

STATE OF ARIZONA  
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DEPT. OF INSURANCE

**REPORT OF TARGET MARKET CONDUCT EXAMINATION**

**OF**

**CORNERSTONE NATIONAL INSURANCE COMPANY**

**NAIC #10783**

**AS OF**

**DECEMBER 31, 2010**

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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 85108-7269

Dear Director Urias:

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

**CORNERSTONE NATIONAL INSURANCE COMPANY**  
**NAIC # 10783**

The above examination was conducted by William Hobert, Examiner-in-Charge, and Market Conduct Insurance Examiner Robert DeBerge.

The examination covered the period of January 1, 2010 through December 31, 2010.

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

Sincerely yours,

A handwritten signature in cursive script that reads "Helene I. Tomme".

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

AFFIDAVIT

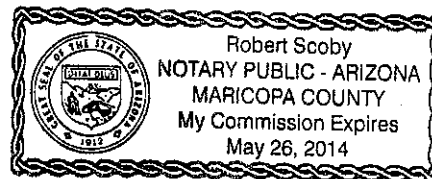
STATE OF ARIZONA )  
 )  
County of Maricopa ) ss.

William P. Hobert 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 Insurance Examiner Robert DeBerge on the Examination of Cornerstone National Insurance Company, hereinafter referred to as the "Company" was performed at 6 Hutton Centre Drive, Suite #1030, Santa Ana, CA 92707 and 23042 Mill Creek Drive, Laguna Hills, CA 92653. 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.

*William P. Hobert*  
William P. Hobert, CPCU, CLU, CIE  
Market Conduct Examiner-in-Charge  
Market Oversight Division

Subscribed and sworn to before me this 6 day of Sept, 2011.

My Commission Expires 5/26/14  
*Robert Scoby*  
Notary Public



## **FOREWORD**

This target market conduct examination report of Cornerstone National 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 target 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) business operations:

1. Complaint Handling
2. Marketing and Sales
3. Producer Compliance
4. Underwriting and Rating
5. Declinations, 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 target market conduct examination of the Company covered the period of

January 1, 2010 through December 31, 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 7.

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, examinations 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 use will not be met if any exception is identified.

### **HISTORY OF THE COMPANY**

The Company commenced business in Missouri in November 1996. Cornerstone Management Partners, LLC is the Company's ultimate parent. There have been no name changes or acquisitions since inception. Other subsidiaries include Cornerstone Finance Company, created primarily to finance mobile home and commercial insurance premiums and Cornerstone General Agency, used to complement and offer products not sold directly by the Company.

The Company has both common and preferred shareholders, including officers and directors of the Company and more than 100 agents. Executive officers are primarily former employees of Silvey Corporation, who ceased operations in 1996 for administrative reasons. The Company's non-standard private passenger automobile (PPA) programs are administered by Managing General Agencies (MGAs) that market, underwrite and handle claims from their offices. The Company currently has active programs in Arizona, California, Colorado, Georgia and Louisiana. In Arizona, the Company's "Falcon" and "Platinum" programs are managed by Freedom National Insurance Services, Inc. ("Freedom") and Sun Coast General Insurance Agency, Inc. ("Sun Coast") respectively. The Company selected Specialty Claims Management, LLC (SCM) as the third party claims administrator for Sun Coast's Arizona claims. Arizona admitted the Company as a property-casualty insurer 7/25/05. The Company's statutory home office and primary location of books and records is 3100 Falling Leaf Court, Columbia, MO 65201.

#### **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

#### **EXAMINATION REPORT SUMMARY**

The examination revealed sixteen (16) issues that resulted in 500 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 four (4) of the six (6) sections of Company operations examined. The following is a summary of the examiners' findings:

##### **Producer Compliance**

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

- The Company failed to require Freedom to be properly licensed as a managing general agent during the exam period.

### **Underwriting and Rating**

In the area of Underwriting and Rating, two (2) compliance issues are addressed in this report as follows:

- The Company failed to provide and an adequate Summary of Rights to all nine (9) Freedom and forty-seven (47) Sun Coast insureds when their PPA policy premiums increased due to an adverse underwriting decision.
- The Company failed to properly document and retain UM and UIM selection forms for forty-eight (48) Sun Coast new business applicants.

### **Declinations, Cancellations and Non-Renewals**

In the area of Cancellations and Non-Renewals, four (4) compliance issues are addressed in this report as follows:

- The Company failed to provide a Summary of Rights to all fifty (50) Freedom and all twenty (20) Sun Coast insureds when their policies were cancelled and all nine (9) Freedom insureds whose policies were non-renewed due to an adverse underwriting decision.
- The Company failed to use a reason allowed by statute to cancel seventeen (17) Freedom and both Sun Coast policies in effect more than sixty (60) days.
- The Company failed to include the unearned premium refund with the policy cancellation notice sent to forty-eight (48) Freedom and twenty (20) Sun Coast policyholders.
- The Company failed to provide forty-eight (48) Sun Coast insureds a premium non-payment cancellation notice containing the right to complain to the Director.

### **Claims Processing**

In the area of Claims Processing, nine (9) compliance issues are 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 accurately identify the state, its statutes and/or Insurance Department in its claim correspondence to fourteen (14) Freedom and two (2) Sun Coast claimants.
- The Company failed to provide a fraud warning statement on three (3) Freedom and one (1) SCM claim form.
- The Company failed to specify on one (1) SCM claim authorization form the purposes for which the information is collected.
- The Company failed to specify on one (1) SCM claim authorization form that the authorization shall remain valid for no longer than the duration of the claim.
- The Company failed to advise on two (2) SCM claim authorization forms that the individual and persons authorized to act on behalf of the individual were entitled to receive a copy of the authorization form.
- The Company failed to correctly calculate and fully pay sales tax owed to three (3) Freedom first and two (2) Freedom third party total loss claimants.
- The Company failed to correctly calculate and fully pay fees owed sixty-nine (69) Freedom and eight (8) SCM total loss claimants.
- The Company failed to fairly and equitably settle seventy (70) Freedom and three (3) SCM third party total losses by imposing a reduction in Actual Cash Value (ACV) for a predetermined salvage amount without prior claimant consent.
- The Company failed to provide two (2) SCM first party claimants a denial in writing.

FACTUAL FINDINGS

RESULTS OF PREVIOUS MARKET EXAMINATIONS

During the past three (3) years, the Company had one (1) market conduct examination conducted by the state of California. The exam was called on 1/10/10 and completed on 3/10/11.

FACTUAL FINDINGS

PRODUCER COMPLIANCE

**The following Producer Compliance Standard was met:**

#	STANDARD	Regulatory Authority
2	An insurer shall not pay any commission, fee, or other valuable consideration to unlicensed producers.	A.R.S. § 20-298

**The following Producer Compliance Standard failed:**

#	STANDARD	Regulatory Authority
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 thru 20-311.03

**Preliminary Finding #11 - Licensing of Producers** - The Company failed to require its producer, Freedom National Insurance Services, Inc., to be properly licensed as a managing general agent during the exam period. This represents one (1) violation of A.R.S. § 20-311.01.

**LICENSING OF PRODUCERS**

Failed to require producer to be properly licensed as a managing general agent  
Violation of A.R.S. § 20-311.01

Population	Sample	# of Exceptions	% to Sample
NA	NA	1	NA

**Any improperly licensed producer does not meet the Standard.**

**Subsequent Event**

*Freedom National Insurance Services, Inc. was granted managing general agency authority effective 3/31/11 by the Department's Licensing Division.*

FACTUAL FINDINGS

UNDERWRITING AND RATING

**Private Passenger Automobile (PPA):**

The examiners reviewed:

- (1) 100 Freedom and fifty (50) Sun Coast PPA new business and/or renewal policies from a combined population of 16,529; and
- (2) fifty (50) Freedom and fifty (50) Sun Coast surcharged policies from a combined population of 1,942.

**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 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, 20-2113
4	All forms and endorsements forming a part of the contract should be filed with the director (if applicable).	A.R.S. § 20-398
5	Policies and endorsements are issued or renewed accurately, timely and completely.	A.R.S. §§ 20-1120, 20-1121
6	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, 20-2110

**Preliminary Findings #12 & #26 – No Summary of Rights** – The Company failed to provide an adequate Summary of Rights to all nine (9) Freedom and all forty-seven (47) Sun Coast applicants or insureds when policy premiums increased due to an adverse underwriting decision because of information from a source other than the applicant or insured. These represent a total of fifty-six (56) violations of A.R.S. § 20-2110(A).

**PPA NEW / RENEWAL & SURCHARGED POLICIES**

Failed to provide Summary of Rights when premium increase due to adverse underwriting action  
Violation of A.R.S. § 20-2110(A)

Population	Sample	# of Exceptions	% to Sample
16,529	56	56	100%

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

**Recommendation #1**

Within ninety (90) days of the filed date of this report, provide the Department with documentation that Company procedures and controls are in place to ensure Sun Coast provides a Summary of Rights, in accordance with the statutes, to any insured when a premium increase results from an adverse underwriting decision.

**Subsequent Event**

*The Company's MGA, Freedom, implemented on 7/21/11 an automated version of the Department's recommended Summary of Rights format. The examiners received examples of this correction to confirm changes are compliant.*

**Preliminary Finding #25 – Missing UM/UIM Selection Forms** - The Company failed to properly document and retain signed UM and UIM selection form pages from the application for forty-eight (48) Sun Coast new business applicants that selected coverage limits less than limits for bodily injury or death contained in their policy. These represent forty-eight (48) violations of A.R.S. § 20-259.01(A) and (B).

**PPA NEW / RENEWAL & SURCHARGED POLICIES**

Failed to retain signed UM/UIM selection forms  
Violation of A.R.S. § 20-259.01(A) and (B)

Population	Sample	# of Exceptions	% to Sample
1,197	100	48	48%

A 48% error ratio does not meet the Standard; therefore, a recommendation is warranted.

**Recommendation #2**

Within ninety (90) days of the filed date of this report, provide the Department with documentation that Company procedures and controls are in place to ensure the Company properly documents and retains signed, dated UM and UIM selection forms from applicants, in accordance with the statute.

FACTUAL FINDINGS

DECLINATIONS, CANCELLATIONS AND NON-RENEWALS



**Private Passenger Automobile (PPA):**

The examiners reviewed:

- (1) 100 Freedom non-payment cancellations from a population of 6,734;
  - (2) fifty (50) Sun Coast non-payment cancellations from a population of 494;
  - (3) fifty (50) Freedom and all twenty (20) Sun Coast underwriting cancellations from a combined population of 161; and
  - (4) all nine (9) Freedom non-renewals.
- Sun Coast had no policies non-renewed during the exam period.

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

#	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 applicant and shall not be unfairly discriminatory.	A.R.S. §§ 20-448, 20-2108, 20-2109 and 20-2110

**Preliminary Findings #10 & #22 – No Summary of Rights** - The Company failed to provide a Summary of Rights to all fifty (50) Freedom and all twenty (20) Sun Coast insureds that had their policies cancelled and all nine (9) Freedom insureds that had their policies non-renewed due to an adverse underwriting decision. These represent a total of seventy-nine (79) violations of A.R.S. § 20-2110.

**PPA CANCELLATIONS & NON-RENEWALS**

Failed to provide a Summary of Rights to insureds with coverage cancelled or non-renewed due to an adverse underwriting decision  
Violation of A.R.S. § 20-2110

Population	Sample	# of Exceptions	% to Sample
170	79	79	100%

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

**Recommendation #3**

Within ninety (90) days of the filed date of this report, provide the Department with documentation that Company procedures and controls are in place to ensure a Summary of Rights is provided to all Sun Coast insureds, in accordance with the applicable statutes, when their policies are cancelled or non-renewed due to an adverse underwriting decision.

**Subsequent Event**

*The Company's MGA, Freedom, implemented on 7/21/11 an automated version of the Department's recommended Summary of Rights format. The examiners received examples of this correction to confirm changes are compliant.*

**The following Declination, 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, and shall not be unfairly discriminatory.	A.R.S. §§ 20-191, 20-443, 20-448, 20-1631, 20-1632, 20-1632.01

**Preliminary Findings #8 & #20 – Invalid Reason for Policy Termination** - The Company failed to use a reason allowed by statute to cancel seventeen (17) Freedom and two (2) Sun Coast policies in effect for more than sixty (60) days. These represent a total of nineteen (19) violations of A.R.S. § 20-1631(D).

**PPA CANCELLATIONS**

Cancelled PPA policies for reasons not permitted by statute  
Violation of A.R.S. § 20-1631(D)

Population	Sample	# of Exceptions	% to Sample
161	70	19	27.1%

**A 27.1% error ratio does not meet the Standard; therefore, a recommendation is warranted.**

**Recommendation #4**

Within ninety (90) days of the filed date of this report, provide the Department with documentation that Company procedures and controls are in place to ensure Company policies, in effect for more than sixty (60) days, are canceled only for reasons allowed by the statute.

**Preliminary Findings #9 & #21 – Late Unearned Premium Refunds** - The Company failed to refund to forty-one (41) Freedom and eight (8) Sun Coast policyholders the unearned premium owed within ten (10) days after policy cancellation. These represent a total of forty-nine (49) violations of A.R.S. § 20-1632(A)(3).

**PPA CANCELLATIONS**

Failed to refund unearned premium within ten (10) days after policy cancellation  
Violation of A.R.S. § 20-1632(A)(3)

Population	Sample	# of Exceptions	% to Sample
161	68	49	72%

**A 72% error ratio does not meet the Standard; therefore, a recommendation is warranted.**

**Subsequent Event**

*The Company's MGA, Freedom, implemented on 11/2/10 an automated refund check issuance program that generates payment within ten (10) days of a PPA policy's cancellation date.*

*Sun Coast reprogrammed its refund check issuance program 8/23/11 and 8/26/11 provided examiners evidence of production in compliance with the statute.*

**Preliminary Finding #23 – Private Passenger Automobile Cancellations for Non- Payment Fail to Include the Right to Complain to the Director** – The Company failed to provide forty-eight (48) Sun Coast insureds a premium non-payment cancellation notice containing the right to complain to the Director about the Company's action within ten (10) days after receipt of the notice. These represent forty-eight (48) violations of A.R.S. § 20-1632.01(B).

**PPA NON-PAYMENT CANCELLATIONS**

Failed to inform insureds on non-payment notice of right to complain to the Director  
Violation of A.R.S. § 20-1632.01(B)

<b>Population</b>	<b>Sample</b>	<b># of Exceptions</b>	<b>% to Sample</b>
494	50	48	96%

**A 96% error ratio does not meet the Standard; therefore, a recommendation is warranted.**

**Recommendation #5**

Within ninety (90) days of the filed date of this report, provide the Department with documentation that Company procedures and controls are in place to ensure Sun Coast's non-payment of premium cancellation notices contain the right to complain to the Director, in accordance with the applicable state statute.

FACTUAL FINDINGS

CLAIMS PROCESSING

**Private Passenger Automobile (PPA):**

The examiners reviewed:

- (1) fifty (50) Freedom and all thirty-nine (39) Sun Coast PPA paid claims from a combined population of 951;
- (2) all sixty-nine (69) Freedom and all eight (8) Sun Coast PPA total losses;
- (3) fifty (50) Freedom and all twenty-seven (27) Sun Coast PPA claims closed without payment from a combined population of 568; and
- (4) all forty-one (41) Freedom and both Sun Coast PPA subrogations.

**The following Claim 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 of rights and excess of loss letters, when appropriate.	A.R.S. § 20-461, 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 Processing Standard failed:**

#	STANDARD	Regulatory Authority
3	The Company's 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

**Preliminary Finding #3 & #16 – Incorrect State / Insurance Department Reference -** The Company failed to accurately identify the state statutes and/or Insurance Department in its claim correspondence with fourteen (14) Freedom and two (2) Specialty Claims Management (SCM) claimants. The reference to an incorrect or conflicting state statute or Insurance Department in correspondence is misleading and deceptive. These represent a total of sixteen (16) violations of A.R.S. § 20-461(A)(1).

	ADOI ID #	DOL	Correspondence		Incorrect Reference Made
			Date	Type	
1	FPDT-39	5/5/10	6/9/10	1 <sup>st</sup> party contributory negligence letter	CA tort law
2	FCWP-24	5/7/10	8/9/10	1st party at-fault letter	CA Code of Regulations...
3	FSUB-5	11/3/08	11/1/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
4	FSUB-11	3/15/09	7/26/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
5	FSUB-17	6/22/09	7/23/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
6	FSUB-18	6/27/09	7/23/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
7	FSUB-19	6/28/09	11/2/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
8	FSUB-22	9/2/09	7/23/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
9	FSUB-23	10/3/09	7/23/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
10	FSUB-26	11/12/09	7/23/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
11	FSUB-34	2/1/10	9/28/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
12	FSUB-38	4/28/10	12/20/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
13	FSUB-30	6/9/10	12/20/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
14	FSUB-40	6/24/10	10/21/10	Subrogation attempts exhausted letter	CA DOI, Claims Service Bureau
15	SCWP-12	9/3/10	9/21/10	Claim denial letter	CA DOI Consumer Affairs Div
16	SCWP-25	6/9/10	6/10/10	Claim denial letter	CA DOI Consumer Affairs Div

### CLAIM FORMS

Failed to correctly identify Arizona statutes and/or Insurance Department in claim correspondence  
Violation of A.R.S. § 20-461(A)(1)

Population	Sample	# of Exceptions	% to Sample
N/A	N/A	16	N/A

**Any error does not meet the Standard; therefore a recommendation is warranted.**

#### **Recommendation #6**

Within ninety (90) days of the filed date of this report, provide documentation to the Department that procedures and controls are in place to ensure any claim correspondence with Arizona claimants correctly identifies that state's statutes and Insurance Department, in accordance with the applicable state statute.

#### **Subsequent Event**

*The Company responded 8/11/11 that Freedom had revised their exhausted subrogation attempts letter to identify the Arizona Department and provided the examiners a copy of the change.*

**Preliminary Finding #4 & #14 – Fraud Warning Statement** – The Company failed to provide a fraud warning statement, in at least twelve (12) point type, on three (3) Freedom and one (1) SCM claim form. These represent a total of four (4) violations of A.R.S. § 20-466.03. The following table summarizes the fraud warning statement findings.

	<b>Form Description / Title</b>	<b>Form Number</b>	<b>Ed. Date</b>
1F	Promissory Note	Payment Agreement (CNIC)	None
2F	Conservator-S General Release	Conservator release - CNIC-AZ	None
3F	Release & Settlement of Claim	BI Release - Full Final (CNIC-AZ)	None
4S	Affidavit of Vehicle Theft	None	None

#### **CLAIM FORMS**

Failed to provide fraud warning statement in at least twelve (12) point type  
Violation of A.R.S. § 20-466.03

<b>Population</b>	<b>Sample</b>	<b># of Exceptions</b>	<b>% to Sample</b>
N/A	N/A	4	N/A

**Any error does not meet the Standard; therefore a recommendation is warranted.**

#### **Recommendation #7**

Within ninety (90) days of the filed date of this report, provide documentation to the Department that the required fraud warning statement, in 12-point type, is included on the SCM claim form cited, in accordance with the applicable state statute.

#### **Subsequent Event**

*The Company before the close of the exam provided the examiners copies of the three (3) Freedom forms cited containing the correct fraud warning statement.*

**Preliminary Finding #15 – Authorization Disclosures** – On two (2) SCM claim authorization forms shown in the table below, the Company failed to:

- (a) specify the purposes for which the information is collected;
- (b) specify the authorization remains valid for no longer than the duration of the claim; and
- (c) advise the individual or a person authorized to act on behalf of the individual that they are entitled to receive a copy of the authorization form.

These forms fail to comply with A.R.S. § 20-2106(6), (8)(b) and (9) and represent four (4) violations of the statute. The following table summarizes these authorization form findings.

<b>Form Description / Title</b>	<b>Form #</b>	<b>Statute Provision</b>
Medical Authorization	None	6 and 9
Authorization for Release and/or Disclosure of Medical Info	None	8(b) and 9

**CLAIM FORMS**

Failed to specify the purposes for which the information is collected  
Violation of A.R.S. § 20-2106(6)

Population	Sample	# of Exceptions	% to Sample
N/A	N/A	1	N/A

**Any error does not meet the Standard; therefore a recommendation is warranted.**

Failed to specify the authorization remains valid for no longer than the duration of the claim  
Violation of A.R.S. § 20-2106(8)(b)

Population	Sample	# of Exceptions	% to Sample
N/A	N/A	1	N/A

**Any error does not meet the Standard; therefore a recommendation is warranted.**

Failed to advise the individual or a person authorized to act on behalf of the individual that they  
are entitled to receive a copy of the authorization form

Violation of A.R.S. § 20-2106(9)

Population	Sample	# of Exceptions	% to Sample
N/A	N/A	2	N/A

**Any error does not meet the Standard; therefore a recommendation is warranted.**

**Recommendation #8**

Within ninety (90) days of the filed date of this report, provide documentation to the Department that these forms, as needed,

- (a) specify the purposes for which the information is collected;
- (b) specify the authorization remains valid for no longer than the duration of the claim; and
- (c) 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,

in accordance with the applicable state statute.

**The following Claim Processing Standard failed:**

#	STANDARD	Regulatory Authority
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, 20-468, 20-469, A.A.C. R20-6-801

**Preliminary Findings #6, #7 and #18 – Total Loss Sales Tax and Fees –** The Company failed to accurately calculate and fully pay the correct:

- (a) sales tax with five (5) Freedom total loss settlements; and
- (b) fees with sixty-nine (69) Freedom and eight (8) SCM total loss settlements.



These represent a total of eight-two (82) violations of A.R.S. § 20-461(A)(6) and A.A.C. R20-6-801(H)(1)(b).

**PPA TOTAL LOSSES**

Failed to correctly calculate and pay sales taxes and fees associated with total loss settlements.  
Violation of A.R.S. § 20-461(A)(6), A.A.C. R20-6-801(H)(1)(b)

Population	Sample	# of Exceptions	% to Sample
77	77	82	106.5%

**A 106.5% error ratio does not meet the Standard; therefore a recommendation is warranted.**

**Recommendation #9**

Within ninety (90) days of the filed date of this report, provide documentation to the Department that procedures and controls are in place to ensure the Company correctly calculates and fully pays any sales tax and title, registration or other fees, owed any claimant in the settlement of a total loss, in accordance with applicable state statutes and regulations. In addition, the Company should make restitution to these claimants, including interest, and provide the Department appropriate documentation of payments. With each payment of restitution, provide a letter indicating that an audit of claims by the Department resulted in identification and correction of the previous claim payment.

**Subsequent Event**

*The Company's MGA, Freedom, between 7/12/11 and 7/21/11 in preparation for the examiners' arrival on site, identified all Company total losses involving fees, both in and out of the exam period, and paid 104 claimants \$1,112.34 total restitution, which included \$150.34 interest. As of the date of this report, five (5) Freedom sales tax and eight (8) Sun Coast fee violations have had no restitution paid.*

**Preliminary Findings #2 & #19 – Third Party Total Loss Settlements** – The Company failed, within the exam period, to process seventy (70) Freedom and three (3) SCM third party total loss vehicle settlements in a fair and equitable manner consistent with the statute. If the owner retains possession of a salvage or non-repairable vehicle, the owner must obtain a salvage title as required by A.R.S. § 28-2091 before receiving a total loss settlement from the Company. The Company settled each loss cited before they determined whether the owner actually wanted to retain the vehicle and if that owner had complied with A.R.S. § 28-2091. These represent a total of seventy-three (73) violations of A.R.S. § 20-461(A)(6).

**PPA THIRD PARTY TOTAL LOSSES**

Failed to handle third party total loss settlements in a fair and consistent manner  
Violation of A.R.S. § 20-461(A)(6)

Population	Sample	# of Exceptions	% to Sample
73	73	73	100%

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

**Recommendation #10**

Within ninety (90) days of the filed date of this report, provide documentation to the Department that procedures and controls are in place to ensure the Company processes both first and third party owner vehicle retentions following a total loss similarly and in accordance with applicable state statutes and regulations.

**The following Claim Processing Standard failed:**

#	STANDARD	Regulatory Authority
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

**Preliminary Finding #17 – Written Claim Denial** – The Company failed to provide two (2) SCM first party claimants a written denial of their claims with reference to the specific policy provision, condition or exclusion. These represent two (2) violations of A.R.S. § 20-461(A)(5) and A.A.C. R20-6-801(G)(1)(a).

**PPA CLAIMS CLOSED WITHOUT PAYMENT**

Failed to provide first party claimants claim denial in writing  
Violation of A.R.S. § 20-461(A)(5) and A.A.C. R20-6-801(G)(1)(a)

Population	Sample	# of Exceptions	% to Sample
27	27	2	7.4%

**A 7.4% error ratio does not meet the Standard; therefore a recommendation is warranted**

**Recommendation #11**

Within ninety (90) days of the filed date of this report, provide documentation to the Department that procedures and controls are in place to ensure the Company provides all first party claimants a written explanation for the Company's claim denial, in accordance with applicable state statutes and regulations.

**SUMMARY OF FAILED STANDARDS**

EXCEPTION	Rec. No.	Page No.
<b>PRODUCER COMPLIANCE</b>		
<u>Standard #1</u> The producers are properly licensed in the jurisdiction where the application is taken.	N/A	11
<b>UNDERWRITING &amp; RATING</b>		
<u>Standard #2</u> Disclosures to insureds concerning rates and coverage are accurate and timely.	1 & 2	15
<b>DECLINATIONS, CANCELLATIONS &amp; NON-RENEWALS</b>		
<u>Standard #1</u> 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.	3	17
<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, and shall not be unfairly discriminatory.	4 & 5	18 & 19
<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.	6,7, & 8	22, 23 & 24
<u>Standard #5</u> Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations.	9 & 10	25 & 26
<u>Standard #9</u> Denied and closed without payment claims are handled in accordance with policy provisions and state law.	11	26

**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 and 20-443)	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. (A.R.S. §§ 20-259.01, 20-262, 20-263, 20-264, 20-266, 20-267, 20-2110)		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	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. §§ 20-157, 20-2104, 20-2106, 20-2110 and 20-2113)	X	
5	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1120 and 20-1121)	X	
6	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463 and 20-1109)	X	

**E. Declinations, Cancellations 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 and 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, and shall not be unfairly discriminatory. (A.R.S. §§ 20-191, 20-443, 20-448, 20-1631, 20-1632, 20-1632.01)		X

**F. Claim 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

#	STANDARD	PASS	FAIL
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	
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, 20-468, 20-469, 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. (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	