in relation to services rendered. A competitive market in a type of insurance subject to this act is presumed to exist unless the commissioner after notice of hearing determines and orders that a reasonable degree of competition does not exist in the market. Such order shall expire no later than one year after issuance unless the commissioner renews the rule after a hearing and a finding of the continued lack of a reasonable degree of competition. In determining whether a reasonable degree of market competition exists, the commissioner shall consider all relevant tests, including: (1) The number, market share, and concentration of insurers, as measured by the 1992 horizontal merger guidelines published in the Federal Register September 10, 1992 (57 FR 41552), actively engaged in the class of business; (2) the existence of rate differentials in that class of business; (3) ease of entry into the market; and (4) whether long-run profitability for insurers in that class of business is unreasonably high in relation to its riskiness. If such competition does not exist, rates are excessive if they are likely to produce a long run profit that is unreasonably high in relation to the riskiness of the class of business, or if expenses are unreasonably high in relation to the services rendered

...

**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.

...