

STATE OF ARIZONA  
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JUN - 1 2011

DEPT. OF INSURANCE

**REPORT OF TARGET MARKET CONDUCT EXAMINATION**

**OF**

**FARMERS INSURANCE EXCHANGE**

**NAIC #21652**

**AS OF**

**June 30, 2010**

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**JANICE K. BREWER**  
Governor

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**CHRISTINA URIAS**  
Director of Insurance

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Honorable Christina Urias  
Director of Insurance  
State of Arizona  
2910 North 44<sup>th</sup> Street  
Suite 210, Second Floor  
Phoenix, Arizona 85018-7269

Dear Director Urias:

Pursuant to your instructions and in conformity with the provisions of the Insurance Laws and Rules of the State of Arizona, a desk examination has been made of the market conduct affairs of the:


**Farmers Insurance Exchange**  
**NAIC #21652**

The above examination was conducted by Helene I. Tomme, CPCU, CIE, Market Examinations Supervisor, Examiner-in Charge, and Linda L. Hofman, AIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner and Christopher G. Hobert, CIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner.

The examination covered the period of July 1, 2009 through June 30, 2010.

As a result of that examination, the following Report of Examination is respectfully submitted.

Sincerely yours,

  
Helene I. Tomme, CPCU, CIE  
Market Examinations Supervisor  
Market Oversight Division

AFFIDAVIT

STATE OF ARIZONA )  
 )  
County of Maricopa ) ss.

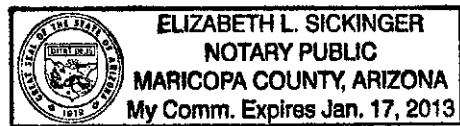
Helene I. Tomme, CPCU, CIE being first duly sworn, states that I am a duly appointed Market Examinations Examiner-in-Charge for the Arizona Department of Insurance. That under my direction and with my participation and the participation of Linda L. Hofman, AIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner and Christopher G. Hobert, CIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner on the Examination of Farmers Insurance Exchange, hereinafter referred to as the "Company" was performed at the office of the Arizona Department of Insurance. A teleconference meeting with appropriate Company officials in Los Angeles, California was held to discuss this Report, but a copy was not provided to management as the Examination was incomplete and had not yet been finalized. The information contained in this Report, consists of the following pages, is true and correct to the best of my knowledge and belief and that any conclusions and recommendations contained in and made a part of this Report are such as may be reasonably warranted from the facts disclosed in the Examination Report.

Helene I. Tomme  
Helene I. Tomme, CPCU, CIE  
Market Examinations Supervisor  
Market Oversight Division

Subscribed and sworn to before me this 7<sup>th</sup> day of February, 2011.

Elizabeth L. Sickinger  
Notary Public

My Commission Expires Jan. 17, 2013



## FOREWORD

This targeted market conduct examination report of the Farmers Insurance Exchange (herein referred to as, "FIE", or the "Company"), was prepared by employees of the Arizona Department of Insurance (Department) as well as independent examiners contracting with the Department. A market conduct examination is conducted for the purpose of auditing certain business practices of insurers licensed to conduct the business of insurance in the state of Arizona. The Examiners conducted the examination of the Company in accordance with Arizona Revised Statutes (A.R.S.) §§ 20-142, 20-156, 20-157, 20-158 and 20-159. The findings in this report, including all work product developed in the production of this report, are the sole property of the Department.

The examination consisted of a review of the following Commercial Multi-Peril (CMP) and Homeowners' (HO) lines of business operations:

1. Complaint Handling
2. Marketing and Sales
3. Producer Compliance
4. Underwriting and Rating
5. Cancellations and Non-Renewals
6. Claims Processing

Certain unacceptable or non-complying practices may not have been discovered in the course of this examination. Additionally, findings may not be material to all areas that would serve to assist the Director.

Failure to identify or criticize specific Company practices does not constitute acceptance of those practices by the Department.

## SCOPE AND METHODOLOGY

The examination of the Company was conducted in accordance with the standards and procedures established by the National Association of Insurance Commissioners (NAIC) and the Department. The market examination of the Company covered the period of July 1, 2009 through June 30, 2010 for business reviewed. The purpose of the examination was to determine the Company's compliance with Arizona's insurance laws, and whether the Company's operations and practices are consistent with the public interest. This examination was completed by applying tests to each examination standard to determine compliance with the standard. Each standard applied during the examination is stated in this report and the results are reported beginning on page 8.

In accordance with Department procedures, the Examiners completed a Preliminary Finding ("Finding") form on those policies, claims and complaints not in apparent compliance with Arizona law. The finding forms were submitted for review and comment to the Company representative designated by Company management to be knowledgeable about the files. For each finding the Company was requested to agree, disagree or otherwise justify the Company's noted action.

The Examiners utilized both examinations by test and examination by sample. Examination by test involves review of all records within the population, while examination by sample involves the review of a selected number of records from within the population. Due to the small size of some populations examined, examination by test and by sample were completed without the need to utilize computer software.

File sampling was based on a review of underwriting and claim files that were systematically selected by using Audit Command Language (ACL) software and computer data files provided by the Company. Samples are tested for compliance with standards established by the NAIC and the Department. The tests applied to sample data will result in an exception ratio, which determines whether or not a standard is met. If the exception ratio found in the sample is, generally less than 5%, the standard will be considered as "met." The standard in the areas of procedures and form use will not be met if any exception is identified.

## HISTORY OF THE COMPANY

(Provided by the Company)

Farmers Insurance Exchange was organized on March 28, 1928, under the Reciprocal or Inter-Insurance Act of California and commenced business on April 6, 1928 with the title Farmers Automobile Inter-Insurance Exchange. The present title was adopted on May 1, 1947. The Company is currently licensed in 48 states including Arizona.

Farmers Insurance Exchange, Fire Insurance Exchange and Truck Insurance Exchange, along with their various subsidiaries and affiliates, comprise the Farmers Insurance Group, which is based in Los Angeles, California. Each of the three reciprocal insurers is owned by its respective policyholders. The policyholders of each Exchange appoint an exclusive attorney-in-fact to provide certain non-claims management services to each Exchange.

Farmers Group, Inc. dba Farmers Underwriters Association is the attorney-in-fact for Farmers Insurance Exchange and the parent company of the Fire Underwriters Association (attorney-in-fact of Fire Insurance Exchange) and Truck Underwriters Association (attorney-in-fact of Truck Insurance Exchange).

Today, the Farmers Insurance Group is the country's third-largest writer of both private passenger automobile and homeowners insurance. The Farmers Insurance Group distributes their property and casualty insurance products in all states through a network of direct writing agents, district managers, independent agents and the direct distribution channel.

## **PROCEDURES REVIEWED WITHOUT EXCEPTION**

The Examiners review of the following Company departments<sup>1</sup> or functions indicates that they appear to be in compliance with Arizona statutes and rules:

Complaint Handling

Marketing and Sales

Producer Compliance

## **EXAMINATION REPORT SUMMARY**

The examination identified three (3) compliance issues that resulted in 105 exceptions due to the Company's failure to comply with statutes and rules that govern all insurers operating in Arizona. These issues were found three (3) of the six (6) sections of Company operations examined. The following is a summary of the Examiners' findings:

### **Underwriting and Rating**

In the area of Underwriting and Rating, one (1) compliance issue is addressed in this Report as follows:

- The Company's time variances between effective dates on 100 Homeowners' New/Renewal Declaration Pages and its Cancellation notices are confusing and misleading.

### **Cancellation and Non Renewals**

In the area of Cancellations and Non Renewals, one (1) compliance issue is addressed in this Report as follows:

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<sup>1</sup> If a department name is listed there were no exceptions noted during the review.



- The Company failed to provide written notification to three (3) Homeowners giving an additional 30-days notice to remedy the identified conditions prior to sending the non renewal notice based on “condition of premises”.

### **Claims Processing**

In the area of Claims Processing, one (1) compliance issue is addressed in this Report as follows:

- The Company failed to include a fraud warning statement in at least 12-point type on two (2) claim forms.

FACTUAL FINDINGS

**RESULTS OF PREVIOUS MARKET CONDUCT EXAMINATIONS**

During the past three (3) years, there were four (4) Market Conduct Examinations completed by the states of Arizona, Indiana, North Carolina and Oklahoma. No significant patterns of non-compliance were noted.

**UNDERWRITING AND RATING**

Commercial Multi Peril (CMP):

The Examiners reviewed 50 CMP New/Renewal Business files out of a population of 4,721 during the examination period.

Homeowners (HO):

The Examiners reviewed 100 HO New/Renewal Business files out of a population of 70,690 during the examination period.

All new/renewal files reviewed were to ensure compliance with Arizona Statutes and Rules.

**The following Underwriting and Rating Standards were met:**

#	STANDARD	Regulatory Authority
1	The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company Rating Plan	A.R.S. §§ 20-341 through 20-385
3	All forms and endorsements forming a part of the contract should be filed with the director (if applicable).	A.R.S. § 20-398
4	Schedule rating, individual risk premium modification (IRPM) or experience rating plans, where permitted, are based on objective criteria with usage supported by appropriate documentation.	A.R.S. § 20-400.01
5	All mandated disclosures are documented and in accordance with applicable statutes, rules and regulations, including, but not limited to, the Notice of Insurance Information Practices and the Authorization for Release of Information.	A.R.S. §§ 20-2104, 20-2106, 20-2110 and 20-2113
6	Policies and endorsements are issued or renewed accurately, timely and completely.	A.R.S. §§ 20-1120, 20-1121, 20-1654 and 20-1674
7	Rescissions are not made for non-material misrepresentations.	A.R.S. §§ 20-463, 20-1109

**The following Underwriting and Rating Standard failed:**

#	STANDARD	Regulatory Authority
2	Disclosures to insureds concerning rates and coverage are accurate and timely.	A.R.S. §§ 20-259.01, 20-262, 20-263, 20-264, 20-266, 20-267, 20-443, 20-2110

**Underwriting and Rating, Standard #2 - failed**

**Preliminary Finding 009 – Time Variance** – The Examiners identified 100 Homeowners New/Renewal files where the effective time/date on the Homeowners’ New/Renewal Declaration (DEC) Pages all incorrectly stated the time as “**12:00 Noon Standard Time**”. This incorrect time/date is confusing and misleading, an apparent violation of A.R.S. § 20-443(A)(1).

**HOMEOWNERS TIME VARIANCE**  
Incorrect time/date on HO Declaration pages  
A.R.S. § 20-443(A)(1)

Population	Sample	# of Exceptions	% to Sample
70,690	100	100	100%

**A 100% error ratio does not meet the Standard; therefore, a recommendation is warranted.**

**Recommendation #1**

Within 90 days of the filed date of this report provide the Department with documentation that Company procedures are in place so that the Homeowners’ New/Renewal Declaration (DEC) Page displays the correct expiration time of 12:01 AM in Arizona.

**CANCELLATIONS AND NON-RENEWALS**

Commercial Multi Peril (CMP):

The Examiners reviewed 50 CMP cancellation files for non-payment of premium out of a population of 1,139, 4 CMP cancellation files for underwriting reasons out of a population of 4 and 6 CMP non renewals out of a population of 6. This cancellation/non renewal review included a total sample size of 60 CMP files from a total population of 1,149.

Homeowners (HO):

The Examiners reviewed 50 HO cancellation files for non-payment of premium out of a population of 3,674, 50 HO cancellation files for underwriting reasons out of a population of 2,031 and 50 HO non renewals out of a population of 232. This cancellation and non renewal review included a total sample size of 150 HO files from a total population of 5,937.

All cancellation and nonrenewal files reviewed were to ensure compliance with Arizona Statutes and Rules.

**The Following Cancellation and Non Renewal Standard was met:**

#	STANDARD	Regulatory Authority
1	Declinations, Cancellations and Non-Renewals shall comply with state laws and company guidelines including the Summary of Rights to be given to the policyholder and shall not be unfairly discriminatory.	A.R.S. §§ 20-448, 20-2108, 20-2109, 20-2110

**The following Cancellation and Non Renewal Standard failed:**

#	STANDARD	Regulatory Authority
2	Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory.	A.R.S. §§ 20-191, 20-443, 20-448, 20-1651 through 20-1656 and 1671 through 1678

**Cancellation and Nonrenewal, Standard #2 – failed**

**Preliminary Finding 003 – Non Renewals “Condition of Premises Letters”** – The Examiners identified three (3) HO non renewal files where the Company failed to provide an additional 30-days notice to remedy the identified conditions prior to sending the non renewal notice based on “condition of premises”, an apparent violation of A.R.S. § 20-1652(B).

**HOMEOWNERS’ NON RENEWALS**

Failed to provide additional 30-day notice based “Condition of Premises”  
A.R.S. § 20-1652(B)

<b>Population</b>	<b>Sample</b>	<b># of Exceptions</b>	<b>% to Sample</b>
232	50	3	6%

**A 6% error ratio does not meet the Standard; therefore, a recommendation is warranted.**

**Recommendation #2**

Within 90 days of the filed date of this report provide the Department with documentation that Company procedures are in place so that in the event of nonrenewal based on condition of the premises, the insured shall be given thirty days notice to remedy the identified conditions.



**CLAIMS PROCESSING**

Commercial Multi Peril (CMP):

The Examiners reviewed 50 CMP claims closed without payment from a population of 81; 50 CMP paid claims from a population of 262 and 2 CMP subrogation claims out of a population of 2. This claim review included a total sample size of 102 CMP claims files from a total population of 345.

Homeowners (HO):

The Examiners reviewed 50 HO claims closed without payment from a population of 2,125; 50 HO paid claims from a population of 1,238 and 29 HO subrogation claims from a population of 29. This claim review included a total sample size of 129 HO claims files from a total population of 3,392.

All claim files reviewed were to ensure compliance with Arizona Statutes and Rules.

The Following Claim Standards were met:

#	STANDARD	Regulatory Authority
1	The initial contact by the Company with the claimant is within the required time frame.	A.R.S. § 20-461, A.A.C. R20-6-801
2	Timely investigations are conducted.	A.R.S. § 20-461, A.A.C. R20-6-801
4	Claim files are adequately documented in order to be able to reconstruct the claim.	A.R.S. §§ 20-461, 20-463, 20-466.03, A.A.C. R20-6-801
5	Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations.	A.R.S. §§ 20-268, 20-461, 20-462, A.A.C. R20-6-801
6	The Company uses reservation of rights and excess of loss letters, when appropriate.	A.R.S. § 20-461, A.A.C. R20-6-801
7	Deductible reimbursement to insured upon subrogation recovery is made in a timely and accurate manner.	A.R.S. §§ 20-461, 20-462, A.A.C. R20-6-801
8	The Company responds to claim correspondence in a timely manner.	A.R.S. § 20-461, 20-462, A.A.C. R20-6-801
9	Denied and Closed Without Payment claims are handled in accordance with policy provisions and state law.	A.R.S. §§ 20-461, 20-462, 20-463, 20-466, 20-2110, A.A.C. R20-6-801
10	No insurer shall fail to fully disclose to first party insureds all pertinent benefits, coverages or other provisions of an insurance policy or insurance contract under which a claim is presented.	A.A.C. R20-6-801
11	Adjusters used in the settlement of claims are properly licensed.	A.R.S. §§ 20-321 through 20-321.02

**The following Claim Standard failed:**

#	STANDARD	Regulatory Authority
3	The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations.	A.R.S. §§ 20-461, 20-466.03, 20-2106, A.A.C. R20-6-801

**Claims Processing Standard #3 - failed**

**Preliminary Finding 001 – Fraud Warning Statement** The Company failed to include the Fraud Warning statement in at least twelve-point type on two (2) claim forms/letters, an apparent violation of A.R.S. § 20-466.03.

**Form without a Fraud Warning Statement**

Hotel Assistance Agreement

**Form with a Fraud Warning Statement less than “12 point type”**

Building Loss Report

**Recommendation #3**

Within 90 days of the filed date of this report provide the Department with documentation that Company procedures are in place to include the Fraud Warning statement in at least twelve-point type on the two (2) claim forms/letters identified above.

*Subsequent Events: During the course of the Phase I Examination, the Company agreed with the finding and provided corrected forms to the Department prior to completion of the Examination. The finding stands as written.*

**SUMMARY OF FAILED STANDARDS**

<b>EXCEPTIONS</b>	<b>Rec. No.</b>	<b>Page No.</b>
<b>UNDERWRITING AND RATING</b>		
<u>Standard #2</u> Disclosures to insureds concerning rates and coverage are accurate and timely.	1	13
<b>CANCELLATIONS AND NON RENEWALS</b>		
<u>Standard #2</u> Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory.	2	16
<b>CLAIM PROCESSING</b>		
<u>Standard #3</u> The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations.	3	19

## SUMMARY OF PROPERTY AND CASUALTY STANDARDS

### Complaint Handling

#	STANDARD	PAGE	PASS	FAIL
1	The Company takes adequate steps to finalize and dispose of the complaints in accordance with applicable statutes, rules, regulations and contract language. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	
2	The time frame within which the Company responds to complaints is in accordance with applicable statutes, rules and regulations. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	

### Marketing and Sales

#	STANDARD	PAGE	PASS	FAIL
1	All advertising and sales materials are in compliance with applicable statutes, rules and regulations. (A.R.S. §§ 20-442 and 20-443)	8	X	

### Producer Compliance

#	STANDARD	PAGE	PASS	FAIL
1	The producers are properly licensed in the jurisdiction where the application was taken. (A.R.S. §§ 20-282, 20-286, 20-287 and 20-311 through 311.03)	8	X	
2	An insurer shall not pay any commission, fee, or other valuable consideration to unlicensed producers. (A.R.S. § 20-298)	8	X	

### Underwriting and Rating

#	STANDARD	PAGE	PASS	FAIL
1	The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company Rating Plan. (A.R.S. §§ 20-341 through 20-385)	12	X	

#	STANDARD	PAGE	PASS	FAIL
2	Disclosures to insureds concerning rates and coverage are accurate and timely. (A.R.S. §§ 20-259.01, 20-262, 20-263, 20-264, 20-266, 20-267, 20-443, 20-2110)	13		X
3	All forms and endorsements forming a part of the contract should be filed with the director (if applicable). (A.R.S. § 20-398)	12	X	
4	Schedule rating, individual risk premium modification (IRPM) or experience rating plans, where permitted, are based on objective criteria with usage supported by appropriate documentation. (A.R.S. § 20-400.01).	12	X	
5	All mandated disclosures are documented and in accordance with applicable statutes, rules and regulations, including, but not limited to, the Notice of Insurance Information Practices and the Authorization for Release of Information. (A.R.S. §§ 20-2104, 20-2106, 20-2110 and 20-2113)	12	X	
6	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1120, 20-1121, 20-1654 and 20-1674)	12	X	
7	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463, 20-1109)	12	X	

**Declinations, Cancellation and Non-Renewals**

#	STANDARD	PAGE	PASS	FAIL
1	Declinations, Cancellations and Non-Renewals shall comply with state laws and company guidelines including the Summary of Rights to be given to the policyholder and shall not be unfairly discriminatory. (A.R.S. §§ 20-448, 20-2108, 20-2109 and 20-2110)	15	X	
2	Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory. (A.R.S. §§ 20-191, 20-443, 20-448, 20-1651 through 20-1656 and 1671 through 1678).	15		X

**Claims Processing**

#	STANDARD	PAGE	PASS	FAIL
1	The initial contact by the Company with the claimant is within the required time frame. (A.R.S. § 20-461 and A.A.C. R20-6-801)	19	X	
2	Timely investigations are conducted. (A.R.S. § 20-461, and A.A.C. R20-6-801)	19	X	
3	The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations. (A.R.S. §§ 20-461, 20-466.03, 20-2106, and A.A.C. R20-6-801)	19		X
4	Claim files are adequately documented in order to be able to reconstruct the claim. (A.R.S. §§ 20-461, 20-463, 20-466.03 and A.A.C. R20-6-801)	19	X	
5	Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations. (A.R.S. §§ 20-268, 20-461, 20-462 and A.A.C. R20-6-801)	19	X	
6	The Company uses reservation of rights and excess of loss letters, when appropriate. (A.R.S. § 20-461 and A.A.C. R20-6-801)	19	X	
7	Deductible reimbursement to insured upon subrogation recovery is made in a timely and accurate manner. (A.R.S. §§ 20-461, 20-462 and A.A.C. R20-6-801)	19	X	
8	The Company responds to claim correspondence in a timely manner. (A.R.S. § 20-461, 20-462 and A.A.C. R20-6-801)	19	X	
9	Denied and closed without payment claims are handled in accordance with policy provisions and state law. (A.R.S. §§ 20-461, 20-462, 20-463, 20-466, 20-2110 and A.A.C. R20-6-801)	19	X	
10	No insurer shall fail to fully disclose to first party insureds all pertinent benefits, coverages, or other provisions of an insurance policy or insurance contract under which a claim is presented. (A.A.C. R20-6-801)	19	X	
11	Adjusters used in the settlement of claims are properly licensed (A.R.S. §§ 20-321 through 20-321.02)	19	X	