



# **Market Conduct Examination**

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## **Liberty Mutual Fire Insurance Company**

Boston, Massachusetts

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

Market Conduct Examination and Anti-Fraud Compliance Section

Date Report Adopted: February 19, 2010

MARKET CONDUCT EXAMINATION

of the

Liberty Mutual Fire Insurance Company

located in

Boston, Massachusetts

as of

April 7, 2008

BY EXAMINERS

of the

STATE OF NEW JERSEY  
DEPARTMENT OF BANKING AND INSURANCE

OFFICE OF CONSUMER PROTECTION SERVICES  
MARKET CONDUCT EXAMINATION AND ANTI-FRAUD COMPLIANCE SECTION

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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 Liberty Mutual Fire Insurance Company, hereinafter referred to as Liberty Mutual 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, William Sonntag and John Sivon.

The scope of the examination included homeowner and dwelling fire insurance sold by the Company in New Jersey. The examiners evaluated Liberty Mutual Fire Insurance Company's compliance with the regulations and statutes that pertain to homeowner and dwelling fire insurance claims, rating, underwriting, and terminations. The review period for the examination was January 1, 2007 through December 31, 2007. The examiners completed their fieldwork at the Company's Wilmington, Delaware office between February 25, 2008 and March 28, 2008. 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 Regulation Handbook.

## 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 Liberty Mutual 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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Liberty Mutual Fire Insurance Company was incorporated on October 31, 1908 under the laws of Massachusetts as "United Druggists Mutual Fire Insurance Company." The word "Druggists" was deleted from its title in 1918. The present name was adopted on December 15, 1949. On March 19, 2002, the Company reorganized from a mutual insurance company to a stock insurance company as part of a mutual holding company structure. In 2005, the Company transferred its domicile from Massachusetts, becoming a Wisconsin stock insurance company.

All lines of insurance, except title insurance are written by the Company and its companion carriers, Liberty Mutual Insurance Company, The First Liberty Insurance Corporation, LM Insurance Corporation, Liberty Insurance Corporation, and Liberty Life Assurance Company of Boston.

## II. CLAIMS REVIEW

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### A. INTRODUCTION

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This review covers paid and denied homeowners claims closed during the review period of January 1, 2007 to December 31, 2007. The Company closed 9,752 claims during the review period of which 5,123 were paid and 4,629 were denied. From this total, the examiners randomly selected and reviewed 25 paid and 25 denied claims.

In reviewing each claim, the examiners checked for compliance with all applicable statutes and regulations that govern timeliness requirements in settling first party claims. The examiners conducted specific reviews, placing particular emphasis on **N.J.S.A. 17:29B-4(9)** and **N.J.A.C. 11:2-17** (unfair claim and settlement practices). These requirements relate to NAIC Market Conduct standards, Section G, Chapter VIII Property and Casualty Insurance Examinations, of the Market Regulation Handbook.

### B. ERROR RATIOS

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The examiners calculated the error ratios by applying the procedure outlined in the introduction of this report. The chart below itemizes all randomly selected paid and denied claims reviewed along with total files in error and error ratio.

<b><u>Type of Claim</u></b>	<b><u>Files Reviewed</u></b>	<b><u>Files in Error</u></b>	<b><u>Error Ratio</u></b>
Paid	25	2	8%
Denied	<u>25</u>	<u>0</u>	0
Total	50	2	4%

### C. EXAMINERS' FINDINGS

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#### 1. **Failure to Disclose Pertinent Benefit (Option to Recover Depreciation Deduction from Settlement) - 2 Files in Error**

**N.J.A.C. 11:2-17.5(a)** and **(b)** states no insurer shall fail to fully disclose or conceal from first party claimants all pertinent benefits, coverages or other provisions of an insurance policy or insurance contract under which a claim is presented. Contrary to the above regulation, the examiners found two claims in which the Company failed to advise the claimant that a depreciation holdback could be recovered once repairs were

completed. This benefit is applicable in the event that repair costs exceed the initial settlement offer that includes a depreciation deduction.

The Company disagreed with this finding, stating that the file notes indicate the insured was advised of the settlement process. The examiners note, however, that the Company could not affirmatively demonstrate that it advised the policyholder that the replacement depreciation holdback could be recovered at a later time with appropriate, additional proofs of loss. Although the files in error included activity notes that stated "... explained claim process as well as next steps after initial settlement ... Explained RD and supplement process..." and variations of a similar nature, these disclosures do not include reference to the insureds' right to recoup the applicable depreciation holdback where warranted. In other files not cited for error, such disclosure was in fact stated in writing. This error occurred on 2 of 7 claims in which this error could have occurred. This represents an error rate of 29%.

**SEE APPENDIX A-1 FOR A LIST OF FILES IN ERROR**

# III. UNDERWRITING AND RATING

## A. INTRODUCTION

The examiners reviewed randomly selected dwelling fire and homeowner policy files from Liberty Mutual's in-force book of business written or renewed between January 1, 2007 and December 31, 2007. The Company reported 138,968 homeowner policies and 2,484 dwelling fire policies for a total of 141,452 in-force contracts. 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), N.J.A.C. 11:1-5.5 (flood notice) and N.J.S.A. 17:29A-4(d) (rate reductions for structures equipped with operative smoke detection devices).

## B. ERROR RATIOS

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>			
HO	25	25	100%
<b>Renewals:</b>			
HO	<u>25</u>	<u>25</u>	100%
<b>New Business &amp; Renewal Total</b>	50	50	100%

## C. EXAMINERS' FINDINGS

The examiners reviewed 50 homeowner policies to confirm that the Company provided the required notices and gave the correct premium discounts. The results of this review are as follows.

### **1. Deficient Flood Notice – 50 Files in Error (Improper General Business Practice)**



Pursuant to **N.J.A.C. 11:1-5.5(a)1** through **7**, insurers are required to provide insureds with flood insurance informational disclosures on an annual basis. The examiners determined that Liberty Mutual’s disclosure form (control number FMHO 1174 R1 in effect and used from 2/13/01 to the present) failed to include 2 of the 7 required informational items. Specifically, this form failed to include the following language:

- a. **N.J.A.C. 11:1-5.5(a)4**: “A separate policy of flood insurance may be available to cover flood damage at an additional premium.”
- b. **N.J.A.C. 11:1-5.5(a)5**: “The insurer or insurance agent should be consulted to obtain further information about how to secure flood insurance, including the availability, terms and coverage.”

In response to this error, Liberty Mutual advised that the omitted language referenced above is included as a supplemental document to a new business application. The examiners note, however, that the flood insurance notice is required annually, and not simply at policy inception. Regardless, the examiners found that the language contained in the supplemental notice did not include specific reference to additional cost (**N.J.A.C. 11:1-5.5(a)4**), and further failed to reference availability, terms and coverages (**N.J.A.C. 11:1-5.5(a)5**). Lastly, this error occurred from February 13, 2001 to the present. Accordingly, the examiners cited this error as an improper general business practice.

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

## **D. OTHER FINDINGS**

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### **1. Premium Discounts**

**N.J.S.A. 17:29A-6 & 15** requires an insurer to file its rating system with DOBI and observe those rates. Additionally, **N.J.S.A. 17:29A-4(d)** mandates an insurer to give a rate reduction for structures equipped with operative smoke detection devices.

On all 50 policies reviewed, the examiners checked for proper application of premium policy discount types in addition to fire protection code and class information as displayed on the policy declaration pages. The examiners found no error in this review.

### **2. Insurance Score**

Liberty Mutual determines insurance score by considering several factors. The examiners found no errors in the company’s use of insurance

scores to rate policies. The examiners found no instance in which insurance score was used as a sole reason to decline, cancel or non-renew a policy in New Jersey.

### **3. Fuel Storage Tanks**

The examiners reviewed Liberty Mutual's handling of above and below ground fuel storage tanks and found no rating or underwriting errors.

# IV. TERMINATIONS REVIEW

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## A. INTRODUCTION

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During the review period of January 1, 2007 to December 31, 2007, Liberty Mutual Fire Insurance Company reported that it declined 52 new business applications, cancelled 71 new business policies within the first 60 days and terminated 4,624 policies beyond the first 60 days. In the same time period, the Company nonrenewed 215 policies. The examiners randomly selected and reviewed 25 declinations, 25 non-renewals, 25 first 60-day cancellations and 25 midterm cancellations for a total of 100 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. 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>Non-renewals</b>	<b>25</b>	<b>22</b>	<b>88%</b>
<b>Declinations</b>	<b>25</b>	<b>0</b>	<b>0%</b>
<b>First 60 Day</b>	<b>25</b>	<b>0</b>	<b>0%</b>
<b>Midterm</b>	<b><u>25</u></b>	<b><u>2</u></b>	<b>8%</b>
<b>Overall Totals:</b>	<b>100</b>	<b>24</b>	<b>24%</b>

## C. EXAMINERS' FINDINGS

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### **1. Failure to Provide Standard or Reason and Factual Basis for Termination - 24 Files in Error (Improper General Business Practice)**

**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. The examiners checked for compliance with Standard 23 in the underwriting and rating section of the NAIC Market Regulation Handbook.

Contrary to this regulation, the examiners found that Liberty Mutual only gave a general reason for the termination, but did not provide the standard or reason upon which the termination is premised or specify in detail the factual basis for the cancellation on 22 nonrenewals and two mid-term cancellations. The Company agreed with the examiners' findings.

**SEE APPENDIX C-1 FOR A LIST OF POLICIES IN ERROR  
AND DESCRIPTION OF DEFICIENCY**

## V. RECOMMENDATIONS

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Liberty Mutual Fire 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 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.

Various non-compliant practices were identified in this report, some of which may extend to other jurisdictions. The company is directed to take immediate corrective action to demonstrate its ability and intention to conduct business according to New Jersey law and regulations. When applicable, corrective action for other jurisdictions should be addressed.

The examiners acknowledge that during the examination, Liberty Mutual Fire Insurance Company 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 Roebing 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 accompanies additional claim payments should be sent to the insured with an accompanying cover letter containing the following first paragraph:

"During a recent review of our files by market conduct examiners from the New Jersey Department of Banking and Insurance, they found that we failed to advise you that you had the option to recoup depreciation when we settled your homeowner claim. In the event that your repair or replacement

costs exceeded the initial claim settlement by the amount of depreciation, please contact us to determine if supplemental payments are warranted.”

## **B. CLAIMS REVIEW**

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1. In order to comply with **N.J.A.C. 11:2-17.5(a) and (b)** the Company must provide written instruction to all appropriate personnel stating that an insurer must disclose all pertinent benefits to a claimant. The Company’s instruction shall include procedures designed to assure that all first party claimants are fully aware of the option to submit documentation once repairs are complete in order to be reimbursed at full replacement cost value.

## **C. UNDERWRITING AND RATING REVIEW**

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2. In order to comply with **N.J.A.C. 11:1-5.5(a) 4 & 5**, the Company must revise the Flood Notice to include the following information:
  - a. A separate policy of flood insurance may be available to cover flood damage at an additional premium; and
  - b. The insurer or insurance agent should be consulted to obtain further information about how to secure flood insurance, including the availability, terms and coverage.

## **D. TERMINATION REVIEW**

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3. In order to comply with **N.J.A.C. 11:1-20.2(g)**, the Company must issue written instructions 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 specify in detail the factual basis upon which the insurer relies.

## APPENDIX A – CLAIM ERRORS

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1. **Failure to Disclose Pertinent Benefit (Option to Recover Depreciation Deduction from Settlement) - 2 Files in Error**

<b><u>Claim Number</u></b>	<b><u>Settlement Date</u></b>	<b><u>Amount Holdback</u></b>
HD3320080230040001	2/16/07	\$79.12
HD3320083240060001	5/31/07	\$627.11

## APPENDIX B – UNDERWRITING AND RATING ERRORS

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### 1. Deficient Flood Notice – 50 Files in Error

<u>Policy Number</u>		
*H32238122723406	*H322381768134070	H3223808072370
*H3223812186940	*H322384939607072	H322381027654071
*H322381362604073	*H322385612907071	*H322381129644078
*H322381783074071	*H422311624574072	*H3223813667540
*H322384919177074	*H422381408064077	H322381402271079
*H322385552297077	*H322311172794076	H322382057637079
*H322385601297072	*H32238140243403	H322382526891074
*H322311781504075	H322380157577071	H322382886961077
*H322385626907071	H322319615450081	*H3223848802370
*H3223815424440	H32238419077706	*H3223855294570
*H422311378354071	H322319609660080	*H3223855903770
H322315268277074	H322317769930078	*H3223856070770
H322313390381071	H322317720090077	*H32238762570005
H322380315114085	H322317657920077	H323101160440
H322380491844071	H322317075860084	
H322387776890071	H322315812360077	
H322383462621078	H322382599631076	
H3223105332940	H32238011830403	

\* New Business, otherwise Renewal



## APPENDIX C – TERMINATION ERRORS

### **1. Failure to Provide Standard or Reason and Factual Basis for Cancellation - 24 Files in Error (Improper General Business Practice)**

<b><u>Policy Number</u></b>	<b><u>Nonspecific Reason on Termination Notice</u></b>	<b><u>Deficiency</u></b>
H32238400962706 0	The policy is being nonrenewed for loss frequency. Mysterious Disappearance.	Did not give dates of losses nor state what disappeared.
H32231525873706 9	The policy is being nonrenewed for loss frequency. Fire/Removal	Did not give dates of losses.
H32238029207406 4	The policy is being nonrenewed for loss frequency. Water Damage	Did not give dates of losses.
H32238034465406 1	This policy is being non-renewed for moral hazard due to evidence of substantial risk or probability that the circumstances or personal habits of the insured may increase the possibility of loss or liability for which an insurer will be held responsible.	Did not indicate the moral hazard that increased the possibility of loss or liability.
H32231082198406 9	This policy is being non-renewed due to an increase in hazard or material change in the risk assumed by the company when the policy was written. No response to the condition letter sent.	Did not state the increase in hazard or material change in the risk.
H32231342605106 2	The policy is being nonrenewed for loss frequency. Water Damage	Did not state the dates of the losses.
H32231375823106 1	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred.
H32238043773406 7	The policy is being nonrenewed for loss frequency. Mysterious Disappearance.	Did not give dates of losses nor state what disappeared.
H32238048962406 1	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred.
H3223807909640 0	The policy is being nonrenewed due to lack of cooperation from the insured on loss control matters materially affecting insurability of the risk. No response to the condition letter.	Did not indicate what the lack of cooperation was. Did not state what was requested in the condition letter.
H32238064775416 6	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred.
H32231276962106 7	The policy is being nonrenewed for loss	Did not give dates of

	frequency. Mysterious Disappearance.	losses nor state what disappeared.
*H322381198774075	The policy is being canceled due to lack of cooperation from the insured on loss control matters materially affecting insurability of the risk. No response to the adverse condition letter sent.	Did not indicate what the lack of cooperation was. Did not state what was requested in the condition letter.
H32231315759106 0	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred.
H32238506331706 1	This policy is being non-renewed for moral hazard due to evidence of substantial risk or probability that the circumstances or personal habits of the insured may increase the possibility of loss or liability for which an insurer will be held responsible.	Did not indicate the moral hazard that increased the possibility of loss or liability.
H32231018692406 0	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred
H32231320121106 6	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred
H32231004523406 3	This policy is being non-renewed due to an increase in hazard or material change in the risk assumed by the company when the policy was written.	Did not indicate the hazard or material change in the risk.
H32231065663406 3	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred
H32231307249106 2	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred
H32231306235106 2	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred
H32231387822106 9	The policy is being nonrenewed for loss frequency. Water Damage	Did not state when the losses occurred
H32238051116406 8	The policy is being nonrenewed for loss frequency. Mysterious Disappearance.	Did not give dates of losses nor state what disappeared.
*H32238103678407 5	The policy is being nonrenewed for loss frequency. Fire/Removal	Did not state when the losses occurred

\*Midterm Cancellations, otherwise nonrenewals

## VERIFICATION PAGE

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I, Robert J. Only, am the Examiner-in-Charge of the Market Conduct Examination of Liberty Mutual Fire 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 Liberty Mutual Fire Insurance Company as of April 7, 2008.

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