REPORT OF TARGET MARKET CONDUCT EXAMINATION

OF

BALBOA INSURANCE COMPANY

NAIC #24813

AS OF

DECEMBER 31, 2007

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Department of Insurance
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CHRISTINA URIAS
Director of Insurance

Honorable Christina Urias
Director of Insurance
State of Arizona
2910 North 44th 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:

BALBOA INSURANCE COMPANY
NAIC #24813

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 De Berge.

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)
) ss.
County of Maricopa)

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 Balboa 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 11th day of December, 2008.

Elizabeth L. Sickinger
Notary Public

My Commission Expires Jan. 17, 2009

OFFICIAL SEAL
ELIZABETH L. SICKINGER
NOTARY PUBLIC-STATE OF ARIZONA
MARICOPA COUNTY
My Comm. Expires Jan. 17, 2009

FOREWORD

This market conduct examination report of Balboa 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 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 7.

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 on February 6, 1948 under the laws of California and began business on April 15, 1948. Balboa Life Insurance Company held the Company's ownership from 1969 to 1986 when control was passed to Avco Financial Services International. Since that time ownership has frequently passed, concluding with current parent, Country Financial

Corporation is a publicly traded Delaware corporation (NYSE: "CFC"). CFC has been a leading independent residential mortgage lender and service provider.

The Company is currently licensed in all U.S. states, the District of Columbia, Guam, U.S. Virgin Islands and the Northern Mariana Islands. The Company offers a variety of property and casualty products, including Homeowners, renters, and lender-placed insurance. The Company distributes its Homeowner products in Arizona through a network of affiliated, independent, and general agents and brokers.

PROCEDURES REVIEWED WITHOUT EXCEPTION

The examiners review of the following Company departments[1] 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 revealed three (3) compliance issues that resulted in 109 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 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 failed to charge rates for policy coverage in accordance with filed rates on eleven (11) policies.

[1] If a department name is listed there were no exceptions noted during the review.

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 sixty-four (64) cancellations and twenty-six (26) non-renewals for a total of ninety (90).

Claims Processing

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

- 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 three (3) Market Conduct Examinations completed by Washington, Florida and Connecticut. There were no significant patterns of non-compliance noted.

UNDERWRITING AND RATING

Homeowners (HO):

The examiners reviewed one hundred (100) HO new business/renewal files from a population of 6,215.

The following Underwriting and Rating Standards were met:

#	STANDARD	PASS
2	Disclosures to insureds concerning rates and coverage are accurate and timely.	A.R.S. § 20-2110
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	File documentation adequately supports decisions made.	A.R.S. § 20-385
5	Policies and endorsements are issued or renewed accurately, timely and completely.	A.R.S. §§ 20-1120, 20-1121, 20-1654
6	Rescissions are not made for non-material misrepresentations.	A.R.S. §§ 20-463, 20-1109
7	Authorization for Release of Information forms used for underwriting purposes contain required disclosures.	A.R.S. § 20-2106

The following Underwriting and Rating Standard failed:

#	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

Underwriting and Rating Standard #1 failed:

Preliminary Finding #7 – Filed Rates - The Company failed to charge rates for policy coverage in accordance with filed rates on eleven (11) Basic Renters policies. These are violations of A.R.S. § 20-385.

HOMEOWNER NEW BUSINESS/RENEWALS

Failed to charge rates for policy coverage in accordance with filed rates.

Violation of A.R.S. § 20-385

Population	Sample	# of Exceptions	% to Sample
6,215	100	11	11%

An 11% 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 rates charged for the policy coverage are in accordance with filed rates.

Subsequent Event
Of the eleven (11) Basic Renters policies that failed to charge the correct rates for the $100,000 Personal Liability limit, five(5) policies were overcharged by $1.40 each and six (6) policies were overcharged by $1.00 each. Any refunds under $5.00 are waived.

The Company provided the following statement, "The rate for the increased Personal Liability limit of $100,000 in the Basic Renters Product was incorrectly programmed into the system. We are currently undergoing a system fix and expect this be completed no later than October 25, 2008. In addition, 895 impacted policies have been identified and any refund over $5.00 will be issued to the named insured at his/her last known mailing address by November 1, 2008."
This self-audit of 895 impacted policies covers the time period of March 1, 2002 through October 25, 2008, the date the Company corrected system rating error.

CANCELLATIONS AND NON-RENEWALS

Homeowners (HO):

The examiners reviewed one hundred (100) HO non-payment cancellations and sixty-four (64) HO cancellations for underwriting reasons out of a combined total population of 7,048; and fifty (50) HO non-renewals out of a population of 560.

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 #5 – Summary of Rights Omitted - The Company failed, when terminated for an adverse underwriting decision, to provide policyholders a Summary of Rights with sixty-four (64) HO cancellations and twenty-six (26) HO nonrenewals. These represent ninety (90) 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
7,048	64	64	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
560	50	26	52.0%

A 52% 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 programming, procedures and controls are in place to ensure that the required Summary of Rights is sent all policyholders when coverage in 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

Homeowners (HO):

The examiners reviewed fifty (50) HO claims closed without payment [including two (2) sample files] from a population of 147; and fifty (50) HO paid claims from a population of 251. There were no HO subrogations during the exam period.

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
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
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 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 Findings #1 and #2 – Authorization Disclosure - The Company's "Authorization for Wage and Salary Information" form failed to:

(a) 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, and

(b) specify the purpose(s) for which the information is collected.

This form fails to comply with A.R.S. § 20-2106(5) and (6).

Preliminary Findings #3 and #4 – Authorization Disclosure - The following Company authorization forms:

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

failed to:

(a) specify that authorizations shall remain valid for no longer than the duration of the claim, and

(b) 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 authorization form 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)

Population	Sample	# of Exceptions	% to Sample
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

EXCEPTION	Rec. No.	Page No.
UNDERWRITING AND RATING		
Standard #1 The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company Rating Plan.	1	12

CANCELLATIONS AND NON RENEWALS		
Standard #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.	2	15

CLAIMS PROCESSING		
Standard #3 The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations.	N/A	18

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	Disclosures to insureds concerning rates and coverage are accurate and timely.	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)	X	

#	STANDARD	PASS	FAIL
4	File documentation adequately supports decisions made. (A.R.S. § 20-385)	X	
5	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1120, 20-1121, 20-1654)	X	
6	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463, 20-1109)	X	
7	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	