

**REPORT OF
MARKET CONDUCT EXAMINATION
OF**

BALBOA INSURANCE COMPANY
Irvine, California

**AS OF
November 23, 2004**

COMMONWEALTH OF PENNSYLVANIA



**INSURANCE DEPARTMENT
MARKET CONDUCT DIVISION**

Issued: January 20, 2005

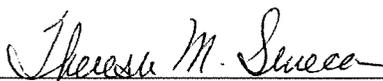
VERIFICATION

Having been duly sworn, I hereby verify that the statements made in the within document are true and correct to the best of my knowledge, information and belief. I understand that false statements made herein are subject to the penalties of 18 Pa. C.S. §4903 (relating to false swearing).

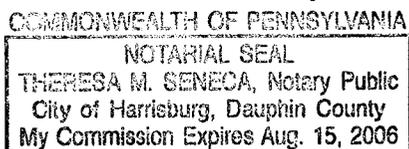

MARY K. SUTTON EXAMINER in Charge

Sworn to and Subscribed Before me

This 23rd Day of November, 2004



Notary Public



Balboa Insurance Company

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BEFORE THE INSURANCE COMMISSIONER
OF THE
COMMONWEALTH OF PENNSYLVANIA

IN RE: : VIOLATIONS:
: :
BALBOA INSURANCE COMPANY : Sections 5(a)(9), 5(a)(9)(i), 5(a)(9)(ii),
3349 Michelson Drive, Suite 200 : 5(a)(9)(iv) and 5(a)(9)(v) of the Unfair
Irvine, CA 92612 : Insurance Practices Act, Act of July 22,
: 1974, P.L. 589, No. 205 (40 P.S. §§
: 1171.5)
: :
: Title 31, Pennsylvania Code, Sections
: 146.6 and 146.7(a)(1)
: :
: Title 18, Pennsylvania Consolidated
: Statutes, Section 4117(k)
: :
Respondent. : Docket No. MC04-12-012

CONSENT ORDER

AND NOW, this 20th day of January, 2005, this Order is hereby issued by the Deputy Insurance Commissioner of the Commonwealth of Pennsylvania pursuant to the statutes cited above and in disposition of the matter captioned above.

1. Respondent hereby admits and acknowledges that it has received proper notice of its rights to a formal administrative hearing pursuant to the Administrative Agency Law, 2 Pa.C.S. § 101, et seq., or other applicable law.

2. Respondent hereby waives all rights to a formal administrative hearing in this matter, and agrees that this Consent Order shall have the full force and effect of an order duly entered in accordance with the adjudicatory procedures set forth in the Administrative Agency Law, supra, or other applicable law.

FINDINGS OF FACT

3. The Deputy Insurance Commissioner finds true and correct each of the following Findings of Fact:

- (a) Respondent is Balboa Insurance Company, and maintains its address at 3349 Michelson Drive, Suite 200, Irving, California 92612.
- (b) A market conduct examination of Respondent was conducted by the Insurance Department covering the period from January 1, 2003 through December 31, 2003.
- (c) On December 8, 2004, the Insurance Department issued a Market Conduct Examination Report to Respondent.
- (d) A response to the Examination Report was provided by Respondent on January 5, 2005.

(e) The Examination Report notes violations of the following:

- (i) Section 5(a)(9) of Act 205 (40 P.S. §1171.5), which defines an unfair act or practice as: (9) cancelling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for 60 days or more or refusing to renew any such policy unless the policy was obtained through material misrepresentation, fraudulent statements, omissions or concealment of fact material to the acceptance of the risk or to the hazard assumed by the company; or there has been a substantial change or increase in hazard in the risk assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium whether such premium is payable directly to the company or its agent or indirectly under any premium finance plan or extension of credit; or for any other reasons approved by the Commissioner pursuant to rules and regulations promulgated by the Commissioner. No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured whether at the address shown in the policy or at a forwarding address;

- (ii) Section 5(a)(9)(i) of Act 205 (40 P.S. § 1171.5), which prohibits a cancellation or refusal to renew by any person to be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (i) Be approved as to form by the Insurance Commissioner prior to use;

- (iii) Section 5(a)(9)(ii) of Act 205 (40 P.S. § 1171.5), which requires that a cancellation notice shall state the date, not less than thirty days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective;

- (iv) Section 5(a)(9)(iv) of the Unfair Insurance Practices Act, No. 205 (40 P.S. § 1171.5), which requires that a cancellation notice shall advise the insured of his right to request, in writing, within ten days of the receipt of the notice of cancellation or intention not to renew that the Insurance Commissioner review the action of the insurer;

- (v) Section 5(a)(9)(v) of the Unfair Insurance Practices Act, No. 205 (40 P.S. § 1171.5), which requires that a cancellation notice shall advise the insured of his possible eligibility for insurance under the act of July 31, 1968, the Pennsylvania Fair Plan Act;

- (vi) Title 31, Pennsylvania Code, Section 146.6, requires that every insurer shall complete investigation of a claim within 30 days after notification of the claim, unless such investigation cannot reasonably be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected;
- (vii) Title 31, Pennsylvania Code, Section 146.7(a)(1), which requires within 15 working days after receipt by the insurer of properly executed proofs of loss, the first-party claimant shall be advised of the acceptance or denial of the claim by the insurer. No insurer shall deny a claim on the grounds of a specific policy provision, condition or exclusion unless reference to such provision, condition or exclusion is included in the denial. The denial must be given to the claimant in writing and the claim file of the insurer shall contain a copy of the denial; and
- (viii) Title 18, Pennsylvania Consolidated Statutes, Section 4117(k), which requires all applications for insurance and all claim forms shall contain or have attached thereto the following notice: “Any person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading, information

concerning any fact material thereto commits a fraudulent insurance act, which is a crime and subjects such person to criminal and civil penalties.”

CONCLUSIONS OF LAW

4. In accord with the above Findings of Fact and applicable provisions of law, the Deputy Insurance Commissioner makes the following Conclusions of Law:

- (a) Respondent is subject to the jurisdiction of the Pennsylvania Insurance Department.
- (b) Respondent’s violations of Sections 5(a)(9), 5(a)(9)(i), 5(a)(9)(ii), 5(a)(9)(iv) and 5(a)(9)(v) of the Unfair Insurance Practices Act, No. 205 (40 P.S. §§ 1171.5) are punishable by the following, under Section 9 of the Unfair Insurance Practices Act (40 P.S. § 1171.9):
 - (i) cease and desist from engaging in the prohibited activity;
 - (ii) suspension or revocation of the license(s) of Respondent.
- (c) In addition to any penalties imposed by the Commissioner for Respondent’s violations of the Unfair Insurance Practices Act (40 P.S. §§ 1171.1 – 1171.5), the Commissioner may, under Sections 10 and 11 of the Unfair Insurance Practices Act (40 P.S. §§ 1171.10, 1171.11) file an action in

which the Commonwealth Court may impose the following civil penalties:

- (i) for each method of competition, act or practice which the company knew or should have known was in violation of the law, a penalty of not more than five thousand dollars (\$5,000.00);
 - (ii) for each method of competition, act or practice which the company did not know nor reasonably should have known was in violation of the law, a penalty of not more than one thousand dollars (\$1,000.00).
- (d) Respondent's violations of Title 31, Pennsylvania Code, Sections 146.6 and 146.7(a)(1) are punishable under Sections 9, 10 and 11 of the Unfair Insurance Practices Act (40 P.S. §§ 1171.9, 1171.10 and 1171.11), as stated above.

ORDER

5. In accord with the above Findings of Fact and Conclusions of Law, the Deputy Insurance Commissioner orders and Respondent consents to the following:

- (a) Respondent shall cease and desist from engaging in the activities described herein in the Findings of Fact and Conclusions of Law.

- (b) Respondent shall file an affidavit stating under oath that it will provide each of its directors, at the next scheduled directors meeting, a copy of the adopted Report and related Orders. Such affidavit shall be submitted within thirty (30) days of the date of this Order.
- (c) Respondent shall comply with all recommendations contained in the attached Report.
- (d) Respondent shall pay Twelve Thousand, Five Hundred Dollars (\$12,500.00) to the Commonwealth of Pennsylvania in settlement of all violations contained in the Report.
- (e) Payment of this matter shall be made by check payable to the Commonwealth of Pennsylvania. Payment should be directed to Sharon L. Harbert, Administrative Assistant, Bureau of Enforcement, 1227 Strawberry Square, Harrisburg, Pennsylvania 17120. Payment must be made no later than thirty (30) days after the date of this Order.

6. In the event the Deputy Insurance Commissioner finds that there has been a breach of any of the provisions of this Order, based upon the Findings of Fact and Conclusions of Law contained herein may pursue any and all legal remedies available, including but not limited to the following: The Deputy Insurance Commissioner may enforce the provisions of this Order in the Commonwealth Court of Pennsylvania or in

any other court of law or equity having jurisdiction; or the Deputy Insurance Commissioner may enforce the provisions of this Order in an administrative action pursuant to the Administrative Agency Law, supra, or other relevant provision of law.

7. Alternatively, in the event the Deputy Commissioner finds that there has been a breach of any of the provisions of this Order, the Deputy Commissioner may declare this Order to be null and void and, thereupon, reopen the entire matter for appropriate action pursuant to the Administrative Agency Law, supra, or other relevant provision of law.

8. In any such enforcement proceeding, Respondent may contest whether a breach of the provisions of this Order has occurred but may not contest the Findings of Fact and Conclusions of Law contained herein.

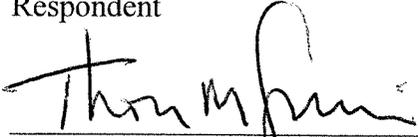
9. Respondent hereby expressly waives any relevant statute of limitations and application of the doctrine of laches for purposes of any enforcement of this Order.

10. This Order constitutes the entire agreement of the parties with respect to the matters referred to herein, and it may not be amended or modified except by an amended order signed by all the parties hereto.

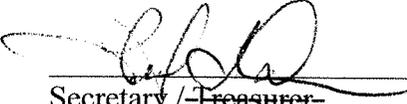
11. This Order shall be final upon execution by the Deputy Insurance Commissioner. Only the Insurance Commissioner or a duly authorized Deputy

Insurance Commissioner is authorized to bind the Insurance Department with respect to the settlement of the alleged violations of law contained herein, and this Consent Order is not effective until executed by the Insurance Commissioner or a duly authorized Deputy Insurance Commissioner.

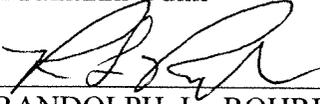
BY: BALBOA INSURANCE COMPANY,
Respondent



~~President / Vice President~~
Thomas M. Scrivener, Managing Director



~~Secretary / Treasurer~~
Franklin Dunn



RANDOLPH L. ROHRBAUGH
Deputy Insurance Commissioner
Commonwealth of Pennsylvania

I. INTRODUCTION

The market conduct examination was conducted at Balboa Insurance Company's offices located in Irvine, California, from August 2, 2004, through August 16, 2004. Subsequent review and follow-up was conducted in the office of the Pennsylvania Insurance Department.

Pennsylvania Market Conduct Examination Reports generally note only those items to which the Department, after review, takes exception. However, the Examination Report may include management recommendations addressing areas of concern noted by the Department, but for which no statutory violation was identified. This enables Company management to review those areas of concern in order to determine the potential impact upon Company operations or future compliance. A violation is any instance of Company activity that does not comply with an insurance statute or regulation. Violations contained in the Report may result in imposition of penalties.

In certain areas of review listed in this Report, the examiners will refer to "error ratio." This error ratio is calculated by dividing the number of policies with violations by the total number of policies reviewed. For example, if 100 policies are reviewed and it is determined that there are 20 violations on 10 policies, the error ratio would be 10%.

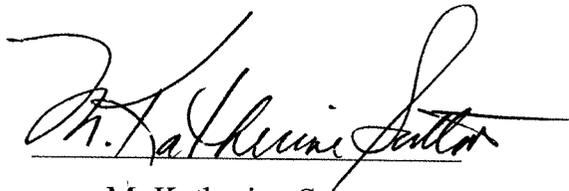
Throughout the course of the examination, Company officials were provided with status memoranda, which referenced specific policy numbers with citation to each section of law violated. Additional information was requested to clarify apparent violations. An exit conference was conducted with Company personnel to discuss the various types of violations identified during the examination and review written summaries provided on the violations found.

The courtesy and cooperation extended by the officers and employees of the Company during the course of the examination is hereby acknowledged.

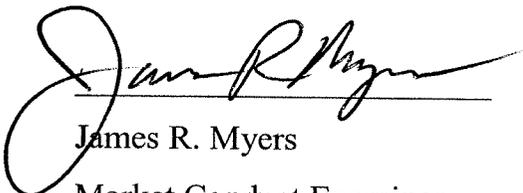
The undersigned participated in this examination and in preparation of this Report.



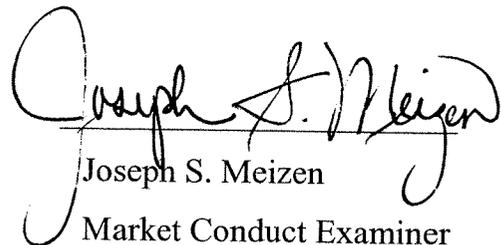
Chester A. Derk, Jr., AIE, HIA
Market Conduct Division Chief



M. Katherine Sutton
Examiner in Charge



James R. Myers
Market Conduct Examiner



Joseph S. Meizen
Market Conduct Examiner

II. SCOPE OF EXAMINATION

The Market Conduct Examination was conducted on Balboa Insurance Company, hereinafter referred to as "Company," at their office in Irvine, CA.

The examination was conducted pursuant to Sections 903 and 904 (40 P.S. § 323.3 and 323.4) of the Insurance Department Act and covered the experience period of January 1, 2003, through December 31, 2003, unless otherwise noted. The purpose of the examination was to determine the Company's compliance with Pennsylvania insurance laws and regulations.

The examination focused on Company operations in the following areas:

1. Commercial Automobile
2. Personal Property
 - Underwriting - Appropriate and timely notices of nonrenewal, midterm cancellations, 60-day cancellations and declinations.
 - Rating - Proper use of all classification and rating plans and procedures.
3. Commercial Property
4. Claims
 - Standards for prompt, fair and equitable settlements.
5. Consumer Complaints
6. Forms
7. Advertising
8. Licensing

III. COMPANY HISTORY AND LICENSING

Balboa Insurance Company was organized on February 6, 1948 under the laws of California and began business on April 15, 1948. On June 30, 1963, the Company assumed all policyholder liabilities of its former companion carrier, Arrowhead Insurance Company. Ownership of Balboa Insurance Company was held by Balboa Life Insurance Company from 1969 to 1986 when control was passed to Avco Financial Services International, Inc. The Company was subsequently sold to Associates First Capital Corporation. Associates sold Balboa Insurance Company to Countrywide Financial Corporation on November 30, 1999.

LICENSING

Balboa Insurance Company is licensed in all states, with the exception of Louisiana, and in the District of Columbia and Puerto Rico. The Company's Certificate of Authority to write business in the Commonwealth was last issued on April 1, 2004.

The Company's 2003 annual statement reflects Direct Written Premium for all lines of business in the Commonwealth of Pennsylvania as \$16,285,872. Premium volume related to the areas of this review were: Homeowners' Multiperil \$1,102,353; Fire and Allied Lines \$13,342,114; Commercial Multiperil \$26,016; and Inland Marine \$293,065.

IV. UNDERWRITING PRACTICES AND PROCEDURES

As part of the examination, the Company was requested to supply underwriting guides, bulletins, directives or other forms of underwriting procedure communications for each line of business being reviewed. Underwriting guides were furnished for personal and commercial lines property coverages. The purpose of this review was to identify any inconsistencies which could be considered discriminatory, specifically prohibited by statute or regulation, or unusual in nature. No violations were noted.

V. UNDERWRITING

The purpose of the review was to determine compliance with Act 86, Section 2 (40 P.S. §3402), which prohibits cancellation except for specified reasons and Section 3 (40 P.S. §3403), which establishes the requirements, which must be met regarding the form and condition of the cancellation notice.

A. Commercial Automobile

1. 60 Day Cancellations

A 60 day cancellation is considered to be any policy, which was cancelled within the first 60 days of the inception date of the policy.

From the universe of 14,884 commercial automobile files identified as being cancelled in the first 60 days of new business during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed. No violations were noted.

2. Midterm Cancellations

A midterm cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date.

From the universe of 9,828 commercial automobile files identified as being cancelled midterm by the Company during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed. No violations were noted.

3. Nonrenewals

A nonrenewal is considered to be any policy that was not renewed, for a specific reason, at the normal twelve-month policy anniversary date.

There were no nonrenewals reported by the Company.

B. Personal Property

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) (40P.S. §1171.5(a)(9)), which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the cancellation notice.

Homeowners

1. 60 Day Cancellations

A 60 day cancellation is considered to be any policy, which was cancelled within the first 60 days of the inception date of the policy.

From the universe of 300 homeowner policies which were cancelled within the first 60 days of new business during the experience period, 100 files were selected for review. All 100 files requested were received and reviewed. Of the 100 files selected, 34 were identified as midterm cancellations. The 136 violations noted were based on 34 files, resulting in an error ratio of 34%.

34 Violations Act 205, Section 5(a)(9)(i) [40 P.S. §1171.5(a)(9)(i)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (i) Be approved as to

form by the Insurance Commissioner prior to use. The violations resulted from the use of a Notice of Cancellation for non-payment of premium which had not been approved.

34 Violations Act 205, Section 5(a)(9)(ii) [40 P.S. §1171.5(a)(9)(ii)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (ii) State the date, not less than thirty days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective. The violations resulted from the failure to provide 30 days notice of cancellation.

34 Violations Act 205, Section 5(a)(9)(iv) [40 P.S. §1171.5(a)(9)(iv)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (iv) Advise the insured of his right to request, in writing, within ten days of the receipt of the notice of cancellation or intention not to renew that the Insurance Commissioner review the action of the insurer. The violations resulted from the failure to advise the insured of his right to request the Insurance Commissioner review the action by the insurer.

34 Violations Act 205, Section 5(a)(9)(v) [40 P.S. §1171.5(a)(9)(v)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or

at a forwarding address. Such notice shall: (v) Advise the insured of his possible eligibility for insurance under the act of July 31, 1968, known as the "The Pennsylvania Fair Plan Act".

AND

2 Adjudications--Donegal v. Hunt P87-4-15 (1987) and PA Nat'l v. Herron PI 87-3-5 (1987) affirmed 551 A. 2nd 368 (Pa Cmwlt. 1988)]

The violations resulted from a failure to advise the insured of his possible eligibility for insurance under the Pennsylvania Fair Plan.

2. Midterm Cancellations

A Midterm cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date.

From the universe of 256 homeowner policies which were cancelled midterm during the experience period, 150 files were selected for review. Of the 150 files selected, 70 were identified as 60 day cancellations. All 150 files requested were received and reviewed. The 192 violations noted were based on 55 files, resulting in an error ratio of 37%.

1 Violation Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)] - Canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless the policy was obtained through material misrepresentation, fraudulent statements, omissions or concealment of fact material to the acceptance of the risk or to the hazard assumed by the company; or there has been a substantial change or increase in hazard in the risk assumed by the company subsequent to the date

the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium when due whether such premium is payable directly to the company or its agent or indirectly under any premium finance plan or extension of credit; or for any other reasons approved by the Commissioner. The violation resulted from an improper reason for cancellation.

26 Violations Act 205, Section 5(a)(9)(i) [40 P.S. §1171.5(a)(9)(i)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (i) Be approved as to form by the Insurance Commissioner prior to use. The violations resulted from the use of a Notice of Cancellation for non-payment of premium which had not been approved.

55 Violations Act 205, Section 5(a)(9)(ii) [40 P.S. §1171.5(a)(9)(ii)]- No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall (ii) State the date, not less than thirty days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective. The violations resulted from failure to provide 30 days notice of cancellation.

55 Violations Act 205, Section 5(a)(9)(iv) [40 P.S. §1171.5(a)(9)(iv)] No cancellation or refusal to renew by any person shall be effective

unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (iv) Advise the insured of his right to request, in writing, within ten days of the receipt of the notice of cancellation or intention not to renew that the Insurance Commissioner review the action of the insurer. The violations resulted from failure to advise the insured of his right to request the Insurance Commissioner review the action by the insurer.

55 Violations Act 205, Section 5(a)(9)(v) [40 P.S. §1171.5(a)(9)(v)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (v) Advise the insured of his possible eligibility for insurance under the act of July 31, 1968, known as the "The Pennsylvania Fair Plan Act".

AND

2 Adjudications--Donegal v. Hunt P87-4-15 (1987) and PA Nat'l v. Herron PI 87-3-5 (1987) affirmed 551 A. 2nd 368 (Pa Cmwlt. 1988)]

The violations resulted from failure to advise the insured of his possible eligibility for insurance under the Pennsylvania Fair Plan Act.

3. Nonrenewals

A nonrenewal is considered to be any policy that was not renewed, for a specific reason, at the normal twelve-month policy anniversary date.

From the universe of 146 Homeowner policies which were nonrenewed during the experience period, 50 files were selected for review. Of the 50 files selected, one file was identified as a mid term cancellation. All 50 files were received and reviewed. The 45 violations noted were based on 20 files, resulting in an error ratio of 40%.

8 Violations Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)] Canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless the policy was obtained through material misrepresentation, fraudulent statements, omissions or concealment of fact material to the acceptance of the risk or to the hazard assumed by the company; or there has been a substantial change or increase in hazard in the risk assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium when due whether such premium is payable directly to the company or its agent or indirectly under any premium finance plan or extension of credit; or for any other reasons approved by the Commissioner. No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. The violations resulted from improper reasons for cancellation.

20 Violations Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)] No cancellation or refusal to renew by any person shall be effective unless a written

notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. The violations resulted from failure to send Notice of Cancellations.

5 Violations Act 205, Section 5(a)(9)(i) [40 P.S. §1171.5(a)(9)(i)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (i) Be approved as to form by the Insurance Commissioner prior to use. The violations resulted from use of forms that were not approved by the Insurance Commissioner prior to use.

2 Violations Act 205, Section 5(a)(9)(ii) [40 P.S. §1171.5(a)(9)(ii)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (ii) State the date, not less than thirty days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective. The violations resulted from failure to provide 30 days notice of cancellation.

5 Violations Act 205, Section 5(a)(9)(iv) [40 P.S. §1171.5(a)(9)(iv)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (iv) Advise the insured

of his right to request, in writing, within ten days of the receipt of the notice of cancellation or intention not to renew that the Insurance Commissioner review the action of the insurer. The violations resulted from failure to advise the insured of his right to request the Insurance Commissioner review the action by the insurer.

5 Violations Act 205, Section 5(a)(9)(v) [40 P.S. §1171.5(a)(9)(v)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall: (v) Advise the insured of his possible eligibility for insurance under the act of July 31, 1968, known as the “The Pennsylvania Fair Plan Act”.

AND

2 Adjudications--Donegal v. Hunt P87-4-15 (1987) and PA Nat'l v. Herron PI 87-3-5 (1987) affirmed 551 A. 2nd 368 (Pa Cmwlt. 1988)]

The violations resulted from failure to advise the insured of his possible eligibility for insurance under the Pennsylvania Fair Plan Act.

C. Commercial Property

The purpose of the review was to determine compliance with Act 86, Section 2 [40 P.S. §3402], which prohibits cancellation except for specified reasons, Section 3 [40 P.S. §3403], which establishes the requirements, which must be met regarding the form and condition of the cancellation notice and Section 4

(40 P.S. §3404) which establishes the requirements for the return of unearned premium to the named insured.

1. Commercial Fire - 60 Day Cancellations

A 60 day cancellation is considered to be any policy, which was cancelled within the first 60 days of the inception date of the policy.

From the universe of 5,188 commercial fire policies and 7 tenant dwelling policies, which were cancelled within the first 60 days, 107 files were selected for review. All 107 files were received and reviewed. No violations were noted.

2. Commercial Fire - Midterm Cancellations

A midterm cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date.

From the universe of 5,129 commercial fire policies, which were cancelled at midterm, 150 files were selected for review. All 150 files were received and reviewed. No violations were noted.

3. Commercial Inland Marine – 60 Day Cancellations

A 60 day cancellation is considered to be any policy, which was cancelled within the first 60 days of the inception date of the policy.

From the universe of 1,729 commercial inland marine policies, which were cancelled within the first 60 days, 100 were selected for review. All 100 files were received and reviewed. No violations were noted.

4. Commercial Inland Marine – Midterm Cancellations

A midterm cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date.

From the universe of 796 commercial inland marine policies, which were cancelled at midterm, 100 files were selected for review. All 100 files were received and reviewed. No violations were noted.

5. Commercial Property - Renewals

The purpose of the review was to measure compliance with Act 86, Section 1 (40 P.S. §3401) which requires 30 days advance notice of an increase in renewal premium.

From the universe of 1,191 commercial property policies identified by the Company as renewals during the experience period, 67 files were selected for review. All 67 files selected were received and reviewed. The policies consisted of commercial inland marine and tenant occupied dwellings. No violations were noted.

VI. RATING

The primary purpose of this portion of the review was to measure compliance with Act 246, The Casualty and Surety Rate Regulatory Act, Sections 4(a) and (h) [40 P.S. §1184], which requires every insurer to file with the Insurance Commissioner every manual of classifications, rules and rates, every rating plan and every modification of any rating plan, which it proposes to use in the Commonwealth. Also, no insurer shall make or issue a contract or policy except in accordance with filings or rates, which are in effect at the time.

The Company processes and issues policies using an automated system. In order to verify the automated system, several policies were manually rated to ensure the computer had been programmed correctly. Once the computer programming had been verified, only the input data needed to be verified. By reviewing territory assignments, fire protection classifications, dwelling construction and base premiums, the examiners were able to determine compliance with the Company's filed and approved rating plans.

A. Personal Property

1. Homeowner – New Business

New business, for the purpose of this examination, was defined as policies written for the first time by the Company during the experience period.

From the universe of 1,419 Homeowner policies written as new business during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed. No violations were noted.

2. Homeowners – Renewals

A renewal is considered to be any policy, which was previously written by the Company and renewed on the normal twelve-month anniversary date.

From the universe of 1,610 Homeowner policies reported as renewed by the Company during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed. No violations were noted.

3. Dwelling Fire – New Business

No new Dwelling Fire policies were reported by the Company during the experience period.

4. Dwelling Fire – Renewals

From the universe of 8 Dwelling Fire – Owner Occupied renewal policies identified by the Company as renewed during the experience period, all 8 files were selected for review. All 8 files selected were received and reviewed. No violations were noted.

VII. CLAIMS

The primary purpose of the review was to determine compliance with Title 31, Pa. Code Pennsylvania Code, Chapter 146, Unfair Claims Settlement Practices. The files were also reviewed to determine compliance with Act 205, Section 4 (40P.S. §1171.4) and Section 5(a)(10)(vi) (40P.S. §1171.5(a)(10)(vi), Unfair Insurance Practices Act.)

A. Commercial Automobile

1. Comprehensive Claims

From the universe of 60 commercial automobile comprehensive claims reported during the experience period, all 60 files were selected and received for review. Of the 60 files received, 16 were towing and glass claims. No violations were noted.

2. Collision Claims

From the universe of 924 commercial automobile collision claims reported during the experience period, 100 files were selected and received for review. No violations were noted.

3. Total Loss Claims

From the universe of 984 commercial automobile total loss claims reported during the experience period, 50 files were selected for review. All 50 files selected were received and reviewed. No violations were noted.

B. Personal Property

From the universe of 139 personal property claims reported during the experience period, 50 files were selected for review. All 50 files selected were

received and reviewed. The 25 violations noted were based on 24 files, resulting in an error ratio of 48%.

24 Violations Title 31, Pa. Code Section 146.6 Every insurer shall complete investigation of a claim within 30 days after notification of claim, unless such investigation cannot reasonably be completed within such time. If the investigation cannot be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected. The violations resulted from failure to send status letters as required.

1 Violation Title 31, Pa. Code, Section 146.7(a)(1) Acceptance or denial of a claim shall comply with the following: (1) Within 15 working days after receipt by the insurer of properly executed proofs of loss, the first-party claimant shall be advised of the acceptance or denial of the claim by the insurer. No insurer shall deny a claim on the grounds of a specific policy provision, condition, or exclusion unless reference to such provision, condition or exclusion is included in the denial. The denial must be given to the claimant in writing and the claim file of the insurer shall contain a copy of the denial. This violation resulted from the failure to accept or deny claim within 15 working days after receipt of proof of loss.

C. Commercial Property

From the universe of 470 Commercial Property claims reported during the experience period, 50 were selected, received and reviewed. The 6 violations noted were based on 6 files, resulting in an error ratio of 12%.

6 Violations Title 31, Pa. Code, Section 146.6 Every insurer shall complete investigation of a claim within 30 days after notification of claim, unless such investigation cannot reasonably be completed within such time. If the investigation cannot be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected. The violations resulted from failure to send the required status letters.

VIII. CONSUMER COMPLAINTS

The purpose of the review was to determine compliance with the Unfair Insurance Practices Act, No. 205 (40 P.S. §1171). Section 5(a)(11) of the Act requires a Company maintain a complete record of all complaints received during the preceding four years. This record shall evidence the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints and the time it took to process each complaint.

The Company was requested to identify all consumer complaints received during the experience period and provide copies of their consumer complaint logs for the preceding four years.

The universe of 24 complaints received by the Company during the experience period of January 1, 2003 through December 31, 2003, was selected for review. All 24 complaint files were received and reviewed.

The following violations were identified in the course of the review of each complaint.

9 Violations Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)] Prohibits canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless the policy was obtained through material misrepresentation, fraudulent statements, omissions or concealment of fact material to the acceptance of the risk or to the hazard assumed by the company; or there has been a substantial

change or increase in hazard in the risk assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium when due or for any other reasons approved by the Commissioner. The violations resulted due to policies being nonrenewed for an improper reason.

2 Violations Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)] No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. The violations resulted from failure to send the nonrenewal notice to the insured.

1 Violation Act 205, Section 5(a)(9)(ii) [40 P.S. §1171.5(a)(9)(ii)] State the date, not less than thirty days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective. The violation resulted from failure to provide 30 days notice of cancellation.

The following synopsis reflects the nature of the 24 complaints that were reviewed.

•	17	Cancellation/Nonrenewal	71%
•	4	Claims	17%
•	3	Service Issues	12%
	—		—
	24		100%

IX. FORMS

Throughout the course of the examination, all underwriting files were reviewed to identify the policy forms used in order to verify compliance with Insurance Company Law, Section 354 (40P.S. §477b), Approval of Policies, Contracts, etc., Prohibiting the Use Thereof Unless Approved. During the experience period of the examination, Section 354 provided that it shall be unlawful for any insurance company to issue, sell, or dispose of any policy contract or certificate covering fire, marine, title and all forms of casualty insurance or use applications, riders, or endorsements in connection therewith, until the forms have been submitted to and formally approved by the Insurance Commissioner. All underwriting and claim files were also reviewed to verify compliance with Act 165 of 1994 (18 Pa. CS §4117)(k)(1) which requires all insurers to provide an insurance fraud notice on all applications for insurance and all claims forms.

43 Violations Title 18, Pa. C.S. § 4117(k)(1) Insurance forms and verification of services. All applications for insurance and all claim forms shall contain or have attached thereto the following notice: Any person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading, information concerning any fact material thereto commits a fraudulent insurance act, which is a crime and subjects such person to criminal and civil penalties. One violation resulted from failure to attach a fraud statement to the personal property inventory form and the remaining 42 were due to the application for new business not including the required fraud warning.

X. ADVERTISING

The purpose of this review was to determine compliance with Act 205, Section 5 (40P.S. §1171.5), which defines unfair methods of competition and unfair or deceptive acts or practices in the business of insurance, as well as Title 31, Pa. Code, Section 51.61.

The Company was requested to provide copies of all advertising and marketing materials used during the experience period. The twenty-seven (27) pieces of advertising material provided included: direct mailers, newspaper ads, Internet, and brochures.

No violations were noted.

XI. LICENSING

In order to determine compliance by the Company and its agency force with the licensing requirements applicable to Act 147, Section 671-A (40 P.S. § 310.71) and Act 147, Section 641.1A (40 P.S. § 310.41a) of the Insurance Department Act, the Company was requested to furnish a list of all active producers during the experience period and a listing of all producers terminated during the experience period. Underwriting files and applications were also checked against department records to verify proper licensing and appointment.

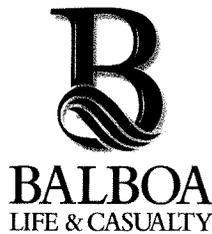
No violations were noted.

XII. RECOMMENDATIONS

The recommendations made below identify corrective measures the Department finds necessary as a result of the number of some violations, or the nature and severity of other statutory or regulatory violations, noted in the Report.

1. The Company must review Act 205, Section 5(a)(9) (40 P.S. §1171.5) regarding cancellations to ensure that violations of the types noted in the Report do not occur in the future.
2. The Company should review and revise internal control procedures to ensure compliance with the claims handling requirements of Title 31, Pennsylvania Code, Chapter 146, Unfair Claims Settlement Practices so that the violations noted in the Report do not occur in the future.
3. The Company must insure that all applications and claim forms contain a statement that clearly states in substance the following:
“Any person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false formation or conceals for the purpose of misleading, information concerning any fact material thereto commits a fraudulent insurance act, which is a crime and subjects such person to criminal and civil penalties.” This is to ensure that violations noted under Title 18 Pa.C.S. § 4117(k)(1) do not occur in the future.

XIII. COMPANY RESPONSE



January 5, 2005

Mel Martinez
First Vice President
Senior Counsel

VIA OVERNIGHT DELIVERY

Mr. Chester A. Derk, Jr., AIE, HIA
Market Conduct Division Chief
Commonwealth of Pennsylvania
Insurance Department
1321 Strawberry Square
Harrisburg, PA 17121

Re: Balboa Insurance Company
Examination Warrant Number: 04-M17-008

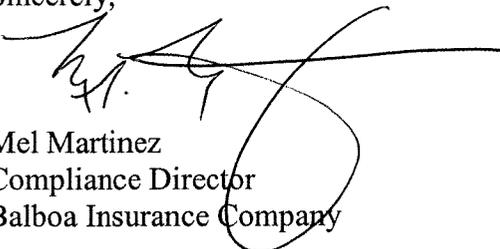
Dear Mr. Derk:

On behalf of Balboa Insurance Company ("Balboa"), I am pleased to respond to the Pennsylvania Insurance Department's Examination Report received December 9, 2004. This response supplements our presentation to you at the exit conference in Harrisburg on Thursday, October 21, 2004. We hope that you find that our attached response addresses the concerns and recommendations offered by the Department. Balboa does, however, take exception to the Department's finding with respect to Act 205, § 5(a)(9)(ii), failure to provide 30 days notice of termination (cancellation or nonrenewal). Our position is briefly explained in the Company Response to Department Recommendation #1.

Balboa endeavors to conduct its business in full compliance with the laws of the Commonwealth of Pennsylvania. As a result, necessary corrective action has been taken to ensure compliance.

We would like to take this opportunity to thank you and your staff for the professionalism and courtesy demonstrated throughout the examination process.

Sincerely,



Mel Martinez
Compliance Director
Balboa Insurance Company

cc: Ms. Heidi B. Hamman Shakely, Esq.
Eckert Seamans Cherin & Mellott, LLC

BALBOA INSURANCE COMPANY'S RESPONSE TO EXAMINATION
WARRANT NUMBER 04-M17-008

Department Recommendation #1

The Company must review Act 205, Section 5(a)(9) (40 P.S. § 1171.5) regarding cancellations to ensure that violations of the types noted in the Report do not occur in the future.

Company Response

Balboa has fully reviewed the cited sections of law and has taken the corrective measures presented at the exit conference. By way of update, all appropriate notice filings have been made and approvals secured. With respect to the failure to provide 30 days notice of cancellation, this finding was limited to the business administered on a third party vendor system. That system was programmed to provide policyholders with a 30 day notice of termination (cancellation or nonrenewal), however, the Department takes the position that Act 205, § 5(a)(9)(ii) requires one additional day and cites the Order and Adjudication (*Pursell/Goschenhoppen Mutual*, PH91-11-24 (1992)) in support of their position. *Pursell* states that when computing the 30 day time period, not only the first, but also the 30th day must be excluded. The interpretation presented in *Pursell* regarding the computation of the 30-day notice period required by §5(a)(9)(ii) was not further reviewed and decided by the Pennsylvania Commonwealth Court.

Balboa points to the clear language of the statutory section which reads: "Such notice shall... (ii) [s]tate the date, not less than 30 days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective." Under the third party vendor system used by Balboa, the termination notice would designate the 30th day after the date of mailing as the effective date of termination. For example, for a notice of cancellation, if January 1 was the date of mailing, January 31 would be the date stated in the notice on which the cancellation would take effect. The date of mailing, January 1, would be excluded from the 30 day computation, and January 31 would fall exactly 30 days after the January 1st mailing date. Balboa contends that this practice conformed to the express requirement in §5(a)(9)(ii) that the date stated for cancellation be "not less than 30 days after the date of... mailing." Pursuant to the Statutory Construction Act of 1972 (Statutory Construction Act), "[w]hen the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa. C.S. §1921(b). Contrary to this rule of statutory construction, the Department's interpretation of §5(a)(9)(ii) disregards the clear language of this section. The Department requires that the cancellation date be not less than 31 days after the mailing date, when, in fact, the statute only requires that the cancellation date be not less than 30 days after the mailing date.

The method of computation used by Balboa's third party vendor also complied with the computation of time set forth in the Statutory Construction Act, 1 Pa. C.S. §1908, which governs Pennsylvania statutes, including Act 205, §5(a)(9)(ii). §1908 states in relevant part: "When any period of time is referred to in any statute, such period in all cases, except as otherwise provided in section 1909 of this title (relating to publication for successive weeks) and section 1910 of this title (relating to computation of months) shall be so computed as to exclude the first and include the last day of such period." In the above example, the first day of the period (January 1st mailing date) was excluded and the last day of the period (January 31st date of cancellation) was included in the computation in accordance with 1 Pa. C.S. §1908.

BALBOA INSURANCE COMPANY'S RESPONSE TO EXAMINATION
WARRANT NUMBER 04-M17-008

Notwithstanding Balboa's disagreement with the Department's statutory interpretation of Act 205, §5(a)(9)(ii), Balboa has voluntarily complied by having the third party vendor system re-programmed to provide for additional days pursuant to the Department's interpretation set forth in the *Pursell* Order and Adjudication.

Department Recommendation #2

The Company should review and revise internal control procedures to ensure compliance with the claims handling requirements of Title 31, Pennsylvania Code, Chapter 146, Unfair Claims Settlement Practices so that the violations noted in the Report do not occur in the future.

Company Response

Balboa's corrective action was presented at the exit conference. Balboa will continue to review and revise internal control procedures to ensure compliance with claims handling requirements.

Department Recommendation #3

The Company must insure that all applications and claim forms contain a statement that clearly states in substance the following:

“Any person who knowingly and with intent to defraud any insurance company or other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading, information concerning any fact material thereto commits a fraudulent insurance act, which is a crime and subjects such person to criminal and civil penalties.” This is to ensure that violations noted under Title 18 Pa. C.S. § 4117(k) (1) do not occur in the future.

Company Response

The required fraud language has been added to Balboa's electronic applications. With respect to the claim forms, before the start of the examination Balboa identified that certain claim forms did not have the required language. Balboa took the appropriate corrective action to ensure all claim forms were bookmarked with the fraud language. The corrective action was presented at the exit conference.

It is further stated that any violations found by the Department in this examination, not specifically addressed by the Department in their recommendations, have been corrected and will be the subject of ongoing quality review.