



# Market Conduct Examination

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Selective Insurance Company of America  
And  
Selective Way Insurance Company

Branchville, New Jersey

STATE OF NEW JERSEY  
DEPARTMENT OF BANKING AND INSURANCE  
Office of Consumer Protection Services

Market Conduct Examination Section

Date Report Adopted: January 4, 2008

MARKET CONDUCT EXAMINATION

of the

Selective Insurance Company of America

And

Selective Way Insurance Company

located in

Branchville, New Jersey

as of

July 13, 2007

BY EXAMINERS

of the

STATE OF NEW JERSEY  
DEPARTMENT OF BANKING AND INSURANCE

OFFICE OF CONSUMER PROTECTION SERVICES  
MARKET CONDUCT EXAMINATION SECTION

**Date Report Filed: January 4, 2008**

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# I. INTRODUCTION

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## A. SCOPE AND PURPOSE OF THE EXAMINATION

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This is a report of the Market Conduct activities of the Selective Insurance Company of America and the Selective Way Insurance Company, hereinafter referred to as Selective Insurance Company of America (SICA) or Selective Way Insurance Company (SWIC) or the Company. In this report, examiners of the New Jersey Department of Banking and Insurance (NJDOBI) present their findings, conclusions and recommendations as a result of their market conduct examination. The Market Conduct Examiners included Examiner-in-Charge Robert J. Only, Anthony Cecere, Richard Segin and William Sonntag.

The scope of the examination included homeowner and dwelling fire insurance sold by the Company in New Jersey. The examiners evaluated Selective Insurance Company of America's and the Selective Way Insurance Company's compliance with the regulations and statutes that pertain to homeowner and dwelling fire insurance. The review period for the examination was January 1, 2006 through December 31, 2006. The examiners completed their fieldwork at the Company's Branchville, New Jersey office between May 14, 2007 and June 15, 2007. On various dates thereafter, the examiners completed additional review work and report writing.

The examiners randomly selected files and records from computer listings and documents provided by the Company. The random selection process is in accordance with the National Association of Insurance Commissioner's (NAIC) Market Conduct Handbook. In addition, the examiners used the NAIC Handbook, Chapter VIII – Conducting the Property and Casualty Examination as a guide to examine the Company and write this report.

## B. ERROR RATIOS

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Error ratios are the percentage of files reviewed which an insurer handles in error. A file is counted as an error when it is mishandled or the insured is treated unfairly, even if no statute or regulation is applicable. If a file contains multiple errors, the examiners will count the file only once in calculating error ratios. However, any file containing more than one error will be cited more than once in the report. In the event that the insurer corrects an error as a result of a consumer complaint or due to the

examiners' findings, the error will be included in the error ratio. If the insurer corrects an error independent of a complaint or NJDOBI intervention, the error is not included in the error ratios.

Whenever the examiners find that a company commits a type of error with sufficient frequency, they will cite the errors as an improper general business practice. If an error constitutes an improper general business practice, the examiners have stated this in the report that follows.

The examiners sometimes find improper general business practices of an insurer that may be technical in nature or which did not have an impact on a consumer. Even though such a practice would not be in compliance with applicable law, the examiners do not count each of these files as an error in determining error ratios. Whenever such business practices do have an impact on the consumer, each of the files in error will be counted in the error ratio. The examiners indicate in the report that follows whenever they did not count any particular files in the error ratio.

The examiners submitted written inquiries to Company representatives on the errors cited in this report. This provided SICA and SWIC the opportunity to respond to the examiners' findings and to provide exception to the statutory and/or regulatory errors or mishandling of files reported herein. In response to these inquiries, the Company agreed with some of the errors cited in this report. On those errors with which the Company disagreed, the examiners evaluated the individual merits of each response and gave due consideration to all of its comments. In some instances, the examiners did not cite the files due to the Company's explanatory responses. In others, the errors remained as cited in the examiners' inquiries.

## **C. COMPANY PROFILE**

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Selective Insurance Group is a holding company for seven property and casualty companies. Selective Insurance Company of America (SICA) was organized in 1926 and Selective Way Insurance Company (SWIC) was incorporated in 1973. Both Companies are part of the Group and are domiciled in Branchville, New Jersey. SICA writes standard and dwelling fire policies and SWIC only writes preferred homeowner policies.

As of December 2006, Selective had approximately 2,100 employees to support its operations. Marketing is done through independent insurance agents. To support its independent agents, Selective employs field underwriting and claim models.

## II. UNDERWRITING AND RATING

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### A. INTRODUCTION

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Selective has two Companies that write homeowner insurance business in New Jersey. Selective Insurance Company of America (SICA) writes all the standard homeowner (HO) and dwelling fire policies (DP). Selective Way Insurance Company (SWIC) writes only the preferred homeowner policies. SWIC does not write dwelling fire policies. The examiners reviewed randomly selected dwelling fire and homeowner policy files from SICA's and SWIC's in-force book of business written or renewed between January 1, 2006 and December 31, 2006. Selective Insurance Company of America reported 21,120 homeowner policies and 2,099 dwelling fire policies for a total of 23,219 in-force contracts. Selective Way Insurance Company reported 18,379 homeowner policies in-force during the review period. The examiners checked for compliance with all applicable New Jersey statutes and regulations including N.J.S.A. 17:29A-6 and 15 (filed and approved rating methodologies), N.J.S.A. 17:23A-4 (Notice of Information Practices) and N.J.S.A. 17:29A-4(d) (rate reductions for structures equipped with operative smoke detection devices).

### B. ERROR RATIOS

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The examiners calculated error ratios for each random sample by applying the procedure outlined in the introduction of this report. Error ratios are itemized separately for the review samples as indicated in the chart that follows.

<u>Review Category</u>	<u>Files Reviewed</u>	<u>Files In Error</u>	<u>Error Ratio</u>
<b>New Business:</b>			
<b>SICA</b>			
HO & DF	54	2	4%
<b>SWIC</b>			
HO	<u>51</u>	<u>0</u>	0%
<b>New Business Total</b>	105	2	2%

**Renewals:**

<b>SICA</b>			
HO & DF	100	4	4%
<b>SWIC</b>			
HO	<u>100</u>	<u>3</u>	3%
<b>Renewal Total</b>	200	7	4%
<b>New Business &amp; Renewal Total</b>	305	9	3%

## **C. EXAMINERS' FINDINGS**

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### **a. Underwriting Review**

The examiners reviewed 276 homeowner and 29 dwelling fire policies to confirm that the Companies provided required protective classification codes and premium discounts. The results of this review are as follows.

#### **1. Failure to Provide the Correct Fire Protection Classification Code - 8 Files in Error**

**N.J.S.A. 17:29A-6 & 15** requires an insurer to file its rating system with the Department and observe those rates. However, the examiners found that one new business policy and seven (four SICA and three SWIC) renewal policies did not reflect the correct fire protection classification code. The required fire protection class on seven of these errors ranged from 02 to 04. Selective had mistakenly determined that the range was 03 to 05. There was no premium disparity on these seven errors because the rate structure grouped the classes in a range of (01-05). One error, with protection class 07 instead of 8B, resulted in a premium undercharge. The Company agreed with this finding.

#### **SEE APPENDIX A-1 FOR A LIST OF POLICIES IN ERROR**

### **b. Select Discount Review:**

SICA and SWIC provide four different types of discount on HO3 policies. These include discounts for fire protection devices, dwellings under 15 years of age, multi-account policies (companion automobile policy) and insurance scores within specified ranges. SICA provides only the fire protection devices discount on dwelling fire policies. SWIC does not write dwelling policies. Additional details regarding these discounts, as well as the examiners' findings, appear below.

## Protective Device Discounts

The Companies provide fire protection credits for homes equipped with fire/smoke detectors, sprinklers and/or burglar alarm systems. Such protection devices can be local or central. These credits range from 2% to 13%. The Companies compute the discount against the base premium. The base premium is determined by considering territory, fire protection class, type of construction (typically frame or masonry), deductible (\$100 to \$2500), type of policy (SICA standard or SWIC preferred) and the dwelling liability (coverage A) limit. The examiners verified that the Company provided the proper protective device discounts on all but one of the 257 policies that qualified for this discount. The policy in error is described below.

### **1. Failure to Provide Discount for Fire Protection Devices - 1 File in Error**

**N.J.S.A. 17:29A-4(d)** requires an insurer to provide a rate reduction on structures equipped with operative smoke detection devices. Contrary to this statute, SICA failed to provide the required 2% credit on dwelling policy DP3100634. This resulted in a \$24.00 overcharge for the 2006 policy period and a \$25.00 overcharge for the 2007 policy period. In response to an inquiry, the Company agreed with the examiners' finding and stated it would endorse the policy to reflect this credit.

## Dwelling Age Discounts

SICA and SWIC provide a dwelling age credit discount for homes that are equal to or less than fifteen years of age. The discounts range from 20% for a home less than two years of age to 2% for a home that is fifteen years old. The Companies compute the discount against the base premium. The examiners found 45 homeowner policies that were eligible for the new home credit. The Companies provided the proper new home credit on all files reviewed.

## Multi-Account Policy Discounts

Selective provides a 10% credit against the base premium for those policyholders who also have an automobile policy with the Company. The examiners found that the Company did provide the multi-account discount to policyholders who qualified for this discount.

## Credit Score Discounts and Rate Impacts

The agent solicits insurance score credit information upon receipt of an insurance application. The Company uses Choicepoint's Attract HO-3 model as the basis for the score, which predicts a policyholder's claim frequency and/or loss ratio. Credit information is gathered and used to characterize a person's history. Such history would include credit account type and number, activity, balances, late payments, financing, obligations and debt burden. Mortgages, automobile payments and bankruptcies may also impact this score. Ultimately, Choicepoint assigns a score range to which Selective applies a rating factor. This factor is applied as a multiplier to the insurance premium on all new and renewal business beginning June 1, 2006.

As an example of the scoring process, levels A (insurance score >824) and B (insurance score between 725-824) allow a 10% and 5% discount factor, respectively. Levels C (insurance score between 625-724) and N (No score) are neutral, with a 1.00 factor. Levels D (insurance score between 576-624) and E (insurance score <576) provide for a 10% increase factor.

The Company indicated that extraordinary life events (death or illness of spouse, catastrophic illness or injury, temporary loss of employment and other factors beyond the applicant's control) may be the basis for the insured's request for reconsideration regarding an unacceptable insurance score. In response to the examiners' inquiries, the Company stated that, "insurance score results will be reconsidered based on an extraordinary life event if the insured makes a written request to the Company. These requests are reviewed and our experience has shown that in almost all instances are approved by the underwriting supervisor." The Company notifies all applicants that such consideration may be requested.

## **D. OTHER FINDINGS**

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The examiners grouped and counted the 23,219 homeowners and dwelling fire policies reported by Selective Insurance Company of America and the 18,379 Selective Way Insurance Company homeowner policies by zip code to illustrate in-force distribution in Urban Enterprise Zones and within the Windstorm Market Assistance Program (Wind-Map) zones. The examiners' findings are as follows.

### **1. In-Force Distribution in Urban Territories**

**N.J.A.C. 11:3-46** identifies 84 zip codes as being urban enterprise zones. The examiners found that SICA wrote homeowner policies in 55 of the 84 urban zones, reflecting an urban zone presence of 65%. Within these territories, SICA wrote 1,542 policies, which represents 7% of its

entire urban and non-urban in-force population. The examiners also found that SWIC wrote policies in 24 of the 84 urban zones, reflecting an urban zone presence of 29%. Within these territories, SWIC wrote 394 homeowner policies in these zones, which represents 2% of its entire urban and non-urban in-force population.

## **2. Windstorm Market Assistance Program (Wind-Map)**

The Windstorm Market Assistance Program (Wind-Map) is a voluntary industry program in which insurers consider applications for insurance from residents of coastal communities that have been unsuccessful in securing coverage through the voluntary market. The appendix to **N.J.A.C. 11:2-41** identifies 92 zip codes that constitute the Wind-Map area. The examiners found that SICA wrote policies in 78, or 85%, of the 92 Wind-Map zip codes. SICA wrote a total of 4,336 policies in these zones, which represents 19% of its entire in-force book of business. SWIC wrote policies in 53, or 58% of the 92 Wind-Map areas. SWIC wrote a total of 3,089 policies in these zones, which represents 17% of its total book of business.

## **3. Fuel Oil Storage Tank Exclusion and Buyback Option**

Selective began excluding coverage for fuel oil and associated contamination from storage tanks on April 15, 2006 on new business homeowner policies. New business policies may qualify with underwriting approval, for a one-time “buy-back” option with limits of \$50,000 or \$100,000 with an insured retained limit of \$2,500 on all HO3 homeowner policies except HO-4s. The premium is based on the age and location of the tank. Policies that renewed on or after April 15, 2007 are also eligible for the “buy-back” if chosen within 12 months of the first renewal term only. Insureds must complete a questionnaire if coverage is desired. During this review, the examiners found no rating or underwriting errors involving fuel oil storage tanks.

## **E. MAIL REVIEW**

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The examiners conducted a mail review at Selective’s Branchville, NJ location. The examiners reviewed the Company’s mail operation to verify that new business and renewal packages were sent in a timely fashion, and to determine that the Company included all required notices and informational disclosures. The examiners found no errors.

# III. TERMINATIONS REVIEW

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## A. INTRODUCTION

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During the review period of January 1, 2006 to December 31, 2006, the Company reported that it cancelled 329 new business policies within the first 60 days and cancelled 3,436 policies beyond the first 60 days. In the same period, the Company nonrenewed 49 policies. The examiners randomly selected and reviewed 39 nonrenewals and 211 cancellations for a total of 250 files reviewed. The examiners checked for compliance with applicable statutes and regulations including N.J.A.C. 11:1-20.2 (nonrenewal and cancellation notice requirements), N.J.A.C. 11:1-20.3 (policy provisions relating to cancellation or nonrenewal) and N.J.A.C. 11:1-20.4 (cancellation and nonrenewal underwriting guidelines).

## B. TERMINATION ERROR RATIOS

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The examiners calculated error ratios for the termination review by applying the procedure outlined in the introduction of this report. The following chart itemizes the review sample, the number of errors and the error ratio by type of termination.

<u>Review Sample</u>	<u>Files Reviewed</u>	<u>Files in Error</u>	<u>Error Ratio</u>
<b>Nonrenewals</b>			
Homeowner	35	0	0%
Dwelling Fire	<u>4</u>	<u>0</u>	0%
Sub-total	39	0	0%
<b>Cancellations</b>			
<b>First 60 Day</b>			
Homeowner	75	2	3%
Dwelling Fire	<u>3</u>	0	0
Sub-total	78	2	3%

<b>Midterm</b>			
Homeowner	123	2	2%
Dwelling Fire	<u>10</u>	0	0%
Sub-total	133	2	2%
<b>Overall Totals:</b>	250	4	2%

## **C. EXAMINERS' FINDINGS**

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### **1. Failure to Provide Standard or Reason and Factual Basis for Cancellation - 2 Files in Error**

**N.J.A.C. 11:1-20.2(g)** states that “No nonrenewal or cancellation shall be valid unless the notice contains the standard or reason upon which the termination is premised and specifies in detail the factual basis upon which the insurer relies.”

Contrary to this regulation, the examiners found that the Company did not provide the standard or reason upon which the termination is premised or specify in detail the factual basis for the cancellation on two midterm cancellation notices. In response to an inquiry, the Company agreed with the examiners’ finding on one of the two files.

Selective disagreed with this error on policy number H2012692, in which the notice stated “risk does not meet Selective’s underwriting criteria due to ownership of dog on the prohibited dog list.” However, this notice lacks specificity because it does not include the breed of dog. The Company disagreed that the reason on the notice is not detailed enough and stated “the Company believes it is not the intent of **N.J.A.C. 11:1-20.2(g)** to require all details related to the reason, rather enough for the insured to identify and have no doubt as to the reason.” However, the notice should contain the breed of dog included on the Company’s prohibited dog list so that the insured can appeal the cancellation if the Company has identified the wrong breed on the notice.

### **SEE APPENDIX B-1 FOR A LIST OF POLICIES IN ERROR**

### **2. Invalid Termination of Policies- 2 Files in Error**

Pursuant to **N.J.A.C. 11:1-20.4(g)**, only those underwriting guidelines which are in effect at the inception date of the original policy or any

subsequent renewal of that policy, as applicable, may be utilized by the insurer to cancel or nonrenew during that policy period.

The Company did not adhere to its own underwriting guidelines on policy H2019199. The Company cancelled the policy due to an open liability claim and an unacceptable insurance score. Additionally, the Company cancelled policy H2013378 due to an unacceptable insurance score. The Company's underwriting guidelines do not support these reasons for cancellation. The Company agreed with these errors.

#### **D. MISCELLANEOUS ERRORS**

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##### **1. Failure to Properly Apply Underwriting Guidelines on New Business Cancellations Files - 21 Files in Error**

Selective's underwriting guidelines state in part that "A copy of the application must be signed and dated by the named insured and the agent and maintained in the agency's file." Selective failed to comply with its own filed underwriting guidelines on 21 applications; the forms did not include the signatures of the insured and agent and the date the application was completed.

In response to the examiners' inquiry, the Company stated that there are instances when the guidelines may not be followed exactly. The Company further stated when an agent transfers his or her book of business to Selective, the Company does not require signatures and dates on the applications. However, Selective's underwriting guidelines do not make this exception when agents are transferring books of business. Since Selective's underwriting guidelines do in fact require signatures on applications, failure to require them is contrary to N.J.A.C. 11:1-20.4. Moreover, prudent business practice suggests that all contracts be properly signed by all parties.

This error was not included in the error ratios. Had they been counted, this error would have resulted in an improper general business practice.

**SEE APPENDIX B-2 FOR LIST OF POLICIES IN ERROR**

## IV. RECOMMENDATIONS

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Selective Insurance Company of America and Selective Way Insurance Company should inform all responsible personnel and third party entities that handle the files and records cited as errors in this report of the examiners' recommendations and remedial measures that follow in the report sections indicated. The examiners also recommend that SICA and SWIC establish procedures to monitor compliance with these measures.

Throughout this report, the examiners cite and/or discuss all errors found. If the report cites a single error, the examiners often include a "reminder" recommendation because if a single error is found, more errors may have occurred.

The examiners acknowledge that during the examination, SICA and SWIC agreed and had already complied with, either in whole or in part, some of the recommendations. For the purpose of obtaining proof of compliance and for the Company to provide its personnel with a document they can use for future reference, the examiners have listed all recommendations below.

### A. GENERAL INSTRUCTIONS

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All items requested for the Commissioner and copies of all written instructions, procedures, recommended forms, etc., should be sent to the Commissioner, c/o Clifton J. Day, Manager of the Market Conduct Examinations and Anti-Fraud Compliance Unit, Mary Roebling Building, 20 West State Street, PO Box 329, Trenton, NJ 08625, within thirty (30) days of the date of the adopted report.

On files reopened as recommended, the letter that offers coverage should be sent to the insured with an accompanying cover letter containing the following first paragraph (variable language is include in parentheses):

#### Offer of Coverage

"During a recent review of our policy files by market conduct examiners of the New Jersey Department of Banking and Insurance, they found that we should not have canceled your (homeowner/ dwelling fire insurance). We are now offering you a new policy to correct our error."

### B. UNDERWRITING AND RATING REVIEW

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1. Pursuant to **N.J.S.A. 17:29A-6 & 15**, the Company should issue written instructions to all appropriate personnel stating that the

- correct fire protection class code should be applied to all homeowner and dwelling policies.
2. The Company should provide a written reminder to all appropriate personnel stating that **N.J.S.A. 17:29A-4(d)** requires an insurer to provide a rate reduction on structures equipped with approved, operative smoke detection devices. On policy number DP3100634, Selective should provide documentation that it refunded or credited the insured's policy for all policy periods in which a protective device discount was required.

### C. TERMINATION REVIEW

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3. Pursuant to **N.J.A.C. 11:1-20.2(g)**, the Company should issue a written reminder to all appropriate personnel informing them that in order for a cancellation notice to be valid, the notice must contain the standard or reason upon which the termination is premised and specifies in detail the factual basis upon which the insurer relies.
4. Pursuant to **N.J.A.C. 11:1-20.4(g)**, the Company should issue written instructions to all appropriate personnel informing them:
  - a. to adhere to the Company's underwriting guidelines when cancelling a policy;
  - b. to not cancel or reject an application due to credit score.Selective should offer coverage on invalidly terminated policy numbers H2019199, H2013378, H2017028 and H2012692.
5. SICA and SWIC should issue written instructions to all appropriate personnel stating that all applications must be signed and dated by the named insured and the agent in accordance with its filed underwriting guidelines.

## APPENDIX A – UNDERWRITING AND RATING ERRORS

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### 1. Failure to Provide Correct Fire Protection Classification Code – 8 Files in Error

<u>Company</u>	<u>Policy #</u>	<u>New or Renewal</u>	<u>Protection Class Required</u>	<u>Protection Class Given</u>
SICA	H2029775	New	03	04
SICA	H772002	Renewal	02	03
SICA	H1128772	Renewal	04	05
SICA	H1064870	Renewal	04	05
SICA	H1034852	Renewal	8B=19	07
SWIC	H751035	Renewal	04	05
SWIC	H1022612	Renewal	04	05
SWIC	H1157948	Renewal	04	05

## APPENDIX B – TERMINATION ERRORS

### **1. Failure to Provide Factual Basis for Cancellations – 2 Files in Error**

<b><u>POLICY NUMBER COMPANY</u></b>	<b><u>NONSPECIFIC REASON ON TERMINATION NOTICE</u></b>	<b><u>DEFICIENCY</u></b>
<b><u>H2017028 SWIC</u></b>	<b>Risk does not meet underwriting guidelines</b>	The message must be specific as to what underwriting guidelines were not met.
<b><u>H2012692 SWIC</u></b>	<b>Risk does not meet Selective's underwriting criteria due to ownership of dog on the prohibited dog list</b>	The message must be specific naming the breed of dog included on Company's prohibited list.

### **2. Failure to Properly Apply Underwriting Guidelines on New Business Cancellations Files – 21 Files in Error**

<b><u>SICA Policy #</u></b>	<b><u>SWIC Policy #</u></b>
H2025846	H2025265
H2025703	H2026783
H2019333	H2024886
H2024496	H2026786
H2015338	H2016713
H2019285	H2017258
H2022842	H2016697
H2025097	H2026058
H2025844	H2025373
H2026207	
H2018763	
H2021943	

## VERIFICATION PAGE

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I, Robert J. Only, am the Examiner-in-Charge of the Market Conduct Examination of Selective Insurance Company of America and Selective Way Insurance Company conducted by examiners of the New Jersey Department of Banking and Insurance. This verification is based on my personal knowledge as acquired in my official capacity.

The findings, conclusions and recommendations contained in the foregoing report represent, to the best of my knowledge, a full and true statement of the Market Conduct examination of Selective Insurance Company of America and Selective Way Insurance Company as of July 13, 2007.

I certify that the foregoing statements are true. I am aware that if any of the foregoing statements made by me is willfully false, I am subject to punishment.

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Date

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Robert J. Only  
Examiner-In-Charge  
New Jersey Department  
of Banking and Insurance