

STATE OF ARIZONA
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DEPT. OF INSURANCE

REPORT OF TARGET MARKET CONDUCT EXAMINATION

OF

HOMESITE INDEMNITY COMPANY

NAIC #20419

AS OF

December 31, 2010

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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 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:

Homesite Indemnity Company
NAIC #20419

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 January 1, 2010 through December 31, 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.

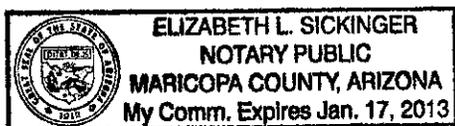
Helene I. Tomme, CPCU, CIE being first duly sworn, states that I am a duly appointed Market Examinations Examiner-in-Charge for the Arizona Department of Insurance. That under my direction and with my participation and the participation of Linda L. Hofman, AIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner and Christopher G. Hobert, CIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner on the Examination of Homesite Indemnity Company, 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 Boston, Massachusetts 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 12th day of May, 2011.

Elizabeth L. Sickinger
Notary Public

My Commission Expires Jan. 17, 2013



FOREWORD

This targeted market conduct examination report of the Homesite Indemnity Company (herein referred to as, "HIC", 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 products 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) 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 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 9.

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)

Homesite Indemnity Company ("Homesite") is a Kansas company, licensed to transact property, casualty and miscellaneous lines of insurance in its state of domicile since 1947. Homesite holds certificates of authority to write similar types of insurance in the states of Arizona, Colorado, Missouri, Nebraska, Nevada, New Mexico, Oklahoma, South Dakota, North Dakota, Texas, Utah and Wyoming. Homesite is a wholly owned subsidiary of Homesite Group Incorporated, a Delaware corporation ("HGI").

Homesite Indemnity Company (the "Company") is a Kansas domestic insurer with its statutory and main administrative offices located at 99 Bedford Street, Boston, MA 02111. The Company was incorporated under the name Cimarron Casualty Company on February 14, 1949. On September 20, 1959, the Company changed its name to Plains Insurance Company. On August 20, 1990, American Fidelity Corporation acquired the Company's parent, Cimarron Investment Company, Inc., and contributed the acquired companies to its wholly-owned subsidiary, American Fidelity Assurance Company, who then contributed them to its subsidiary, American Fidelity Insurance Company. The Company was purchased on October 13, 1994, by Insurance Acquisition Corporation, a wholly-owned subsidiary of Crop Growers Corporation (CGC). CGC and all of its subsidiaries were acquired on August 13, 1997, by Fireman's Fund Insurance Company (Fireman's Fund) who then, on January 4, 1999 sold the common stock of the Company to Homesite Group Incorporated ("HGI"), an insurance holding company incorporated in Delaware. As a condition of the sale, the Company was renamed Homesite Indemnity Company. Homesite Indemnity Company holds thirteen certificates of authority and currently is writing in ten states.

Other subsidiaries in the HGI holding company system include Homesite Insurance Company of the Midwest, a North Dakota Company; Homesite Insurance Company, a Connecticut company; Homesite Insurance Company of California; Homesite Insurance

Company of Georgia (f/k/a Homesite Insurance Company of Pennsylvania); Homesite Insurance Company of New York; Homesite Insurance Company of Illinois; Homesite Insurance Company of Florida; and Homesite Lloyd's of Texas which are also in the business of offering homeowner's insurance and related lines to consumers.

The Company distributes and sells full service homeowners insurance products through its call center, its website and, most significantly, its partnerships with large financial institutions ("partner(s)"). The partners through whom the Company sells its products utilize varied distribution channels including exclusive agencies, independent agents, and through the internet.

The Company bylaws provide the framework for the operation, management and control of a domestic stock property and casualty insurance company in the state of Kansas. The Company is controlled by its sole shareholder and managed by a board of directors.

PROCEDURES REVIEWED WITHOUT EXCEPTION

The Examiners review of the following Company departments¹ 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

EXAMINATION REPORT SUMMARY

The examination identified five (5) compliance issues that resulted in 117 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 Examiner's findings:

Cancellation and Non Renewals

In the area of Cancellations and Non Renewals, two (2) compliance issues are addressed in this Report as follows:

- The Company failed to send written notice, 10 days prior to the effective date of the cancellation, to 3 HO policyholders cancelled for non payment of premium.
- The Company failed to provide a compliant Summary of Rights on 13 HO non renewals, 50 HO cancellations for substantial change in risk and 19 HO cancellations for underwriting reasons to its policyholders/insureds cancelled for an adverse underwriting decision for a total of 82 HO notices.

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

Claims Processing

In the area of Claims Processing, three (3) compliance issues are addressed in this Report as follows:

- The Company failed to include a fraud warning statement in at least 12-point type on one (1) HO claim form.
- The Company failed to pay the correct Transaction Privilege Tax (TPT) on 30 first party homeowner paid claims.
- The Company failed to reimburse one (1) first party homeowner their deductible in a timely manner when subrogation recovery was successful, which resulted in a \$263.08 payment including interest.

FACTUAL FINDINGS

RESULTS OF PREVIOUS MARKET CONDUCT EXAMINATIONS

During the past three (3) years, there was one (1) Market Conduct Examination completed by the state of Missouri. No significant patterns of non-compliance were noted.

CANCELLATIONS AND NON-RENEWALS

Homeowners (HO):

The Examiners reviewed 50 HO cancellation files for non-payment of premium out of a population of 2,336, 60 HO cancellation files for underwriting reasons out of a population of 115, 50 HO cancellation files for substantial change in risk out of a population of 378, and 50 HO non renewals out of a population of 111. This cancellation and non renewal review included a total sample size of 210 HO files from a total population of 2,940.

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

The following Cancellation and Non Renewal Standards 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 policyholder and shall not be unfairly discriminatory.	A.R.S. §§ 20-448, 20-2108, 20-2109, 20-2110
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 and 20-1651 through 20-1656

Cancellation and Nonrenewal, Standard #1 - failed

Preliminary Finding 005 – Summary of Rights – The Examiners identified 13 HO non renewals and 69 cancellations for underwriting reasons which totaled 82 HO notices. The notices failed to provide a compliant Summary of Rights to its policyholders, an apparent violation of A.R.S. §§ 20-2108, 20-2109 and 20-2110.

HOMEOWNERS NON RENEWALS

Failed to provide a compliant Summary of Rights in the event of an adverse underwriting decision

A.R.S. §§ 20-2108, 20-2109 and 20-2110

Population	Sample	# of Exceptions	% to Sample
111	50	13	26%

A 26% error ratio does not meet the Standard; therefore, a recommendation is warranted.

HOMEOWNERS CANCELLATIONS - UNDERWRITING REASON

Failed to provide a compliant Summary of Rights in the event of an adverse underwriting decision

A.R.S. §§ 20-2108, 20-2109 and 20-2110

Population	Sample	# of Exceptions	% to Sample
493	110	69	63%

A 63% 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 a compliant Summary of Rights is sent with all cancellation, non renewal or declination notices that involve an adverse underwriting decision by the Company.

Cancellation for Non Payment, Standard #2 - failed

Preliminary Finding 004 – Cancellations for Non Payment – The Examiners identified 3 HO non payment cancellations where the Company failed to send cancellation notices 10 days prior to the effective date of cancellation, as required by the Company’s own policy form, an apparent violation of A.R.S. § 20-443(A)(1).

HOMEOWNERS CANCELLATIONS NON PAYMENT

Failed to send cancellation notices 10 days prior to effective date of cancellation

A.R.S. § 20-443(A)(1)

Population	Sample	# of Exceptions	% to Sample
2,336	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 a written cancellation notice is sent out for all non payment cancellations 10 days prior to the effective date of the cancellation, as required by the Company’s own policy form.

CLAIMS PROCESSING

Homeowners (HO):

The Examiners reviewed 50 HO claims closed without payment from a population of 483; 50 HO paid claims from a population of 1,348 and 10 HO subrogation claims from a population of 29. This claim review included a total sample size of 110 HO claims files from a total population of 1,860.

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
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 Standards 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
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
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

Claims Processing Standard #3 - failed

Preliminary Finding 003 – Fraud Warning Statement The Company failed to include the Fraud Warning statement in at least twelve-point type on one (1) HO claim form/letter, an apparent violation of A.R.S. § 20-466.03.

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

Denial Letter

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 one (1) claim form/letter identified above.

Claims Processing Standard #5 – failed

Preliminary Finding-007 – Transaction Privilege Tax (TPT). The Examiners identified 30 first party homeowner settlements, in which the Company failed to pay the correct Transaction Privilege Tax (TPT), which is an apparent violation of A.R.S. §§ 20-461, 20-462(A) and 44-1201.

HOMEOWNER CLAIMS

Failed to pay the correct Transaction Privilege Tax
A.R.S. §§ 20-461, 20-462(A) and 44-1201

Population	Sample	# of Exceptions	% to Sample
1,348	50	30	60%

A 60% error ratio does not meet the standards; therefore, a recommendation is warranted.

Recommendation #4

Within 90 days of the filed date of this report provide the Department with documentation that Company procedures are in place to calculate the correct Transaction Privilege Tax (TPT) on Homeowner Paid Claims.

The Company must provide the Department with documentation of restitution paid to the 30 first party homeowners cited under PF007. Documentation should include copies of all AZ Refund letters and checks (including interest) sent to the 30 insureds and a summary spreadsheet.

Also, the Company must conduct a self-audit of the remaining Homeowner Paid Claims in 2010 and provide the Department with documentation that all monies owed have been properly reimbursed including copies of all AZ Refund letters and checks (including interest) to insureds and a summary spreadsheet.

Claims Processing Standard #7 – failed

Preliminary Finding-001 – Subrogation against adverse carrier – delay in returning deductible. The Examiners identified one (1) first party homeowner settlement, in which the Company failed to return the insured’s deductible in a timely manner after subrogation recovery was successful, which is an apparent violation of A.R.S. §§ 20-461, 20-462 and A.A.C. R20-6-801 (H)(4).

HOMEOWNER CLAIMS

Failed to return insured’s deductible in a timely manner
A.R.S. §§ 20-461, 20-462 and A.A.C. R20-6-801 (H)(4).

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

A 10% error ratio does not meet the standards; therefore, a recommendation is warranted.

Recommendation #5

Within 90 days of the filed date of this report provide the Department with documentation that Company procedures are in place for returning and insured’s deductible in a timely manner once received from an adverse carrier.

Subsequent Events: During the Phase I Examination, the Company reimbursed the insured their \$250.00 deductible with \$13.08 of interest for a total of \$263.08. A copy of the letter of explanation and payment were sent to the Department prior to completion of the Examination.

SUMMARY OF FAILED STANDARDS

EXCEPTIONS	Rec. No.	Page No.
CANCELLATIONS AND NON RENEWALS		
<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 policyholder and shall not be unfairly discriminatory.	1	14
<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	14
CLAIM PROCESSING		
<u>Standard #3</u> The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations.	3	17
<u>Standard #5</u> Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations	4	18
<u>Standard #7</u> Deductible reimbursement to insured upon subrogation recovery is made in a timely and accurate manner.	5	18

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)	9	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)	9	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)	9	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)	9	X	
2	An insurer shall not pay any commission, fee, or other valuable consideration to unlicensed producers. (A.R.S. § 20-298)	9	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)	9	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)	9	X	
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 and 20-2113)	9	X	
4	All forms and endorsements forming a part of the contract should be filed with the director (if applicable). (A.R.S. § 20-398)	9	X	
5	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1120, 20-1121 and 20-1654)	9	X	
6	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463, 20-1109)	9	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)	13		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 and 20-1651 through 20-1656)	13		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)	16	X	
2	Timely investigations are conducted. (A.R.S. § 20-461, and A.A.C. R20-6-801)	16	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)	17		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)	16	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)	17		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)	16	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)	17		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)	16	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)	16	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)	16	X	
11	Adjusters used in the settlement of claims are properly licensed (A.R.S. §§ 20-321 through 20-321.02)	16	X	