

MARKET CONDUCT EXAMINATION

of

STATE FARM INDEMNITY COMPANY

located in

WAYNE, NEW JERSEY

as of

December 8, 2000

by EXAMINERS

of the

STATE of NEW JERSEY

DEPARTMENT of BANKING and INSURANCE

DIVISION of ENFORCEMENT and CONSUMER PROTECTION

MARKET CONDUCT EXAMINATION UNIT

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I. INTRODUCTION

This is a report of the Market Conduct activities of one of the State Farm Insurance Companies; specifically, the State Farm Indemnity Company (hereinafter referred to as State Farm 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 were Robert Greenfield, Examiner-in-Charge, Robert J. Only, Rosalyn Benitez and Ralph J. Boeckman.

A. SCOPE OF EXAMINATION

The scope of the examination included private passenger automobile insurance sold by the company in New Jersey. The examiners conducted a limited re-examination of State Farm based on the 1995 market conduct examination report and evaluated the company's compliance with certain New Jersey insurance laws and regulations, including the Automobile Insurance Cost Reduction Act (A.I.C.R.A.) and the Fair Act. Additionally, the examination focused on the issues being addressed in the Multi-State Examination and their particular relevancy to New Jersey. The review period for the examination was September 1, 1999 to December 8, 2000. The examiners completed their field work at the company's Wayne, New Jersey offices between September 11, 2000 and October 7, 2000 and December 4-8, 2000. On various dates following fieldwork, the examiners completed additional review work and the writing of the report.

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 VI – Conducting the Property and Casualty Examination as a guide to examine the company and write this report.

B. ERROR RATIOS

Error ratios are the percentage of policies which the examiners found to be handled in error. A policy will be counted as an error when it is mishandled or the insured is treated unfairly, even if no statute or regulation is applicable. Even though a file may contain multiple errors, the examiners counted the file only once in calculating the error ratios; however, any file that contains more than one error will be cited more than once in the report. In the event that

the company corrected an error as a result of a consumer complaint or due to the examiners' findings, the error is included in the error ratio. If the company corrects an error independent of a complaint or NJDOBI intervention, the error is not included in the error ratios.

Most of the statutes and/or regulations cited in this report define unfair practices or practices in general as specific acts that an insurer commits so frequently that it constitutes an improper general business practice. Whenever the examiners find that the errors cited constitute an improper general business practice, they have stated this in the report.

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

The examiners submitted written inquiries to company representatives on the errors cited in this report. These inquiries provided State Farm the opportunity to respond to the examiners' findings and to provide exceptions to the statutory and/or regulatory errors or mishandling of files reported. In response to these inquiries, State Farm 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 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. For the most part, this is a report by exception.

C. COMPANY PROFILE

The State Farm Group was organized on March 29, 1922 in Illinois and commenced business operations on June 7, 1922. The group is now comprised of several companies with State Farm Mutual Automobile Insurance Company being the lead company of the group. The State Farm Group offers multiple lines of property/casualty and life/health insurance in all 50 states, the District of Columbia and three Canadian provinces. It is the largest personal lines property/casualty insurance group in the country.

The group's property/casualty business is underwritten by State Farm Mutual Automobile Insurance Company and four other property/casualty companies: State Farm Indemnity Company, State Farm Fire and Casualty Insurance Company, State Farm County Mutual Insurance Company of Texas, and State Farm General Insurance Company. State Farm Fire and Casualty Insurance Company was formed in 1935 and is the largest homeowner insurance carrier in the United States. Life insurance products are underwritten by three other subsidiaries. State Farm Mutual Automobile Insurance Company and State Farm Fire and Casualty Insurance Company were admitted to New Jersey by the NJDOBI in 1940. In 1992, State Farm Indemnity Company (a New Jersey only company) began operations to handle private passenger automobile insurance business in this state. The goal was to create greater underwriting and rating flexibility for this new company. The examination focused solely on the State Farm Indemnity Company, as this is the only State Farm company writing private passenger automobile insurance in New Jersey.

II. COMPLAINTS

A. INTRODUCTION

During the period of September 1, 1999 through August 31, 2000, consumers filed a total of 461 complaints against the company. The examiners reviewed 50 complaint files randomly selected from this population. In reviewing these complaints, the examiners checked for compliance with several statutes and regulations with emphasis on N.J.S.A. 17:23-1 (promptness in responding), N.J.A.C. 11:2-17.6(d) and (e) and N.J.S.A. 17:29B-4 (complaint handling procedures), and NAIC standards of Chapter VI-Conducting Property and Casualty Insurance Examinations.

B. COMPLAINT ERROR RATIOS

The examiners reviewed 50 complaint files and found one complaint handling error for an error ratio of two percent. A query from the dataset provided to the examiners was created to test the entire complaint database for timeliness. No exceptions were discovered.

<u>Complaint Category</u>	<u>Files Reviewed</u>	<u>Files in Errors</u>	<u>Error Ratio</u>
<u>Automobile</u>			
Underwriting	14	0	0%
Policyholder Services	6	1	17%
Claims	30	0	0%
Total	50	1	2%

C. COMPLAINT RECORDING ERRORS

1. Failure to Issue a Complete Response – 1 Error

N.J.A.C. 11:2-17.6(e) requires that an appropriate reply be made within 10 working days on all pertinent communications from a claimant which reasonably suggest that a response is warranted. This rule relates to the complaint handling section, standard number 3 of the NAIC Market Conduct Examiners Handbook, which states, “the company takes adequate steps to finalize and dispose of the complaint in accordance with applicable statutes, rules and regulations, and contract language.” Contrary to the regulation, on file Y059321 State Farm failed to issue an appropriate response addressing the complainant’s concerns that the company was not responding to questions of coverage regarding his policy. In response to an inquiry, State Farm disagreed with this cite. The company stated that a response was sent to the complainant

from their home office in accordance with the regulation. However, the response was merely an acknowledgement stating that the complainant's concerns would be addressed by the company's northeastern regional office. The company adequately addressed the complainant's concerns 28 days after it was received.

2. Failure to Log a Direct Consumer Complaint

N.J.S.A. 17:29B-4(10) requires insurers to maintain a complete record of all consumer complaints received by the company. This rule relates to the complaint handling section, standard one of the NAIC Market Conduct Examiners Handbook, which states, "all complaints are recorded in the required format on the company complaint register." The examiners compared the DOBI complaint records with the complaint register maintained by State Farm to check for compliance with this requirement. The examiners found that the Company failed to record complaint file 30-3368-396. In response to an inquiry, the company stated that the complaint was not forwarded to the regional office for entry into the complaint log. The company did address the complainant's concerns. The examiners did not count this failure in the error ratio chart.

D. SUMMARY AND COMPARISON WITH THE 1995 REPORT

In the 1995-market conduct report, the examiners reviewed 45 automobile complaints and found an error ratio of 11%. Errors from the 1995 report included errors in recording complaints, failure to respond promptly to a NJDOBI inquiry, failure to act with reasonable promptness on communications, and failure to accurately reply to NJDOBI communications. The Company also was cited for not having a disposition column on its complaint log.

During the current exam, the examiners reviewed 50 automobile complaints with an error ratio of two percent. The examiners found two files in error: one for failure to issue a complete response and the second for failure to log a direct complaint. This error appeared with less frequency than in the last report. State Farm's complaint handling error ratio decreased from 11% in the prior report to two percent in this report. On the files reviewed, the examiners found that State Farm resolved the complaints in a timely manner.

III. CLAIMS

A. INTRODUCTION

This review covers claims submitted under private passenger automobile insurance only. Any New Jersey claim closed during September 1, 1999 through August 31, 2000 was subject to a full review. The examiners also conducted a select review of denied PIP future treatments from February 1, 2000 to October 31, 2000. During this review period, State Farm closed 52,260 claims. In reviewing each claim, the examiners checked for compliance with all applicable statutes and regulations that govern the handling of claims as well as the NAIC standards related to claim handling. The examiners conducted specific reviews placing particular emphasis on N.J.S.A. 17:29B-4 and N.J.A.C. 11:2-17 (Unfair Claims Settlement Practices), N.J.A.C. 11:3-10 (Automobile Physical Damage Claims), N.J.S.A. 39:6A-5 (Personal Injury Protection Benefits), N.J.A.C. 11:3-4 and 11:3-5 (Personal Injury Protection Benefit - Medical Protocols/ Diagnostic Tests and PIP Dispute Resolution Procedures), N.J.A.C. 11:16-2.4(a) (reporting requirements to the National Insurance Crime Bureau). These requirements relate to the NAIC standards of Chapter VI - Property and Casualty Insurance Examinations. In addition, the examiners reviewed claims-related issues that have been the focus of an NAIC Multi-State Examination, which commenced in September 2000. The multi-state examination covered a longer review period from January 1, 1990, as opposed to this examination which dealt mostly with the company's practices since September 1, 1999.

B. ERROR/EXCEPTION RATIOS

The examiners calculated the error/exception ratios by applying the procedure outlined in the introduction of this report. Error ratios are itemized separately based on the review samples as indicated in the following charts.

<u>Random Sample</u>	<u>Files Reviewed</u>	<u>Files in Error</u>	<u>Error Ratio</u>
<u>Partial Losses</u>			
Property Damage	40	2	5%
Comprehensive	20	0	0%
Collision	23	1	4%
Personal Injury Prot	83	25	30%
Total Losses	<u>20</u>	<u>9</u>	45%
Random Totals	186	37	20%*

*Without the improper general business practices, the error ratio is 13%

(Error Ratio Chart Continued)

	<u>Files Reviewed</u>	<u>Files in Error</u>	<u>Error Ratio</u>
<u>Select Review - PIP - Medical</u>			
<u>Protocols</u>			
Paid	23	0	0%
Denials	<u>100</u>	<u>0</u>	0%
Select Totals	123	0	0%
Overall Totals	309	37	12%

C. PERSONAL INJURY PROTECTION (PIP) CLAIMS

1. PIP Claims Handled by Medical Review Vendor

As part of the Auto Insurance Cost Reduction Act (AICRA, P.L. 1998, chapters 21 and 22), the Department of Banking and Insurance established medical protocols defined at N.J.A.C. 11:3-4 et seq. Effective March 22, 1999, these protocols are used in the evaluation of "medically necessary" treatment and diagnostic testing.

In accordance with N.J.A.C. 11:3-4.7(a), "Insurers shall file for approval policy forms that provide a plan for the timely review of treatment of identified injuries at decision points and for the approval of the administration of the diagnostic tests in N.J.A.C. 11:3-4.5(b)." Insurers may also file for approval, a "Pre-Certification Plan" that provides for pre-certification of certain medical procedures, treatments, diagnostic tests, non-medical services and durable medical equipment. Although no decision point review or pre-certification requirements apply within first 10 days of the accident or to emergency care, all tests and treatments performed during this 10 day period must be "medically necessary" to be eligible for reimbursement.

State Farm received approval from the Department on December 30, 1999 for implementation of its Decision Point Review Plan/Pre-Certification Plan including a "Medical Service Review" and their forms, effective February 1, 2000.

In accordance with State Farm's approved pre-certification plan, a "medical service review" is required on all claims. A "medical service review" is the process in which the insurer or its selected vendor collects essential information about the cause of the accident and injuries, diagnosis, referrals and the proposed course of future treatment. Consolidated Services Group (CSG) of Cherry Hill, New Jersey, the vendor contracted by State Farm to

perform the service, repeats this review every 60 days while the claim remains open. The purpose of the review is to update the insured's claim file as well as to determine if future treatments will be subject to a Decision Point Review or a Pre-Certification.

The examiners did a review of 23 randomly-selected PIP claim files that were paid since February 1, 2000 and did a select review in which they tested for compliance with the regulations that govern Medical Protocols and Diagnostic Testing and with its filed Medical Protocol program. The examiners found no errors in the 23 PIP files.

In a separate review from the same time frame, the examiners analyzed 100 PIP claims, which encompassed disapproval of future treatments, medical diagnostic tests, services or procedures deemed "not medically necessary" to determine whether the denials were appropriate and compliant. After reviewing all documentation associated with these 100 denials, the examiners found that the company properly denied these claims according to N.J.A.C. 11:3-4 et seq. None of these denials were for charges already incurred; rather, they were for future treatments requested.

The examiners also observed that the majority of the claims submitted for review to CSG were eligible and approved for payment and followed the Care Path Treatment Protocols as outlined in N.J.A.C. 11:3-4. The examiners noted that the CSG Medical review summaries were individually signed by physicians and medical professionals. In addition, the examiners reviewed four denials by CSG that were medical overrides by State Farm. The company reversed the CSG denial stating "After careful consideration of all available information, State Farm has decided to extend claim payments for the proposed care..." These overrides demonstrate the Company's involvement in CSG's medical service review procedure.

2. Failure to Comply with filed and Approved Precertification Plan when Notifying Insured of Claim – 47 Errors

Pursuant to N.J.A.C. 11:3-4.7 and Bulletin 99-05, insurers are required to file for approval either a decision point review plan or a precertification plan. Bulletin 99-05 further notified insurers that any plan filed with the Department "...must include samples of all the information that will be provided to insureds at policy inception or renewal and when a loss occurs." State Farm's PIP Pre-certification/Decision Point Review Plan was approved by the NJDOBI on December 30, 1999. On February 1, 2000 the NJDOBI approved the associated forms that were submitted with this Plan.

Pursuant to Bulletin 99-05 State Farm filed a sample of the communications the Company intended to utilize in notifying claimants and providers of denied claims. The filed sample denial letters show State Farm's

undersignature and would include enclosures of CSG's Decision Point/Precertification Evaluation Letters that recommended the denial. The examiners randomly selected 100 denied PIP claims and performed a select review in which they tested for compliance with medical protocol and denial requirements only. The examiners found that CSG, instead of State Farm, routinely issued letters of denial to PIP claimants. These letters were issued on CSG letterhead. As noted, State Farm's approved filing does not identify CSG letterhead or CSG as a signatory on any of the specimen denial letters provided in this filing.

In response to an inquiry, State Farm disagreed with the examiners' findings and stated that "Although it is not an error for the purposes of this market conduct examination, we agree our actual work procedures should be consistent with our designed workflows." The examiners note, however, that State Farm's admitted inconsistency resulted in the transmission of letters that deviated from sample letters filed with and approved by the Department.

3. Delays in Paying PIP Claims -21 Errors

N.J.S.A. 39:6A-5g states that a claim "shall be overdue if not paid within 60 days after the insurer is furnished written notice of the fact of a covered loss..." N.J.A.C. 11:2-17.7(b) states that "The maximum period for all personal injury protection (PIP) claims shall be 60 calendar days after the insurer is furnished written notice of the fact of a covered loss...; provided however that an insurer may secure a 45-day extension in accordance with N.J.S.A. 39:6A-5." This rule relates to Standard Number 3 in the claims section of the NAIC Market Conduct Examination handbook that states the company should take adequate steps to resolve claims in a timely manner in accordance with applicable statutes, rules and regulations. The examiners reviewed 83 PIP claims and found that State Farm failed to settle 21 claims within the maximum 60 calendar day time frame set forth by both the statute and regulation.

Except for one claim that the examiners did not cite, the Company did not advise the claimants in writing that additional time was needed to investigate the claim. This error is discussed in more detail in the following paragraph.

PLEASE SEE APPENDIX A FOR CLAIMS IN ERROR

4. PIP Interest Errors-13 Errors (Failure to Pay Interest) - Improper General Business Practice; 1 Error (Underpayment of Interest Due)

a. Failure to Pay Interest

N.J.S.A. 39:6A-5h requires insurers to pay interest on any overdue PIP benefits. Of the 21 PIP claims cited in the prior paragraph, the examiners found a total of 13 claims where interest was owed and not paid and one underpayment. Even though the statute permits insurers to extend the time frame for paying the claim by 45 additional days beyond 60 calendar days, the Company did not issue the written notice to the claimant or the health provider advising them of additional time needed to investigate the claim. Therefore, the failure to pay interest on these 13 PIP claims for the total number of calendar days beyond 60 that the company paid the claim, is contrary to N.J.S.A. 39:6A-5h. In an inquiry response, the company agreed it did not pay interest on 13 of the 21 PIP claims (62%) for which it delayed payments beyond 60 days. This high error ratio is indicative of an improper general business practice. The examiners also cited the error in the 1995 report; this indicates that State Farm has not completely corrected the problem.

In its response to the filed market conduct examination report, the company disagreed that its failure to pay interest constituted an improper general practice. State Farm argues that, "The number of PIP payments in the 13 files was higher than the average, about 10 per file and only some of these payments were late and only some of those late payments did not include the required interest payment." However, the examiners reviewed only one randomly selected bill per file; thus, the number of bills per file has no effect on the error ratio reported. On consideration of the Company's comments, the examiners conducted a follow-up review of only those claim payments that exceeded 60 days. Out of a total of 69 delayed claim payments reviewed from a random sample of 125 files, the examiners found that the company failed to pay interest on 45 bills for an error ratio of 65%. The combined error ratio of the 90 claim payments reviewed from initial and additional samples is 64%. This additional file review supports the examiners' finding.

b. Underpayment of Interest Due

On claim number 30V074479, a bill was received on March 9, 1999. The Company issued payment to the health provider on April 24, 2000, or 307 days beyond the 105-day maximum payment period. The examiners found that the Company underpaid interest on the overdue benefits by \$6.87. In response to an examiner's inquiry, the company agreed and stated "we will issue a draft for the \$6.87 shortfall." In accordance with N.J.S.A. 39:6A-5h, the insurer is required to pay interest at the percentage of interest prescribed in the Rules Governing the Courts of the State of New Jersey for judgements, awards and orders for payment of money.

**PLEASE SEE APPENDIX A FOR CLAIMS ON WHICH THE COMPANY
FAILED TO PAY INTEREST**

5. Delay in Sending Claim Forms to First Party Claimants (PIP Applications and PIP Wage Loss Forms) - 6 Errors

In accordance with N.J.A.C. 11:2-17.6(c), every insurer, upon receiving notification of claim shall, within 10 working days, provide first party claimants the necessary claim forms, instructions and reasonable assistance so claimants can comply with the policy conditions and the insurer's reasonable requirements in presenting a claim. These rules relate to Standard Number 6 in the claims section of the Market Conduct Examination handbook that states claims should be properly handled in accordance with policy provisions and applicable statutes, rules and regulations. The examiners found four PIP claims and two PIP Wage Loss claims where the Company failed to send the necessary claim forms to the claimants in a timely manner. The failure to timely send the required forms is contrary to N.J.A.C. 11:2-17.6(c). The Company agreed with these six errors listed below.

<u>Claim Number</u>	<u>PIP Notification Date</u>	<u>PIP Application Sent</u>	<u>Working Days Beyond 10</u>
30V074479	2/9/99	3/30/99	23 workdays
30V078486	2/23/99	3/18/99	7 workdays
30V080099	3/4/99	3/20/99	2 workdays
30V092901	4/20/99	Unknown	Unknown
30V125786	8/2/99	9/3/99	13 workdays
30V143273	9/23/99	10/19/99	8 workdays

D. PHYSICAL DAMAGE AND PROPERTY DAMAGE CLAIMS

1. Failure to Send Delay Notice on Service First Claims - 1 Error

For automobile damage claims, State Farm offers first and third party claimants the option of using its Service First Program in which they utilize auto repair shops that are under contract with the Company. Claimants who utilize the Service First Program select from a list of approved repair facilities. When the Company is notified of an automobile damage loss and the claimant agrees to have repairs done at a Service First repair shop, the insured/claimant then signs an authorization to repair the vehicle. This authorization also directs State Farm to pay the repair shop instead of the insured upon completion of those repairs.

The company's claim manual states that State Farm's claims representatives should routinely monitor the Service First repairers for compliance with the requirements of the program, including pricing, customer satisfaction, and quality of repairs.

The examiners found that on collision loss (30V202231), the insured never left his car for repairs. As a result, State Farm was unable to settle the claim within the required 30 day time frame and the service first shop did not repair the vehicle until after the time frame. Insurers should make realistic attempts to resolve the claim and close out the reserve even when the insured is uncooperative or unresponsive. N.J.A.C. 11:3-10.5(b) states, "If any element of a physical damage claim remains unresolved more than 30 calendar days from the date of receipt of notice of loss by the insurer, the insurer shall provide the insured with a written explanation of the specific reasons for delay in the claim settlement." This rule requires the company to send the delay notice to the insured even on this justified delay. Further, this rule relates to Standard Number Six, the claims section of the NAIC Market Conduct Examination handbook, that states "claims are to be properly handled in accordance with policy provisions and applicable statutes, rules and regulations."

In response to inquiries addressing this issue and State Farm's reply to this report, the Company maintains that the claim has been resolved once the customer signs the authorization to repair and to directly pay the repair shop. The examiners disagree. N.J.A.C. 11:3-10.5(a) states that the claim is not resolved until the vehicle is repaired and returned to the insured. The Company's policy is therefore not in accord with this requirement. State Farm also stated that "as part of the program, the repairer agrees to report delays in repairs promptly to both the car owner and us." N.J.A.C. 11:3-10.5(b) states that this notice requirement rests with the insurer. An insurer's delegation of its notice requirements to a third party vendor, whose principal mission is to repair vehicles, increases the potential for errors in effectuating this obligation.

2. Settlement Delay and Failure to Issue Notice of Delay on Non-Service First Claim - 1 Error

N.J.A.C. 11:2-17.7(c)2 states that unless clear justification exists, or unless otherwise provided by law, insurers have a maximum of 45 days from notice of loss to settle a third party property damage claim. N.J.A.C. 11:2-17.7(f) further states that, if the claim cannot be settled within the 45 day period specified in N.J.A.C. 11:2-17.7(c)2, the insurer must send the claimant a written notice stating why additional time is needed to settle the claim. These requirements are related to Standard Number Six of the claims section of the NAIC Market Conduct Examination handbook, which specifies that claims must be handled in accordance with policy provisions, applicable statutes and regulations. On property damage claim number 30V146633, State Farm received notice of loss on November 24, 1999 and ultimately issued payment 65

days later, on January 28, 2000. Since settlement occurred 20 days beyond the maximum 45 day period, State Farm failed to comply with N.J.A.C. 11:2-17.7(c)2. Additionally, State Farm was required to but did not send a delay notice as specified in N.J.A.C. 11:2-17.7(f).

3. Failure to Provide Notice of Right of Recourse at Time of Settlement on Total Loss Claims - 7 Errors

N.J.A.C. 11:3-10.4(c) and N.J.A.C. 11:2-17.10(a) require insurers to provide insureds/claimants with a written notice of the rights of recourse at the time a total loss settlement draft is issued and to retain a copy of that notice in the claim file.

Contrary to these regulations, the Company failed to issue the written notice advising the insureds/claimants of their rights of recourse on four collision and three property damage total loss claims. All seven of these errors occurred in State Farm's drive-in claim centers located throughout the State of New Jersey.

The Company agreed with the examiner's findings on all seven claim files. In its response, the company stated "Over half the claims where we failed to send or deliver a right of recourse letter to the car owner, our claim representative had settled the total loss with the car owner in the drive-in. This takes the claim outside the usual workflow. In each instance, because the claim rep wasn't mailing any other paperwork to the claimant, he forgot to mail or deliver the right of recourse letter." The company supplemented its response by advising the examiners that it has e-mailed a reminder to the appropriate claims personnel in the drive-in centers, to provide the claimant the rights of recourse letter and document each claim file accordingly.

SEE APPENDIX A FOR FILES IN ERROR

4. After Market Parts

In accordance with the rules for fair and equitable settlements applicable to property and liability claims, the New Jersey Department of Banking and Insurance closely regulates the use of "after market" automobile replacement parts. N.J.A.C. 11:2-17.10(a)12 states, "Insurers specifying the use of after market parts shall pay for any modifications which may become necessary in making the repair." In the course of reviewing auto physical damage and property damage claims, the examiners routinely checked estimates for signs of use of any "after market" replacement parts and for compliance with N.J.A.C. 11:2-17.10(a)(10 through 13). The examiners found some evidence of "after market" part usage. In the instances where "after market" parts were utilized, the estimates in the claim files clearly identified these parts and State Farm provided the mandatory disclosure about the use of these parts in conformity with N.J.A.C. 11:2-17.10(a)13.

5. Subrogation Review

The examiners reviewed twenty randomly selected subrogation files and found that State Farm routinely pursued their indemnity payment where the opportunity for recovery existed, pursuant to N.J.A.C. 11:3-10.7(a). Moreover, the company returned the insured's deductible when recovery occurred as required. This review relates to Standard Number 8 in the claims section of the NAIC Market Conduct Examination handbook that states deductible reimbursement to insureds upon subrogation recovery should be made in a timely and accurate manner. The examiners did not find any errors.

6. Miscellaneous Errors

All rules cited below relate to Standard Number 6 in the claims section of the Market Conduct Examination handbook that states claims should be properly handled in accordance with policy provisions and applicable statutes, rules and regulations.

a. Failure to Report Salvage Retained by Third Party Claimant to the National Insurance Crime Bureau (NICB) - 1 Error

N.J.A.C. 11:16-2.4(a)2 requires all insurers to report to the National Insurance Crime Bureau (NICB) all losses involving motor vehicle salvage, however sustained, including salvage retained by a third party claimant within five working days after the sale of the salvage. On claim number 30V165107, the claimant retained the salvaged vehicle; however, the examiners found no evidence in the claim file that this was reported to the NICB in accordance with the aforementioned regulation.

The Company agreed with the error. It also advised that it issued an email to all claim representatives reminding them to report total losses to the NICB whenever the car owner keeps the salvage, first or third party claimants alike.

b. Failure to Advise Third Party Claimant of Availability of Rental Coverage - 1 Error

N.J.A.C. 11:2-17.10(a) 8 states, "When an insurer acknowledges receipt of an automobile property damage liability claim, or sooner if the claimant inquires, it shall inform the claimant whether and to what extent he or she is entitled, if the insurer's liability later becomes reasonably clear, to payment for the rental of an automobile or substitute transportation." On claim number 30V168113, the company failed to advise the third party claimant of their entitlement to a rental vehicle or to substitute transportation contrary to this regulation. The Company agreed with this error.

E. COMPARISON TO 1995 REPORT

The examiners checked for compliance with the recommendations as specified in the 1995 report and found several of the same claim errors in the current examination: failure to pay interest on overdue PIP benefits (improper general business practice in current examination), failure to advise third party claimant if rental is available (one error), and delays in sending claimants the PIP application. In the 1995 report, the examiners found 37 files in error out of 65 files reviewed for an overall error ratio of 57%. In the current exam, the examiners found errors on 37 files out of 309 claims files reviewed for an overall error ratio of 12%.

IV. POLICY TERMINATIONS

A. INTRODUCTION

During the period September 1, 1999 to August 31, 2000, State Farm Indemnity Company nonrenewed 1,997 personal automobile policies and declined 2,138 new business automobile applications within the first 60 days. The company had 507,931 automobile policies in force as of August 26, 2000. The examiners checked for compliance with applicable statutes and regulations such as N.J.A.C. 11:3-8 (nonrenewal of automobile policies), N.J.A.C. 11:3-34 (eligible persons), N.J.S.A. 17:29C-7 and N.J.S.A. 17:29C-10 (automobile insurance cancellations) and NAIC Standards 15(rejections and declinations), 16 and 17(cancellation/nonrenewal notices).

B. ERROR RATIOS

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

Random Sample Error Ratio Chart

<u>Type of Review</u>	<u>Files Reviewed</u>	<u>Files in Error</u>	<u>Error Ratio</u>
Auto Nonrenewals	51	33	65%
Auto Declinations	<u>25</u>	<u>0</u>	<u>0%</u>
Random Totals	76	33	43%*

*Excluding the improper general business practice, the overall error ratio is 1%

C. EXAMINERS FINDINGS

1. Failure to Include in the Nonrenewal Notice the Specific Reason for Termination -32 errors - Improper General Business Practice

N.J.A.C. 11:3-8.3(f) 1 states “No notice of nonrenewal shall be valid unless it includes the designated provision(s) of this subchapter under which action is being taken and the correct facts which bring the insured under the provision(s), including dates and any other facts necessary for identification of the incidents.” This regulation is related to Standard Sixteen: Termination Practices in the underwriting and rating section of the NAIC handbook which maintains that nonrenewal/cancellation notices must comply with policy provisions, state laws and company guidelines. State Farm’s procedure is to include in the nonrenewal notice the date, the points and the incident.

However, the company's information source for the incident data appears as an abbreviated code and the notice does not include a definition of the abbreviated code that would enable the insured to understand the source from where the company obtained the information. The use of the undefined abbreviated code is an improper general business practice.

In response to an inquiry, the company agreed that the abbreviations are not specific enough and should be changed. State Farm advised that it would no longer use abbreviations on non-renewal letters.

SEE APPENDIX B FOR LIST OF POLICIES IN ERROR

D. MAIL REVIEW

The examiners performed several mail reviews during the course of the examination. They found a total of 10 nonrenewal notices, 9 mid-term termination notices and 10 declination notices on several different dates. With regard to the nonrenewal notice for policy 0019312D0830E, the examiners found two errors. The errors were failure to send the nonrenewal notice between 60 and 90 days prior to expiration of the policy and failure to include in the notice the proper, designated provision of the nonrenewal regulation, contrary to N.J.A.C. 11:3-8.3(f) and N.J.A.C. 11:3-8.3(f)1(i). These errors are related to Standard seventeen: Termination Practices of the Underwriting and Rating section of the NAIC Handbook.

In response to the examiners' inquiry, the company provided a thorough explanation and concurred with the findings. They stated that they had already taken the necessary corrective action by offering the insured the option of having the policy reinstated with no lapse in coverage.

E. COMPARISON WITH 1995 REPORT

The examiners checked for compliance with the recommendations for automobile policies as specified in the 1995 report and found that the company repeated only one previously cited error. During the prior exam, the examiners cited the company for failure to issue a timely nonrenewal notice; this error appeared in the current exam on one file. In the 1995 report, the overall termination error ratio for automobile policy terminations was 3%. In the current exam the examiners found the overall error ratio to be 43% (improper general business practice included).

V. UNDERWRITING

A. INTRODUCTION

The examiners reviewed randomly selected policy files from State Farm's computer databases of 507,931 private passenger automobile policies (total of 812,690 vehicles) in force as of August 26, 2000. The examiners checked for compliance with all applicable laws and regulations including N.J.S.A. 17:29A-6, 15 and 38 (filed and approved rating methodologies); N.J.S.A. 39:6A-4.1, N.J.A.C. 11:3-21 (PIP rate discounts); and N.J.A.C. 11:3-39.6 (safety feature discounts and passive restraint discounts); and the implementation of the Auto Insurance Cost Reduction Act (AICRA), P.L. 1998, chapters 21 and 22 and NAIC standards of Chapter VI – Conducting the Property and Casualty Insurance Examinations.

B. EXAMINERS FINDINGS

1. Billing Notices Fail to State the Effect of Non-payment of Premium by the Due Date - 50 Errors - **Improper General Business Practice.**

Pursuant to N.J.A.C. 11:3-8.3(b), "Each renewal offer shall be in the usual form of either a renewal policy, a certificate, or a renewal bill. With respect to payment of the renewal premium, notice shall be given not more than 45 days nor less than 30 days prior to the expiration of the existing policy or the due date of the premium, whichever is later, and shall clearly state the effect of not paying the renewal premium by the due date." The examiners reviewed 50 renewal notices and found that State Farm mailed them to the insureds within the required 30 to 45 day timeframe.

However, the examiners found that the billing notice failed to include the effect of non-payment, contrary to N.J.A.C. 11:3-8.3(b). In the Company's response to an inquiry, it stated that "under our procedures, there is no immediate effect of not paying the renewal premium by the renewal date. If the policyholder does not pay the renewal premium by the due date then nothing happens to the policy. If the payment is not received by the due date, a notice of cancellation is mailed no less than six days later, which provides that, if payment is not received 16 days from the date of notice, the policy will be canceled as of that date." The Company also stated that "because there is no effect on the policy itself of not paying the renewal premium, N.J.A.C. 11:3-8.3(b) requirement of stating the effect of not paying the renewal premium does not apply to the renewal notice. The subsequent non-pay cancellation notice is not governed by N.J.A.C. 11:3-8.3(b), because the policy has already renewed (it is a cancellation under N.J.S.A. 17:29C-6 et seq). Of course, the cancellation notice does state the consequence of non-payment of the premium due."

However, the effect of non-payment of State Farm's premium is that the policy will cancel or that a cancellation notice will be issued. The regulation requires in all instances that the renewal billing or notice must include the effect of not paying the renewal premium by the due date. State Farm's failure to include the effect of non-payment on their renewal billings or notices constitutes an improper general business practice.

Although the Company disputes that its failure to state the effect of non-payment on its renewal billing is contrary to the regulation, it has agreed to add the following statement: "We are required by New Jersey insurance legislation to inform you that if your payment is not received within six days after the due date, a notice will be sent stating the effective date of any cancellation for non-payment."

SEE APPENDIX C FOR LIST OF POLICIES IN ERROR

C. ADVERTISING

The examiners checked for compliance with all statutory and regulatory requirements as they relate to advertising, placing particular emphasis on N.J.S.A. 17:29B-4(3), which prohibits the circulation of false statements in advertising, and N.J.S.A. 17:29B4(7), which prohibits discrimination. The examiners reviewed State Farm's radio and television advertising dialogues, marketing manual, brochures and posters. It was determined that the company is in compliance with these statutes.

State Farm was also in compliance with these statutes on its Internet website.

D. COMPARISON TO 1995 REPORT

The current examination did not reveal any of the same errors that were cited in the 1995 report. Compared to the 1995 report, the current report was the product of a more limited review of the company's underwriting practices. The Improper General Business Practice cited in this report did not occur in the prior examination.

During the course of the current examination, it was noted that the company regularly provided passive restraint, anti-theft, AICRA and two car one driver discounts on the applicable policies.

VI. RECOMMENDATIONS

State Farm should inform all responsible personnel and third party entities who 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 the Company 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, the Company had 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

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, N.J. 08625, within thirty (30) days of the date of the adopted report.

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

Claim Adjustment

"During a recent review of our claim files by market conduct examiners of the New Jersey Department of Banking and Insurance, they found we have (failed to pay or underpaid) interest on your Personal Injury Protection claim. Enclosed is our payment in the amount of (insert amount) to correct out error."

B. COMPLAINTS

1. State Farm should remind all appropriate personnel that pursuant to N.J.A.C. 11:2-17.6(e) complete responses to direct complaints must be made within 10 working days.

2. The Company should remind all appropriate personnel that N.J.S.A. 17:29B-4(10) requires insurers to maintain a complete record of all consumer complaints received by the Company.

C. CLAIMS

3. The Company must issue written instructions to all appropriate personnel, including outside vendors when applicable, that when they are handling first and third party claims, they must:
 - a. Settle all Personal Injury claims within 60 calendar days from the receipt of written notice of the loss. State Farm must also instruct all appropriate claims personnel that if the claim cannot be settled within 60 days, they may secure a 45 day extension, so long as it is secured within the 60 day period, pursuant to N.J.S.A. 39:6A-5g and N.J.A.C. 11:2-17.7(b).
 - b. Pay interest on overdue PIP benefits, when a claim payment is issued after the maximum payment period set forth under N.J.S.A. 39:6A-5h.
 - c. When paying interest on overdue PIP benefits, the Company must correctly calculate the interest owed based on the percentage of interest prescribed in the Rules Governing the Courts of the State of New Jersey pursuant to N.J.S.A. 39:6A-5h.
4. State Farm should reopen and review all delayed PIP claim payments from the beginning of the review period through the present, including the 13 PIP claims which the examiners cited for failure to pay interest in the Claims Section of this report. For all payments made beyond the 60 day required timeframe, interest of \$1.00 or more should be paid for the period of delay, as required by N.J.S.A. 39-6A-5h. See general instructions for the language to be used in the cover letter with each interest payment. A computer listing of all files reopened, including the amount of the interest paid, is to be sent to the Commissioner as compliance with this recommendation.
5. The Company must pay additional interest due under claim number 30V074479 since the correct amount was not paid initially and send a copy of the draft to the Commissioner. The Company should remind all appropriate claims personnel that the interest due on overdue PIP benefits must be calculated correctly in accordance with N.J.S.A. 39:6A-5h at the percentage of interest prescribed in the Rules Governing the Courts of the State of New Jersey.

6. State Farm must advise all claims personnel that N.J.A.C. 11:2-17.6(c) requires insurers to provide first party claimants with all forms necessary to submit a claim within 10 working days from receipt of notice of claim, including PIP applications and PIP Wage Loss claim forms.
7. State Farm should advise all claims personnel that N.J.A.C. 11:3-10.5(a) requires that first party physical damage claims must be settled within 30 calendar days, and that N.J.A.C. 11:2-17.7(c)2 requires that all third party property damage claims must be settled within 45 calendar days of receipt of notification of loss. If State Farm is unable to settle a claim within the specified timeframe, the company must send a notice of delay within the timeframes set forth by N.J.A.C. 11:3-10.5(b) for first party claims and N.J.A.C. 11:2-17.7(f) for third party claims.
8. Advise all claims personnel, including those who handle Drive-in Claim Centers located throughout the state, to send the insureds the written advisory of the rights of recourse on all total loss claims at the time the settlement draft is issued and retain a copy of that notice in the claim file pursuant to N.J.A.C. 11:3-10.4(c). In addition, the requirements of N.J.A.C. 11:3-10.4 shall be construed to apply to third party property damage claims pursuant to N.J.A.C. 11:2-17.10(a). A copy of the notice must be sent to the Commissioner as proof of compliance with this recommendation.
9. The Company should remind all claims personnel of the requirements listed below. Copies of each of the following reminders must be sent to the Commissioner indicating compliance with these recommendations:
 - a. Report all losses involving motor vehicle salvage on all model years, including salvage retained by an insured or third party claimant, to the NICB within five working days pursuant to N.J.A.C. 11:16-2.4(a)2 and 3.
 - b. Remind all appropriate personnel that when an insurer acknowledges receipt of a first party physical damage or third party property damage claim, it shall inform the claimant of the terms, conditions and availability of rental benefits or entitlement to substitute transportation pursuant to N.J.A.C. 11:2-17.10(a)7 and 11:2-17.10(a)8.

D. POLICY TERMINATIONS

10. The Company must issue written instructions to all appropriate personnel that all non-renewal letters should clearly specify the source of the event and not utilize abbreviations so as to comply with N.J.A.C. 11:3-8.3(f)1.
11. The company must issue written instructions to all appropriate personnel that nonrenewal notices must be mailed to the insured between 60 and 90 days prior to the expiration of the policy period pursuant to N.J.A.C. 11:3-8.3(f).

E. UNDERWRITING

12. State Farm should issue written instruction to all appropriate personnel that its renewal premium billing statement must clearly state the effect of nonpayment of the renewal premium by the due date so as to comply with N.J.A.C. 11:3-8.3(b).

APPENDIX A – CLAIM ERRORS

1. Failure to Comply with Filed and Approved Precertification Plan when Notifying Insured of Claim – 47 Errors

30V192012	30V229182	30V244154
30V194650	30V230180	30V244347
30V199005	30V230723	30V245451
30V199346	30V231010	30V245881
30V203055	30V231895	30V246083
30V211661	30V232230	30V247454
30V211905	30V232765	30V247960
30V215234	30V232877	30V250391
30V215461	30V233448	30V253637
30V216321	30V233926	30V254727
30V216442	30V235250	30V256140
30V216555	30V235740	30V258307
30V216975	30V235928	30V258981
30V218552	30V237057	30V259985
30V219972	30V240687	30V271645
30V226954	30V242229	

2. Failure to Pay PIP Claims Within 60 Days - 21 Errors

303497408	30V106176
30V043908	30V107509
30V055612	30V113246
30V064437	30V115064
30V076059	30V117726
30V080099	30V120254
30V086835	30V122670
30V089261	30V123592
30V091405	30V158200
30V074479	30V102869
	30V172008

3. Failure to Pay Interest on Delayed PIP Payments - **Improper General Business Practice** - 13 Errors

<u>Claim Number</u>	<u>Amount Of claim</u>	<u>Date of Receipt</u>	<u>Date Claim paid</u>	<u>Days Over 60</u>
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<u>Claim Number</u>	<u>\$ Amount Of claim</u>	<u>Date of Receipt</u>	<u>Date Claim paid</u>	<u>Days Over 60</u>
303497408*	\$ 179.20	12/9/97	3/24/98	45
30V064437	\$2,292.28	11/29/99	8/13/00	198
30V076059	\$1,285.20	6/2/99	2/14/00	197
30V086835	\$ 136.80	5/27/99	10/8/99	74
30V089261	\$2,302.00	12/6/99	4/4/00	60
30V102869	\$ 320.80	11/5/99	2/16/00	63
30V107509	\$ 734.40	11/19/99	1/31/00	13
30V113246	\$1,330.50	10/12/99	1/24/00	64
30V117726	\$ 518.40	11/16/99	6/22/00	159
30V120254	\$97.60	5/28/99	8/02/99	5
30V122670	\$ 128.00	5/18/00	8/21/00	35
30V123592	\$ 674.40	9/14/99	12/1/99	18
30V158200	\$ 112.96	3/2/00	5/17/00	16

*Claim closed in 1999

4. Failure to Provide Notice of their Rights to Recourse at Time of Settlement on Total Loss Claims - 7 Errors

30V194651 - Property Damage	30V157301 - Collision
30V168113 - Property Damage	30V161685 - Collision
30V179202 - Property Damage	30V178883 - Collision
	30V198189 - Collision

APPENDIX B - TERMINATION ERRORS

1. Failure to Include in the Nonrenewal Notice the Specific Reason for Termination - 32 Errors - Improper General Business Practice

<u>Policy Number</u>	<u>Policy Number</u>
001 2515 C23	Y27 7656 F07 30B
Y53 5164 A08	Y42 9310 D24 30C
Y53 9217 A18	X04 5323 F20 30L
007 1126 B19	Y02 9773 F21 30B
Y51 2217 D02	Y0778926F0730D
007 9803 C02	Y12 8137 F001
Y50 1495 B12	Y43 9912 F16 30B
009 3648 D28	Y26 6418 F03 30
Y51 2658 D21	Y27 2201 E15 30
Y31 0818 B22 30F	Y33 8869 D09 30
Y53 4080 A21	Y39 1265 F03 30B
Y53 4226 A04	Y41 4138 D21 30B
Y45 0878 B02	Y48 2000 A001
Y47 6215 E14	Y42 2414 C23 30C
Y49 5322 B26	Y44 6534 A12 30C
Y49 6008 A28	Y43 6294 E19 30D

APPENDIX C – UNDERWRITING AND RATING ERRORS

1. Billing Notices Fail to Clearly State the Effect of Non-payment of Premium by the Due Date - 50 Errors - **Improper General Business Practice**

X00-7417-E09-30J	Y30-5423-E10-30B	X01-2990-E10-30F
X06-4743-E10-30G	Y47-3896-E10-30	Y01-7285-E10-30C
Y30-8074-E10-30F	3-2472-E06-30B	Y01-2190-E10-30C
Y15-2819-E10-30	Y22-5523-E10-30B	X03-0603-E10-30
Y02-6011-E10-30F	X17-5557-E10-30I	Y52-5452-E10-30A
15-4980-E10-30	Y26-7426-E10-30D	X35-5493-E10-30F
3-3608-E10-30A	Y30-4302-E10-30A	X30-3307-E10-30B
3-3929-E10-30	X30-0763-E10-30G	Y27-0303-E10-30C
X23-3736-E10-30A	X04-3352-E10-30B	Y52-0801-E10-30
Y06-7799-E10-30E	Y34-2994-E10-30	9-7753-E10-30A
3-3454-E10-30A	Y07-0190-E10-30H	Y51-7095-D26-30A
15-1039-E01-30	X18-6465-E10-30B	Y11-8021-E10-30C
Y22-7729-E10-30C	9-7562-E10-30A	X14-0642-E10-30F
9-7970-E10-30D	15-5464-E10-30	X16-7319-E10-30E
X21-4023-E10-30G	Y22-9980-E10-30C	Y43-2473-E10-30D
3-3693-E10-30D	X23-2146-E10-30C	X07-9758-E10-30E
Y30-5423-E10-30B	X13-1193-E10-30D	

VERIFICATION PAGE

I, Robert Greenfield, am the Examiner-in-Charge of the Market Conduct Examination of the State Farm Indemnity 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 the State Farm Indemnity Company as of December 8, 2000.

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.

Date:

Robert Greenfield
Examiner-In-Charge
New Jersey Department
of Banking and Insurance