

STATE OF ARIZONA  
FILED

JAN 21 2009

DEPT OF INSURANCE  
BY H. Tomma

**REPORT OF TARGET MARKET CONDUCT EXAMINATION**

**OF**

**NEWPORT INSURANCE COMPANY**

**NAIC #24848**

**AS OF**

**DECEMBER 31, 2007**

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**JANET NAPOLITANO**  
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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 85108-7256

Dear Director Urias:

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

**NEWPORT INSURANCE COMPANY**  
**NAIC #24848**

The above examination was conducted by Helene I. Tomme, CPCU, CIE, Market Conduct Examinations Supervisor, Examiner-in Charge, and Market Conduct Examiners Laura Sloan-Cohen, AIE, and Robert DeBerge.

The examination covered the period of January 1, 2007 through December 31, 2007.

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

Sincerely yours,

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

**AFFIDAVIT**

STATE OF ARIZONA                     )  
  )  
County of Maricopa                    )    ss.

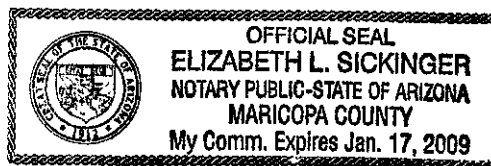
Helene I. Tomme, CPCU, CIE being first duly sworn, states that I am a duly appointed Market Conduct Examinations Examiner-in-Charge for the Arizona Department of Insurance. That under my direction and with my participation and the participation of Market Conduct Examiners Laura Sloan-Cohen, AIE, and Robert DeBerge an Examination of Newport Insurance Company, hereinafter referred to as the "Company," was performed at the Arizona Department of Insurance. A teleconference meeting with appropriate Company officials 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 Conduct Examinations Supervisor  
Market Oversight Division

Subscribed and sworn to before me this 11<sup>th</sup> day of December, 2008.

Elizabeth L. Sickinger  
Notary Public

My Commission Expires Jan. 17, 2009



## **FOREWORD**

This market conduct examination report of Newport Insurance Company (herein referred to as 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 Private Passenger Automobile (PPA) 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 conduct examination of the Company covered the period of January 1, 2007 through December 31, 2007 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, forms, 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 forms in use will not be met if any exception is identified.

### **HISTORY OF THE COMPANY**

The Company was organized and incorporated as a wholly owned subsidiary of Balboa Insurance Company under the laws of the state of Arizona on March 25, 1964 and commenced doing business on April 16, 1964. The Company filed amended articles of incorporation August

15, 1978 to add disability, marine and transportation, property, surety and vehicle lines of business.

Control of the Company was held by Balboa Life Insurance Company, the parent of Balboa Insurance Company, until 1986 when control passed to Avco Financial Services International, Inc., a subsidiary of Textron, Inc. In January 1999, Textron sold the subsidiaries of Avco Financial Services (including the Company) to Associates First Capital Corporation and November 30, 1999 Associates First sold the Company, and its affiliates, to the insurance unit of Countrywide Financial Corporation (CFC). CFC later renamed these affiliates the Balboa Insurance Group, Inc.

CFC is a publicly traded Delaware corporation (NYSE: "CFC"). CFC had been top independent residential mortgage lender and service provider, until January 11, 2008, when Bank of America Corporation (BAC) announced a definitive agreement to acquire CFC, the Company's ultimate controlling parent. The all-stock transition, which requires the approval of bank and insurance regulators and CFC stockholders, is expected to close in the third quarter of 2008. On June 12, 2008, the Department issued a no-objection letter in response to BAC's application to acquire control of the Company.

The Company is currently licensed in Arizona, California, New Jersey, New York, Oregon, Virginia and Washington as a multi-line underwriter. The Company is also listed as surplus lines underwriter in Arkansas, Louisiana, Mississippi, Tennessee and Texas.

**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

Underwriting and Rating

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

## **EXAMINATION REPORT SUMMARY**

The examination revealed three (3) compliance issues that resulted in 73 exceptions due to the Company's failure to comply with statutes and rules that govern all insurers operating in Arizona. These issues were found in two (2) of the six (6) sections of Company operations examined. The following is a summary of the examiners' findings:

### **Cancellation and Non Renewals**

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

- The Company failed, when terminated for an adverse underwriting decision, to provide policyholders a Summary of Rights with forty-nine (49) HO cancellations and sixteen (16) HO non-renewals for a total of sixty-five (65).

### **Claims Processing**

In the area of Claims Processing, two (2) compliance issues are addressed in this report as follows:

- The Company passed with comment Claim Standard #5 because the Company failed to pay the correct sales tax on one (1) first party PPA total loss, resulting in restitution of \$160.90, including \$16.98 interest.
- The Company failed Claim Standard #3 due to the following authorization form deficiencies:
  - (a) One (1) authorization form failed to name the insurance institution, insurance producer or identify by generic reference representatives of the insurance institution to whom the individual is authorizing information to be disclosed
  - (b) One (1) authorization form failed to specify the purpose(s) for which the information is collected.
  - (c) Three (3) authorization forms failed to specify that the authorization remains valid for no longer than the duration of the claim



(d) Three (3) authorization forms failed to advise the individual or a person authorized to act on behalf of the individual, that the individual or the individual's authorized representative is entitled to receive a copy of the authorization form.

FACTUAL FINDINGS

RESULTS OF PREVIOUS MARKET CONDUCT EXAMINATIONS

During the past three (3) years, there were no Market Conduct Examinations completed by any jurisdiction.

**CANCELLATIONS AND NON-RENEWALS**

**Private Passenger Automobile (PPA):**

The examiners reviewed one hundred (100) PPA non-payment cancellations out of a population of 5,246, twenty-two (22) PPA cancellations for underwriting reasons files out of a population of 22, and fifty (50) PPA surcharged files from a population of 2,551.

**Homeowners (HO):**

The examiners reviewed fifty (50) HO non-payment cancellations and forty-nine (49) HO cancellations for underwriting reasons out of a combined total population of 987; and fifty (50) HO non-renewals out of a population of 235.

**The following Cancellation and Non-Renewal Standard is met:**

#	STANDARD	Regulatory Authority
2	Cancellation 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, 20-448, 20-1651 through 20-1656

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

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

**Cancellation and Non-Renewal Standard #1 failed:**

**Preliminary Finding #7 – Summary of Rights Omitted** - The Company failed, when terminated for an adverse underwriting decision, to provide policyholders a Summary of Rights with forty-nine (49) HO cancellations and sixteen (16) HO nonrenewals. These are violations of A.R.S. § 20-2110.

**HOMEOWNER CANCELLATIONS**

Failed to provide a Summary of Rights in the event of an adverse underwriting decision  
Violation of A.R.S. § 20-2110

Population	Sample	# of Exceptions	% to Sample
987	49	49	100%

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

### HOMEOWNER NON-RENEWALS

Failed to provide a Summary of Rights in the event an adverse underwriting decision  
Violation of A.R.S. § 20-2110

Population	Sample	# of Exceptions	% to Sample
235	50	16	32.0%

**A 32% 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 programming, procedures and controls are in place to ensure that the required Summary of Rights is sent all policyholders when coverage is cancelled, non-renewed or declined based on an adverse underwriting decision.

#### **Subsequent Event**

*During the course of the examination, the Company provided the examiners a corrected, compliant notice to be sent policyholders when reprogrammed and in production. The Company will send its requested programming changes to confirm compliance as soon as available to the Department.*

**CLAIMS PROCESSING**

**Private Passenger Automobile (PPA):**

The examiners reviewed fifty (50) PPA claims closed without payment from a population of 203; fifty (50) PPA paid claims from a population of 168 and all ten (10) PPA total loss claims [including two (2) sample files] and both PPA subrogation claims.

**Homeowners (HO):**

The examiners reviewed all thirty-eight (38) HO claims closed without payment [including two (2) sample files]; fifty (50) HO paid claims from a population of 90; and the only HO subrogation claim.

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

**The following Claims Processing 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
6	The Company uses reservation or 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 Claims Processing Standard passed with comment:**

#	STANDARD	Regulatory Authority
5	Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations.	A.R.S. §§ 20-461, 20-462, A.A.C. R20-6-801

**Claims Processing Standard #5 passed with comment**

**Preliminary Finding #6 – PPA Total Loss Tax Underpaid** - The Company failed to pay one (1) first party PPA claimant the appropriate sales tax in the settlement of their total loss. This represents one (1) violation of A.R.S. § 20-461(A)(6) and A.A.C. R20-6-801(H)(1)(b).

**PRIVATE PASSENGER AUTOMOBILE TOTAL LOSS CLAIMS**

Failed to pay correct sales tax on a total loss

Violation of A.R.S. § 20-461(A)(6) and A.A.C. R20-6-801(H)(1)(b)

Population	Sample	# of Exceptions	% to Sample
10	10	1	10.0%

**Subsequent Event**

*During the course of the examination, the Company resettled this one (1) underpaid claim, resulting in total restitution of \$160.90, which included \$16.98 interest.*

**The following Claims Processing 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 #2 – Authorization Disclosure** - The Company’s “Authorization for Wage and Salary Information” form failed to name the insurance institution, insurance producer or identify by generic reference representatives of the insurance institution to whom the individual is authorizing information to be disclosed. This form fails to comply with A.R.S. § 20-2106(5).

**Preliminary Finding #3 – Authorization Disclosure** - The Company’s “Authorization for Wage and Salary Information” form failed to specify the purpose(s) for which the information is collected. This form fails to comply with A.R.S. § 20-2106(6).



**Preliminary Findings #4 and #5 – Authorization Disclosure** - On the following claim authorization forms:

- Wage and Salary Information” (form # None)
- Consent to Disclose and Release Form (form # None)
- Authorization to Obtain Medical Records (form # None)

The Company failed to specify that the authorization remains valid for no longer than the duration of the claim and failed to advise the individual or a person authorized to act on behalf of the individual, that the individual or the individual’s authorized representative is entitled to receive a copy of the authorization form.

These forms fail to comply with A.R.S. § 20-2106(8)(b) and (9), respectively.

The following table summarizes these findings:

Form Description	Statute	Provision
Authorization for Wage and Salary Information	A.R.S. §20-2106	5, 6, 8(b), and 9
Consent to Disclose and Release form	A.R.S. §20-2106	8(b) and 9
Authorization to Obtain Medical Records	A.R.S. §20-2106	8(b) and 9

**CLAIM FORMS**

Failed to name the insurance institution, insurance producer or identify by generic reference representatives of the insurance institution to whom the individual is authorizing information to be disclosed

A.R.S. §§ 20-2106(5)

Population	Sample	# of Exceptions	% to Sample
3 forms	3	1	33.3%

**Any error does not meet the Standard.**

Failed to specify the purpose(s) for which the information is collected

A.R.S. §§ 20-2106(6)

Population	Sample	# of Exceptions	% to Sample
3 forms	3	1	33.3%

**Any error does not meet the Standard.**

Failed to specify the authorization remains valid for no longer than the duration of the claim

A.R.S. §§ 20-2106(8)(b)

Population	Sample	# of Exceptions	% to Sample
3 forms	3	3	100%

**Any error does not meet the Standard.**

Failed to advise the individual or a person authorized to act on behalf of the individual, that the individual or the individual's authorized representative is entitled to receive a copy of the authorization form.

A.R.S. §§ 20-2106(9)

<b>Population</b>	<b>Sample</b>	<b># of Exceptions</b>	<b>% to Sample</b>
3 forms	3	3	100%

**Any error does not meet the Standard.**

**Subsequent Event**

*During the course of the examination, the Company provided the examiners with a revised new form, entitled "Authorization to Disclose Health Information and Other Records (HIPAA Compliant)", intended to replace each of the forms cited above. A corrected version of the "Authorization to Disclose Health Information and Other Records (HIPAA Compliant)" was approved by the Department on 11-6-08.*

**SUMMARY OF FAILED STANDARDS**

<b>EXCEPTION</b>	<b>Rec. No.</b>	<b>Page No.</b>
<b>CANCELLATIONS AND NON RENEWALS</b>		
<u>Standard #1</u> Declinations, Cancellations and Non-Renewal shall comply with state laws and Company including the Summary of Rights to be given to the applicant and shall not be unfairly discriminatory.	1	13

<b>CLAIMS PROCESSING</b>		
<u>Standard #3</u> The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations.	N/A	N/A

**SUMMARY OF PROPERTY AND CASUALTY STANDARDS**

**A. Complaint Handling**

#	STANDARD	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, A.A.C. R20-6-801)	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, A.A.C. R20-6-801)	X	

**B. Marketing and Sales**

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

**C. Producer Compliance**

#	STANDARD	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, 20-311 through 311.03)	X	
2	An insurer shall not pay any commission, fee, or other valuable consideration to unlicensed producers. (A.R.S. § 20-298)	X	

**D. Underwriting and Rating**

#	STANDARD	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)	X	
2	All forms and endorsements forming a part of the contract should be filed with the director (if applicable). (A.R.S. § 20-398)	X	
3	File documentation adequately supports decisions made. (A.R.S. § 20-385)	X	

#	STANDARD	PASS	FAIL
4	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1120, 20-1121, 20-1654)	X	
5	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463, 20-1109)	X	
6	Authorization for Release of Information forms used for underwriting purposes contain required disclosures (A.R.S. § 20-2106)	X	

**E. Declinations, Cancellation and Non-Renewals**

#	STANDARD	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 applicant and shall not be unfairly discriminatory. (A.R.S. §§ 20-448, 20-2108, 20-2109, 20-2110)		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, 20-448, 20-1651 through 20-1656)	X	

**F. Claims Processing**

#	STANDARD	PASS	FAIL
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)	X	
2	Timely investigations are conducted. (A.R.S. § 20-461, A.A.C. R20-6-801)	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, A.A.C. R20-6-801)		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, A.A.C. R20-6-801)	X	

#	STANDARD	PASS	FAIL
5	Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations. (A.R.S. §§ 20-461, 20-462, A.A.C. R20-6-801)	X	
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)	X	
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)	X	
8	The company responds to claim correspondence in a timely manner. (A.R.S. §§ 20-461, 20-462, A.A.C. R20-6-801)	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, A.A.C. R20-6-801)	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. Arizona Rule (A.A.C. R20-6-801)	X	
11	Adjusters used in the settlement of claims are properly licensed (A.R.S. §§ 20-321 through 20-321.02)	X	