

# **MARKET CONDUCT EXAMINATION REPORT**

## **SAFECO INSURANCE COMPANY OF AMERICA**

NAIC # 24740; Group #111

175 Berkeley Street

Boston, MA 02116

ETS # KS057-M17

As of

September 30, 2013



**KANSAS INSURANCE DEPARTMENT**

# TABLE OF CONTENTS

<u>SUBJECT</u>	<u>PAGE NO.</u>
Salutation .....	1
Purpose and Scope of Review.....	2
Executive Summary .....	3
Desk Examination	
Operations and Management .....	4
Complaint Handling.....	6
Underwriting and Rating.....	7
Summarization .....	11
Conclusion .....	12
Appendices	
Appendix A: Applicable Statutes and Regulations .....	A-1
Appendix B: Breakdown of Auto Rating Violations .....	B-1

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:

Safeco Insurance Company of America  
NAIC # 24740  
175 Berkeley Street  
Boston, MA 02116

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

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

## **PURPOSE AND SCOPE OF REVIEW**

A market conduct examination of Safeco Insurance Company of America, 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, 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 as well as some file review at a Company office in Overland Park, Kansas. The review was conducted according to the guidelines and procedures recommended in the 2013 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 January 1, 2012 through September 30, 2013. 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, complaint handling, underwriting and rating.

## **EXECUTIVE SUMMARY**

A market conduct examination of Safeco Insurance Company of America, 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 September 30, 2013. The focus of the exam was operations and management, complaint handling, underwriting and rating related to both private passenger automobile and homeowners insurance.

There were some issues noted in the handling of complaints. The most significant areas of concern were in the rating of both auto and homeowner policies. The Company was unable to provide a complete rate and rule manual that corresponded with the rates they were using throughout the exam period. In addition, there were delays in getting responses to questions about the policy rating. Lack of internal controls in the area of policy rating likely contributed to the large number of errors encountered by the examiners.

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 have written procedures in place to audit both complaint handling and policy rating. The Company should do periodic testing of their policy rating to ensure they are following the rates and rules as filed.
2. The Company should consider a longer document retention period for ease of viewing by examiners as well as Company personnel.
3. When responding to the Kansas Insurance Department, the Company should ensure personnel tasked with responding are knowledgeable in the subject matter and can supply appropriate replies within the requested timeframe.

#### **COMPLAINT HANDLING**

1. The Company should ensure the complaint register contains accurate information.
2. The Company should take steps to ensure all complaints are adequately responded to within the timeframes specified by Kansas regulations. Responses should not only be timely, but must address each item requested by KID regarding the complaint file.

## **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. The Company was given a list of items found by the examiners to be noncompliant, although the Company should not limit its review to these items. Any future filings with KID must clearly specify all of the factors being altered and a complete rate and rule manual must be presented to KID with each filing. Changes should be filed in the Rate/Rule tab in SERFF and not be made in the “Supporting Documentation” tab. [Note: Prior to the filing of this exam report, the Company did submit updated filings for approval by the Kansas Insurance Department.]
2. The Company should ensure policies are issued with the approved rating methodology and policyholders are offered approved rates in a similar manner.

## **DESK EXAMINATION**

### **OPERATIONS AND MANAGEMENT**

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

Safeco Insurance Company of America (the “Company”) was incorporated on September 2, 1953 in the State of Washington. Operations were conducted under the corporate name of Selective Auto and Fire Insurance Company of America until November 2, 1953, at which time the present name was adopted. Since January 1, 1973, all outstanding capital stock has been held by Safeco Corporation. Safeco Corporation acquired ownership from its subsidiary, General Insurance Company of America.

On September 22, 2008, Liberty Mutual Insurance Group acquired control of Safeco Corporation, which is the parent of Safeco Insurance Company of America.

On January 13, 2012, the Company redomesticated from Washington to New Hampshire.

Safeco Corporation owns 100% of the stock of the Company. Liberty Mutual Agency Corporation owns 100% of the stock of Safeco Corporation. Liberty Insurance Holdings, Inc. owns 100% of the stock of Liberty Mutual Agency Corporation. Liberty Mutual Insurance Company owns 100% of the stock of Liberty Insurance Holdings, Inc. Liberty Mutual Group Inc. owns 100% of the stock of Liberty Mutual Insurance Company. LMHC Massachusetts Holdings Inc. owns 100% of the stock of Liberty Mutual Group Inc. Liberty Mutual Holding Company Inc., the ultimate controlling parent of the Company, owns 100% of the stock of LMHC Massachusetts Holdings Inc.

The Company is licensed in the District of Columbia, Guam and all states.

[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 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.

Per the Company's response to our interrogatories, "[o]ur internal Audit Department does not have written procedures specifically to complaints and policy rating. However, these areas are regularly audited based on the processes and state rules for the particular areas. Reports will set forth issues only where findings are identified."

When requesting specific reports on rate reviews for Kansas policyholders, the Company was unable to produce any.

Recommendation: The Company should have written procedures in place to audit both complaint handling and policy rating. The Company should do periodic testing of their policy rating to ensure they are following the rates and rules as filed.

### **Standard 7**

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

The Company cited a 15-month retention period on documents after which time they are stored in an off-site facility. While this is not a violation of statute, it did lead to some delays in retrieving documents during the underwriting and rating portion of the examination.

Recommendation: The Company should consider a longer document retention period for ease of viewing by examiners as well as Company personnel.

### **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.

There were several instances on the rate review portion of the examination that the Company had delays in responding to the examiner, some of which were significant.

Recommendation: When responding to the Kansas Insurance Department, the Company should ensure personnel tasked at responding are knowledgeable in the subject matter and can supply appropriate replies within the requested timeframe.

**COMPLAINT HANDLING**

The examiners reviewed the Company’s procedures for handling various types of complaints. Also, the examiners reviewed a sample which contained 40 files submitted to the Company from the Kansas Insurance Department (DOI Complaints) and 30 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.

The complaint register given to the Kansas examiners contains several instances where the dates the complaints were received and/or disposed of by the Company were inaccurate. There are ten (10) complaints (in the sample of 70) with incorrect dates on the complaint record provided by the company (one case had both received and disposition dates incorrect). With the high percentage of complaints that were not accurately reflected, the record is not entirely compliant with K.S.A. 40-2404 (10).

Result: Fail

Recommendation: The Company should ensure the complaint register contains accurate information.

**Standard 4**

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

<b>Sample Type</b>	<b>Sample Size</b>	<b>Number of Errors</b>	<b>Percent Compliance</b>
DOI Complaints	40	5	88%
Consumer Complaints	30	0	100%

There were five DOI complaint file related to a claim that were not adequately responded to within fifteen working days. This is a violation of K.A.R. 40-1-34, Section 6(b).

Result: Fail

Recommendation: The Company should take steps to ensure all complaints are adequately responded to within the timeframes specified by Kansas regulations. Responses should not only be timely, but must address each item requested by KID regarding the complaint file.

## **UNDERWRITING AND RATING**

The examiners reviewed the rate and rule manuals and policy rating for both private passenger automobile and homeowner policies. Samples of 26 auto policies and 30 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.

<b>Sample Type</b>	<b>Sample Size</b>	<b>Number of Errors</b>	<b>Percent Compliance</b>
Auto Policies	26	25	4%
Homeowner Policies	30	9	70%

#### Auto Policies

Twenty-five of the auto policies in the sample were rated in a manner inconsistent with the rates and rules on file with the Department and thus in violation of K.S.A. 40-955(a)(g). Some of the policies had multiple items incorrect. {See Appendix B for number of policies affected by various rating issues.} The Company had many instances where they either had rules that were being used that were not included in or were inconsistent with the filed rates and rules. The examiners also noted areas where the filings needed clarification on the rate order of calculation and various rating rules. Due to the number of inconsistencies in the rate and rules on file with KID, the examiners were not able to accurately re-rate the policies. One particular area of concern is regarding the territory definitions. The territory factors being used by the Company were not consistent with those that were filed and approved, which could result in possible discriminatory rating practices.

In 2012 there was a consent order (Docket No. 4460-CO) by the Kansas Insurance Department in which Safeco was fined \$5,000 for issuing auto rates prior to approval. Over 800 new business policies that had been rated incorrectly were accounted for in that fine. The policies written during the time period were omitted from the sample as they had already been addressed by the

legal order. It was discovered during the course of the examination that there were also 129 Hawkeye conversion policies that were also issued using unapproved rates. This was not disclosed to the Department until specifically asked by the examiners on the policy rate review, though information on the rating errors had been previously requested. One of the auto policies in the sample reviewed was affected by this error.

The Company has agreed with the examiners' that the following items were incorrect, inconsistent, or missing in the various filings:

- Accident Prevention Course Discount vs. Mature Driver Discount
- Additional PIP Limit/Deductible Factor
- Advance Quote Discount Rule
- Audio, Visual & Customized Equipment Limit/Deductible Factor
- Drive Other Car Base Rate
- Drive Other Car Tier Factor
- Driver Restriction Surcharge
- Emergency Assistance Package Limit/Deductible Factor
- Employee Discount Factor/Premium Amount
- Expense Constant Rule
- General Calculation Rules (i.e. rounding, interpolation, etc.)
- Good Student Discount Factors/ Premium Amount (missing in the first filing, added prior to the end of the exam period)
- Group Discount Rule
- Hawkeye Conversion Cap Factors
- In-Force Rate Stabilization Factors Rules
- Loss of Use Limit/Deductible Factor
- Named Non Owner Factor for MED, COMP and COLL
- Optimum Package Plus Factors
- Paid in Full Discount vs. Billing Plan Discount
- Physical Damage Minimum Premium
- Policy Discount Factors/Account Credit/Account Discount Factors
- Policy Term Factor
- Rate Order of Calculation Incorrect
- Roadside Assistance / Tow Base Rate
- Roadside Assistance Limit/Deductible Factor
- Symbol Definitions
- Tapes, Records & Discs Limit/Deductible Factor
- Territory Definitions
- Value Class Factors
- Vehicle Age Factors Calculation Rule
- Vehicle Use vs. Usage Factor

### Homeowner Policies

Nine homeowner policies in the sample were rated in a manner inconsistent to the rates and rules on file with the Department and in violation of K.S.A. 40-955(a)(g). Various problems were encountered with some factors not being filed and there were some areas where clarification is needed in the filing. Some of the items listed below affected multiple policies. The Company has agreed with the findings that the following rates and rules were used in rating policies but not in the corresponding filing:

- Book Transfer Rate Stabilization Rules
- Capping Factors (incorrect in early filings, correct in later filings during the exam period)
- Additional Dwelling Liability Factors/Premiums
- Aged Old Premium Calculation Instructions
- Earthquake Capping Factors
- Employee Discount Factors/Premiums
- General Calculation Rules (missing in early filings, added prior to the end of the exam period)
- Incorrect calculation on Rate Order of Calculation
- In-Force Stabilization Factor Rules
- Market Definitions
- Ultra Package Factors (one filing period only)

One other item of concern with homeowner rating is regarding the company issuing policies based on the filing in effect on the quote date instead of date of policy issuance. The approved rating rules indicate that if the rate decreases with the filing change between the quote date and the issue date, the person may be offered the lower rate. The method currently used by the Company to offer the available rates is potentially discriminatory, as it is left up to the agents to decide whether to offer the lower rates when available and not systematically offered by the Company. There could be instances where similar individuals would be rated differently, as it is based on the discretion of the agent.

Result: Fail

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. The Company was given a list of items found by the examiners to be noncompliant, although the Company should not limit its review to these items. Any future filings with KID must clearly specify all of the factors being altered and a complete rate and rule manual must be presented to KID with each filing. Changes should be filed in the Rate/Rule tab in SERFF and not be made in the “Supporting Documentation” tab. [Note: Prior to the filing of this exam report, the Company did submit updated filings for approval by the Kansas Insurance Department.]

**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 Standard 1.

Recommendation: The Company should ensure policies are issued with the approved rating methodology and policyholders are offered approved rates in a similar manner.

**Standard 5**

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

Result: Pass

Recommendation: None

**Standard 6**

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

Result: Pass

Recommendation: None

**Standard 8**

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

<b>Sample Type</b>	<b>Sample Size</b>	<b>Number of Errors</b>	<b>Percent Compliance</b>
Auto Policies	84	0	100%
Homeowner Policies	24	0	100%

Result: Pass

Recommendation: None

## SUMMARIZATION

This examination was conducted to review the operations and management, complaint handling, underwriting and rating practices of the Company. In the complaint handling area there were problems with inaccurate dates on the complaint register as well as untimely and incomplete responses to KID.

Most of the issues discovered during the examination were related to rating of both private passenger automobile and homeowners business. 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. Prior to the examination there had been a legal order and fine against the Company for issuing over 800 new policies prior to the new rates being approved. After further review, there had been additional Hawkeye conversion policies issued with incorrect rates as well during that time period. This was not disclosed to the Department and was discovered by the examiners during the rating review.

As detailed in the exam report above, there were many areas on both the auto and homeowner rating where the Company was using rates either not in the filing for the appropriate time period or inconsistent with the filing. Additionally, there were problems with the rate order of calculations in the filings. With the number of inconsistencies in the rate and rule filings, it was not possible to recalculate accurate rates for the policies.

Another issue encountered during the examination was significant delays in responding to some of the rating inquiries. It is recommended that the Company do a thorough review of their rates and rules and their business practices to ensure the rates and rules are applied consistently. Also it is noted that when new rates and rules are filed with KID that the Company be able to identify all changes being made and submit the entire manual for review. The Company should implement audit procedures to ensure the rates being used are correct. A follow up exam will be recommended after rating issues are fixed by the Company.

**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  
Market Conduct Manager

Nicole Boyd  
Market Conduct Examiner

Tate Flott  
Market Conduct Examiner

Shannon Lloyd  
Market Conduct Examiner

Respectfully submitted,



Stacy Rinehart, FLMI, MCM, CIE, AIRC, ACS  
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. 40-955. 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.

**K.S.A. 40-2404. Unfair methods of competition and unfair or deceptive acts or practices**

...

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

...

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

...

(b) Every insurer, upon receipt of any inquiry from the insurance department respecting a claim shall, within fifteen working days of receipt of such inquiry, furnish the department with an adequate response to the inquiry.

...

**APPENDIX B**

<b>Specific Issue</b>	<b>Number of Auto Policies in Sample (Out of 26)</b>
Advanced Quoting Discount	10
Age of Vehicle Factor	13
APIP Limit/Deductible Factor	9
EAP Limit/Deductible Factor	3
Expense Constant	16
Filing Period	1
Good Student - Driver Discount	2
HAWKEYE	1
LOU Limit/Deductible Factor	13
MED Named Non Owner Factor	8
Optimum Package	1
Policy Term Factor	14
Roadside Assistance Base Rate	12
Stabilization Factor	1
Symbol Factor	2
Tapes/Discs/Records Limit/Deductible Factor	2
Territory Factor	1