

STATE OF ARIZONA
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DEPT. OF INSURANCE

REPORT OF TARGET MARKET CONDUCT EXAMINATION

OF

COAST NATIONAL INSURANCE COMPANY

NAIC #25089

AS OF

December 31, 2013

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GERMAINE L. MARKS
Director of Insurance

Honorable Germaine L. Marks
Director of Insurance
State of Arizona
2910 North 44th Street
Suite 210, Second Floor
Phoenix, Arizona 85018-7269

Dear Director Marks:

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:

Coast National Insurance Company
NAIC #25089

The above examination was conducted by Helene I. Tomme, CPCU, CIE, Market Examinations Supervisor, Examiner-in Charge, and Christopher G. Hobert, CIE, MCM, Market Conduct Senior Examiner and Laura Sloan-Cohen, CIE, MCM, Market Conduct Senior Examiner.

The examination covered the period of January 1, 2013 through December 31, 2013.

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

FOREWORD

This targeted market conduct examination report of the Coast National Insurance Company (herein referred to as, "Coast National", 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 Private Passenger Auto (PPA) 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, 2013 through December 31, 2013 for business reviewed. The purpose of the examination was to determine the Company's compliance with Arizona's insurance laws, and whether the Company's operations and practices are consistent with the public interest. This examination was completed by applying tests to each examination standard to determine compliance with the standard. Each standard applied during the examination is stated in this report and the results are reported beginning on page 8.

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

The Examiners utilized both examinations by test and examination by sample. Examination by test involves review of all records within the population, while examination by sample involves the review of a selected number of records from within the population. Due to the small size of some populations examined, 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

(Provided by the Company)

The Company is a stock property and casualty insurance company organized under the laws of the State of California in July 1986. It is wholly owned by Coast National Holding Company, a California corporation. In July 1998, the Company and its affiliates, including Coast National Holding Company, were acquired by Bristol West Holdings, Inc. (formerly BRW Acquisition, Inc.), which was formed in 1998 by an affiliate of Kohlberg Kravis Roberts & Company.

In July 2007, Bristol West Holdings, Inc. was acquired by Mid-Century Insurance Company and the three insurance exchanges of the Farmers Insurance Group. Thus, in July 2007, the Company became a member of the Farmers holding company system. Bristol West Holdings, Inc. is currently owned by Farmers Insurance Exchange (42%), Fire Insurance Exchange (3.75%), Truck Insurance Exchange (6.75%), and Mid-Century Insurance Company (47.50%).

The Company writes private passenger auto liability and physical damage lines of business.

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 4 compliance issues that resulted in 17 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 include the specific facts which constitute the reason for three (3) non renewals and one (1) cancellation for underwriting reasons for a total of four (4) notices.
- The Company failed to mail three (3) PPA non renewal notices and one (1) PPA cancellation for underwriting reasons via certified mail or United States post office certificate for a total of four (4) notices.

Claims Processing

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

- The Company failed to correctly calculate and pay the appropriate tax, license

registration and/or air quality fees on seven (7) PPA first party total loss settlements, which resulted in additional payments of \$1,554.75 (including interest).

- The Company failed to reimburse two (2) PPA insureds their entire deductible in a timely manner when subrogation recovery was successful, which resulted in a payments of \$1,050.82 (including interest).

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

FACTUAL FINDINGS

RESULTS OF PREVIOUS MARKET CONDUCT EXAMINATIONS

The Company did not have any Market Conduct Examinations in the prior five (5) years.

CANCELLATIONS AND NON-RENEWALS

Private Passenger Automobile (PPA):

The Examiners reviewed 102 PPA cancellation files for non-payment of premium (included 2 sample files) out of a population of 6,505, 18 PPA cancellation files for underwriting reasons out of a population of 18 and 8 PPA non renewals out of a population of 8. This cancellation review included a total sample size of 128 PPA files from a total population of 6,531.

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

The following Cancellation and Non Renewal Standard was met:

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

The following Cancellation and Non Renewal Standard failed:

#	STANDARD	Regulatory Authority
2	Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory.	A.R.S. §§ 20-191, 20-443, 20-448, 20-1631, 20-1632, 20-1632.01, 20-1651 through 20-1656

Cancellation and Nonrenewal, Standard #2 - failed

Preliminary Finding 003 – Personal Automobile Specific Facts which constitute the reason for non renewals and cancellations– The Examiners identified three (3) PPA Non Renewals and one (1) PPA Cancellation for Underwriting Reasons notices for a total of four (4) notices where the Company failed to give the specific reason for non renewal, an apparent violation of A.R.S. § 20-1632(A)(1).

PRIVATE PASSENGER AUTOMOBILE
Summary of Findings – Standard 2 File Review
Failed to provide specific non renewal and cancellation reasons
A.R.S. § 20-1632(A)(1)

Files Reviewed	Population	Reviewed	Exceptions	Request #
PPA Non Renewals	8	8	3	009
PPA UW Reasons	18	18	1	011
Totals	26	26	4	
			Error Ratio	15%

A 15% 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 to provide policyholders with the specific facts which constitute the reason for their non renewal or cancellation.

Subsequent Events: During the course of the Examination, the Company agreed with the Examiners Finding and has corrected the system problem on October 17, 2013, which was causing the specific reason to not print on some notices.

Cancellation and Nonrenewal, Standard #2 - failed

Preliminary Finding 004 – Personal Automobile Non Renewal and Cancellations for Underwriting Reason Notices sent by Certified Mail – The Examiners identified three (3) PPA Non Renewals and one (1) PPA Cancellation for Underwriting Reasons, for a total of four (4) notices where the Company failed to mail the notices via certified mail or United States post office certificate of mailing, an apparent violation of A.R.S. § 20-1632(A).

PRIVATE PASSENGER AUTOMOBILE
Summary of Findings – Standard 2 File Review
Failed to provide non renewal and cancellations for underwriting reason notices
via certified mail or United States post office certificate of mailing
A.R.S. § 20-1632(A)

Files Reviewed	Population	Reviewed	Exceptions	Request #
PPA Non Renewals	8	8	3	009
PPA UW Reasons	18	18	1	011
Totals	26	26	4	
			Error Ratio	15%

A 15% 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 to provide policyholders with non renewal and cancellation for underwriting reason notices via certified mail or United States post office certificate of mailing

Subsequent Events: During the course of the Examination, the Company agreed with the Examiners Finding and corrected the system problem on October 17, 2013, which caused a problem with some notices being routed to an "error batch" for special handling.

CLAIMS PROCESSING

Private Passenger Automobile (PPA):

The Examiners reviewed 52 PPA claims closed without payment (included 2 sample files) from a population of 498; 52 PPA paid claims (included 2 sample files) from a population of 3,100; 103 total loss PPA claims (included 2 sample files) out of a population of 982 and 52 PPA subrogation claims (included 2 sample files) out of a population of 71. This claims review included a total sample size of 259 PPA claim files from a total population of 4,651.

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
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
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
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 and A.A.C. R20-6-801

The following Claim Standards passed with comment:

#	STANDARD	Regulatory Authority
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 #5 - failed

Preliminary Finding 001 –Total Loss Taxes and Fees - The Examiners identified seven (7) first party total loss settlements, in which the Company failed to correctly calculate and pay appropriate tax, license registration and/or air quality fees. This resulted in seven (7) first party total loss settlements being underpaid, an apparent violation of A.R.S. §§ 20-461(A)(6), 20-462(A) and A.A.C. R20-6-801 (H)(1)(b).

PRIVATE PASSENGER AUTOMOBILE TOTAL LOSS CLAIMS

Failed to correctly calculate and pay appropriate tax, license registration and/or air quality fees on total loss settlements

A.R.S. §§ 20-461(A)(6), 20-462(A) and A.A.C. R20-6-801 (H)(1)(b)

Population	Sample	# of Exceptions	% to Sample
982	103	7	7%

A 7% error ratio does not meet the Standard; therefore, a recommendation is warranted

Recommendation #3

Within 90 days of the filed date of this Report provide documentation to the Department to show that the Company's procedures have been corrected to comply with Arizona Statutes and Rules when processing total loss settlements for First and Third Parties.

Subsequent Events: During the course of the Examination, the Company agreed with the incorrect settlement of all first party total losses and made restitution payments to all parties affected in the amount of \$1,433.30 plus \$121.45 in interest for a total of \$1,554.75. Copies of

letters of explanation and payments were sent to the Department prior to completion of the Examination.

Claims Processing Standard #7 – passed with comment:

Preliminary Finding-002 – PPA subrogation against adverse carrier – delay in returning deductible. The Examiners identified two (2) first party private passenger automobile settlements, 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).

PRIVATE PASSENGER AUTOMOBILE 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
71	52	2	4%

A 4% error ratio meets the standards; therefore, no recommendation is warranted

Subsequent Events: During the course of Phase I Examination, the Company agreed and made a restitution payment in the amount of \$1,000.00 plus \$50.82 in interest for a total of \$1,052.82. Copies of 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 #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.	1	13
<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 #5</u> Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations.	3	17

SUMMARY OF PROPERTY AND CASUALTY STANDARDS

Complaint Handling

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

Marketing and Sales

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

Producer Compliance

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

Underwriting and Rating

#	STANDARD	PAGE	PASS	FAIL
1	The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company Rating Plan. (A.R.S. §§ 20-341 through 20-385)	8	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 and 20-2110)	8	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)	8	X	
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. §§ 20-2104, 20-2106, 20-2110 and 20-2113)	8	X	
5	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1118, 20-1120, 20-1121, 20-1632 and 20-1654)	8	X	
6	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463 and 20-1109)	8	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)	12	X	
2	Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory. (A.R.S. §§ 20-191, 20-443, 20-448, 20-1631, 20-1632, 20-1632.01, 20-1651 through 20-1656)	12		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)	16	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, 20-468, 20-469 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)	16	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	