

**REPORT OF
MARKET CONDUCT EXAMINATION
OF**

FARMERS' MUTUAL INSURANCE COMPANY
Elizabethtown, Pennsylvania

**AS OF
March 23, 2005**

COMMONWEALTH OF PENNSYLVANIA

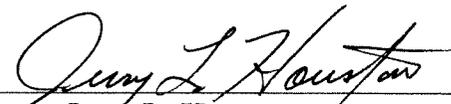


**INSURANCE DEPARTMENT
MARKET CONDUCT DIVISION**

Issued: May 12, 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).



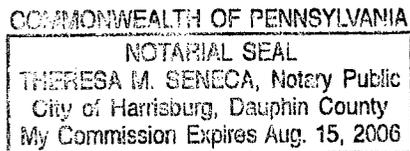
Jerry L. Houston

Sworn to and Subscribed Before me

This *1* Day of *February*, 2005



Notary Public



FARMERS' MUTUAL INSURANCE COMPANY

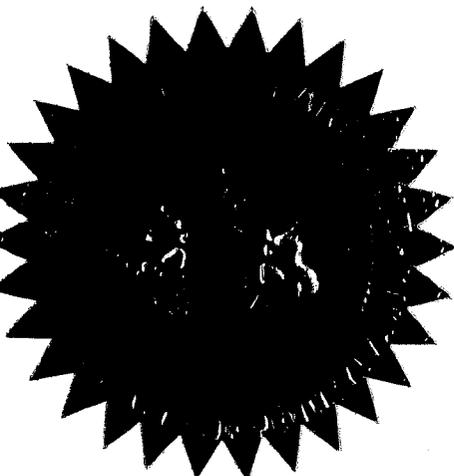
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BEFORE THE INSURANCE COMMISSIONER
OF THE
COMMONWEALTH OF PENNSYLVANIA

ORDER

AND NOW, this 29 day of April, 2002, in accordance with Section 905(c) of the Pennsylvania Insurance Department Act, Act of May 17, 1921, P.L. 789, as amended, P.S. § 323.5, I hereby designate Randolph L. Rohrbaugh, Deputy Insurance Commissioner, to consider and review all documents relating to the market conduct examination of any company and person who is the subject of a market conduct examination and to have all powers set forth in said statute including the power to enter an Order based on the review of said documents. This designation of authority shall continue in effect until otherwise terminated by a later Order of the Insurance Commissioner.



M. Diane Koken
M. Diane Koken
Insurance Commissioner

BEFORE THE INSURANCE COMMISSIONER
OF THE
COMMONWEALTH OF PENNSYLVANIA

IN RE: : VIOLATIONS:
: :
FARMERS' MUTUAL INSURANCE : Section 671-A of Act 147 of 2002
COMPANY : (40 P.S. § 310.71)
56 North Market Street :
Elizabethtown, PA 17022 : Sections 4(a) and 4(h) of the Act of
: June 11, 1947, P.L. 538, No. 246
: (40 P.S. §§ 1184)
: :
: Sections 1, 3(a)(3), 4(a) and 7(c)
: of the Act of July 3, 1986, P.L. 396,
: No. 86 (40 P.S. §§ 3401, 3403, 3404
: and 3407)
: :
: Sections 5(a)(4) and 5(a)(9) of the
: Unfair Insurance Practices Act, Act of
: July 22, 1974, P.L. 589, No. 205 (40
: P.S. §§ 1171.5)
: :
: Title 31, Pennsylvania Code, Sections
: 146.5(a), 146.6 and 146.7(a)(1)
: :
Respondent. : Docket No. MC05-03-025

CONSENT ORDER

AND NOW, this 12th day of May, 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 Farmers' Mutual Insurance Company, and maintains its address at 56 North Market Street, Elizabethtown, Pennsylvania 17022.
- (b) A market conduct examination of Respondent was conducted by the Insurance Department covering the period from July 1, 2003 through June 30, 2004.
- (c) On March 23, 2005, the Insurance Department issued a Market Conduct Examination Report to Respondent.

(d) A response to the Examination Report was provided by Respondent on April 20, 2005.

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

- (i) Section 671-A of Act 147 of 2002 prohibits producers from transacting business within this Commonwealth without written appointment as required by the Act (40 P.S. § 310.71).
- (ii) Sections 4(a) and 4(h) of the Casualty and Surety Rate Regulatory Act, No. 246 (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 this Commonwealth and prohibits an insurer from making or issuing a contract or policy with rates other than those approved;
- (iii) Section 1 of Act 86 (40 P.S. § 3401), which requires a policy of insurance covering property or casualty risks in this Commonwealth shall provide for not less than 30 days advance notice to the named insured of an increase in renewal premium;

- (iv) Section 3(a)(3) of Act 86 (40 P.S. § 3403), which requires that a cancellation notice shall provide at least 60 days advance notice of the effective date of cancellation, whichever is less;
- (v) Section 4(a) of Act 86 (40 P.S. § 3404(a)), which requires that unearned premium be returned to the insured not later than 10 business days after the effective date of termination where commercial property or casualty risks are cancelled in mid-term by the insurer;
- (vi) Section 7(c) of Act 86 (40 P.S. § 3407), which states this act does not apply to commercial property and casualty policies in effect less than 60 days, unless they are renewals. An insurer may cancel the policy provided it gives at least 30 days' notice of the termination and provided it gives notice no later than the 60th day, unless the policy provides for a longer period of notification;
- (vii) Section 5(a)(4) of Act 205 (40 P.S. § 1171.5), which prohibits entering into any agreement to commit, or by a concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of or monopoly in the business of insurance;
- (viii) 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;

- (ix) Title 31, Pennsylvania Code, Section 146.5(a), which requires every insurer, upon receiving notification of a claim, shall, within 10 working days, acknowledge the receipt of such notice unless payment is made within such period of time. If an acknowledgment is made by means other than writing, an appropriate notation of such acknowledgment shall be made in the claim file of the insurer and dated. Notification given to an agent of an insurer

shall be notification to the insurer, dating from the time the insurer receives notice;

(x) 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; and

(xi) 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.

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 Section 671-A of Act 147 of 2002 are punishable by the following, under Section 691-A of Act 147 of 2002 (40 P.S. § 310.91):
 - (i) suspension, revocation or refusal to issue the certificate of qualification or license;
 - (ii) imposition of a civil penalty not to exceed five thousand dollars (\$5,000.00) for every violation of the Act;
 - (iii) an order to cease and desist; and
 - (iv) any other conditions as the Commissioner deems appropriate.

- (c) Respondent's violations of Sections 4(a) and (h) of the Casualty and Surety Rate Regulatory Act, No. 246 (40 P.S. § 1184) are punishable under Section 16 of the Casualty and Surety Rate Regulatory Act:
 - (i) imposition of a civil penalty not to exceed \$50 for each violation or not more than \$500 for each such wilful violation;

- (ii) suspension of the license of any insurer which fails to comply with an Order of the Commissioner within the time limited by such Order, or any extension thereof which the Commissioner may grant.

- (d) Respondent's violations of Sections 1, 3(a)(3), 4(a) and 7(c) of Act 86 (40 P.S. §§ 3401, 3403, 3404 and 3407), are punishable under Section 8 (40 P.S. § 3408) of this act by one or more of the following causes of action:
 - (i) Order that the insurer cease and desist from the violation.
 - (ii) Impose a fine or not more than \$5,000 for each violation.

- (e) Respondent's violations of Sections 5(a)(4) and 5(a)(9) 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.

- (f) 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).

(g) Respondent's violations of Title 31, Pennsylvania Code, Sections 146.5(a), 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 Eighteen Thousand Dollars (\$18,000.00) 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.

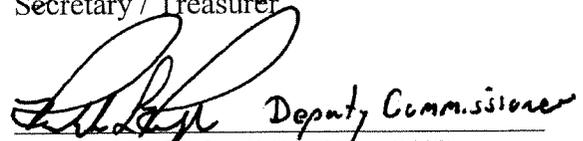
BY: FARMERS' MUTUAL INSURANCE
COMPANY, Respondent



President / Vice President



Secretary / Treasurer



RANDOLPH L. ROHRBAUGH
Deputy Insurance Commissioner
Commonwealth of Pennsylvania

I. INTRODUCTION

The market conduct examination was conducted at Farmers' Mutual Insurance Company's office located in Elizabethtown, Pennsylvania, from January 13, 2005, through January 24, 2005. 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%.

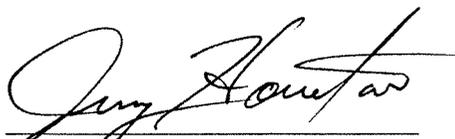
Throughout the course of the examination, Company officials were provided with status memoranda, which referenced specific policy numbers with citation to each section of law violated. Additional information was requested to clarify apparent violations. An exit conference was conducted with Company personnel 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



Jerry L. Houston, CPCU
Market Conduct Examiner



Constance V. Arnold
Market Conduct Examiner

II. SCOPE OF EXAMINATION

The Market Conduct Examination was conducted on Farmers' Mutual Insurance Company, hereinafter referred to as "Company," at their office located in Elizabethtown, Pennsylvania. 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 July 1, 2003, through June 30, 2004, 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. Personal Lines 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.
2. Commercial Lines
 - Underwriting – Appropriate and timely notices of nonrenewals, midterm cancellations, 60-day cancellations, declinations and renewals.
3. Claims
4. Forms
5. Advertising
6. Consumer Complaints
7. Producer Licensing

III. COMPANY HISTORY AND LICENSING

Farmers' Mutual Insurance Company was incorporated under the laws of Pennsylvania on January 13, 1844.

LICENSING

Farmers' Mutual Insurance Company's Certificate of Authority to write business in the Commonwealth was issued on June 8, 1844. The Company is licensed in Pennsylvania. The Company's 2003 annual statement reflects Direct Written Premium for all lines of business in the Commonwealth of Pennsylvania as \$3,527,541. Premium volume related to the areas of this review were: Fire \$729,106; Allied Lines \$283,416; Farm owners Multi Peril \$87,565; Homeowners' Multiple Peril \$1,572,347; Commercial Multiple Peril \$743,440; Inland Marine \$13,983; Other Liability \$97,685.

IV. UNDERWRITING PRACTICES AND PROCEDURES

As part of the examination, the Company was requested to supply manuals, underwriting guides, bulletins, directives or other forms of underwriting procedure communications for each line of business being reviewed. Underwriting guides and agency bulletins were furnished for personal and commercial property including farm owners and business owner's policies. 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.

The following findings were made:

3 Violations Act 205, Section 5(a)(4) [40 P.S. §1171.5(a)(4)] – Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined. Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance. The violations noted were due to the underwriting guides of the standard homeowners, dwelling fire and farm property program requiring supporting business to write seasonal or secondary residential dwellings.

V. UNDERWRITING

A. Personal Lines Property

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.

The primary purpose of the review was to determine compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(7)(iii) [40 P.S. §1171.5(a)(7)(iii)], which prohibits an insurer from canceling a policy for discriminatory reasons and Title 31, Pennsylvania Code, Section 59.9(b), which requires an insurer who cancels a policy in the first 60 days to provide at least 30 days notice of the termination.

The universe of 71 personal lines property policies, which were cancelled within the first 60 days of new business was selected for review. The property policies consisted of homeowners, tenant homeowners, owner occupied dwelling fire and mobile homeowners. All 71 files selected were received and reviewed. The 2 violations noted were based on 2 files, resulting in an error ratio of 3%.

The following findings were made:

2 Violations Act 205, Section 5(a)(4) [40 P.S. §1171.5(a)(4)]

Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance. The noted violations were the result of canceling policies with the

reason of no supporting business for secondary or seasonal residences.

2. Midterm Cancellations

A midterm cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date, and other than the first 60 days of new business.

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) [40 P.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.

From the universe of 690 personal lines property policies, which were cancelled midterm during the experience period, 191 files were selected for review. The property policies consisted of homeowners, tenant homeowners and owner occupied dwelling fire. All 191 files requested were received and reviewed. The violation noted resulted in an error ratio of 1%.

The following finding was made:

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. 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 noted violation was due to a policy cancelled for a reason not permitted under the Act.

3. Nonrenewals

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

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

The universe of 64 personal lines property policies, which were nonrenewed during the experience period, was selected for review. All 64 files selected were received and reviewed. The property policies consisted of homeowners, tenant homeowners, owner occupied dwelling fire and inland marine. The 44 violations noted were based on 44 files, resulting in an error ratio of 69%.

The following findings were made:

44 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 44 violations noted were for cancellation reasons not permitted under the Act.

4. Declinations

A declination is any application that is received by the Company and was declined to be written.

The primary purpose of the review was to determine compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(7)(iii) [40 P.S. §1171.5(a)(7)(iii)], discriminatory reasons.

The universe of 6 personal lines property declarations was selected for review. All 6 files selected were received and reviewed. No violations were noted.

B. Commercial Lines

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.

The primary purpose of the review was to determine compliance with Act 86, Section 7 (40 P.S. §3407), which requires an insurer, who cancels a policy that is in effect less than 60 days, to provide 30 days notice of termination no later than the 60th day unless the policy provides for a longer period of notification.

The universe of 41 commercial property policies, which were cancelled within the first 60 days was selected for review. All 41 files selected were received and reviewed. The commercial lines policies consisted of tenant occupied dwelling fire, commercial package, inland marine and farm owners. All 41 files selected were received and reviewed. The violation noted resulted in an error ratio of 2%.

The following finding was made:

1 Violation Act 86, Section 7(c) [40 P.S. §3407(c)]

This act does not apply to commercial property and casualty insurance policies that are in effect less than 60 days, unless they are renewals. An insurer may cancel the policy provided it gives at least 30 days' notice of the termination and provided it gives notice no later than the 60th day, unless the policy provides for a longer period of notification. The violation noted was for a cancellation notice failing to provide the minimum number of days notice.

2. Midterm Cancellations

A midterm cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date, and other than the first 60 days of new business.

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.

From the universe of 399 commercial property policies, which were cancelled during the experience period, 125 files were selected for review. The commercial policies consisted of tenant occupied dwelling fire, general liability, commercial package, commercial inland marine, and farm owners. All 125 files selected were received and reviewed. The 3 violations noted were based on 3 files, resulting in an error ratio of 2%.

The following findings were made:

2 Violations Act 86, Section 3(a)(3) [40 P.S. §3403(a)(3)]

Requires that a cancellation notice must be forwarded to the named insured or insureds at least 60 days in advance of the effective date of termination. The violations noted were for failure to provide the minimum number of days notice as required.

1 Violation Act 86, Section 4(a) [40 P.S. §3404(a)]

Requires that unearned premium be returned to the insured not later than 10 business days after the effective date of termination where commercial property or casualty risks are cancelled in mid-term by the insurer. The violation was due to unearned premium not returned to insured within the required time.

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.

The review was conducted to determine compliance with Act 86, Section 3 (40 P.S. §3403), which establishes the requirements that must be met regarding the form and condition of the nonrenewal notice.

The universe of 42 commercial lines policies identified as nonrenewals by the Company was selected for review. The commercial policies consisted of tenant occupied dwelling fire, commercial fire, commercial inland

marine, farm owners and commercial package. All 42 files selected were received and reviewed. No violations were noted.

4. Declinations

A declination is any application that is received and the Company declines to write the coverage.

The primary purpose of the review was to determine compliance with Act 205, Section 5 [40 P.S. §1171.5], which defined unfair methods of competition and unfair or deceptive acts or practices.

From the universe of 151 commercial lines applications, which the Company declined to write during the experience period, 25 files were selected for review. All 25 files selected were received and reviewed. No violations were noted.

5. 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.

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 2,204 commercial lines policies, which were renewed during the experience period, 198 files were selected for review. The commercial property policies reviewed consisted of commercial packages, tenant occupied dwelling fire, commercial fire, commercial inland marine, general liability and farm owners. All 198 files selected were received and

reviewed. The 49 violations noted were based on 49 files, resulting in an error ratio of 25%.

The following findings were made:

49 Violations Act 86, Section 1 [40 P.S. §3401]

This section provides that notwithstanding any other provision of law, a policy of insurance covering commercial property or casualty risks in this Commonwealth shall provide for not less than 30 days advance notice to the named insured of an increase in renewal premium. This section does not apply to policies written on a retrospective rating plan. The violations noted were due to the Company's failure to provide the minimum number of days notice.

VI. RATING

A. Homeowners

1. 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.

The purpose of the review was to measure compliance with Act 246, Sections 4(a) and (h) (40 P.S. §1184), which require 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.

New Business Without Surcharges

From the universe of 935 homeowner policies written as new business without surcharges during the experience period, 50 files were selected for review. All 50 files were received and reviewed. No violations were noted.

New Business With surcharges

The universe of 1 homeowner policy written as new business with a surcharge was selected for review. The file selected was received and reviewed. No violations were noted.

2. 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.

The purpose of the review was to determine compliance with Act 246, Sections 4(a) and (h) (40 P.S. §1184), which require 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.

Renewals Without Surcharges

From the universe of 5,080 homeowner policies renewed without surcharges during the experience period, 50 files were selected for review. All 50 files selected were received and reviewed. The 3,242 violations noted were based on the universe of 5,080 files, resulting in an error ratio of 64%.

The following findings were made:

3,242 Violations Act 246, The Casualty and Surety Rate Regulatory Act, Section 4 (40 P.S. §1184)

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 of issue. The violations noted were the result of the Company failing to apply a 5% loss free credit in accordance with their approved filing.

Renewals With Surcharges

The universe of 67 homeowner policies renewed with surcharges during the experience period was selected for review. All 67 files selected were received and reviewed. The violation noted resulted in an error ratio of 1%.

The following finding was made:

1 Violation Act 246, The Casualty and Surety Rate Regulatory Act, Section 4 (40 P.S. §1184)

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 of issue. The violation noted was the result of an improper surcharge, which resulted in an overcharge of \$38.

CONCERN: Homeowner policies that are surcharged for losses require a surcharge disclosure notice by the insurer in accordance with an Insurance Department Important Notice dated September 18, 1998. The Company has not provided the notice as required.

B. Dwelling Fire

1. 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.

The purpose of the review was to measure compliance with Act 246, Sections 4(a) and (h) (40 P.S. §1184), which require 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 universe of 20 dwelling fire policies written as new business during the experience period was selected for review. All 20 files selected were received and reviewed. No violations were noted.

2. 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.

The purpose of the review was to determine compliance with Act 246, 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.

From the universe of 410 dwelling fire policies renewed during the experience period, 50 files were selected for review. All 50 files selected were received and reviewed. No violations were noted.

VII. CLAIMS

The Company was requested to provide copies of all established written claim handling procedures utilized during the experience period. Written claim handling procedures were received and reviewed for any inconsistencies, which could be considered discriminatory, specifically prohibited by statute or regulation, or unusual in nature. No violations were noted.

The Claims review consisted of the following areas of review:

- A. Homeowner Claims
- B. Dwelling Fire Claims

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

A. Homeowner Claims

From the universe of 289 homeowner claims reported during the experience period, 75 files were selected for review. All 75 files selected were received and reviewed. The 4 violations noted were based on 2 files, resulting in an error ratio of 3%.

The following findings were made:

2 Violations Title 31, Pa. Code, Section 146.6

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. The 2 violations noted were due to failure to provide status letters to the claimants.

2 Violations Title 31, Pa. Code, Section 146.7(a)(1)

Within 15 working days after receipt by the insurer or properly executed proofs of loss, the first-party claimant shall be advised of the acceptance or denial of the claim by the insurer. The 2 violations noted resulted from failure to accept or deny the claim within the required time.

B. Dwelling Fire Claims

The universe of 55 dwelling fire claims reported during the experience period was selected for review. All 55 files selected were received and reviewed. The 4 violations noted were based on 4 files, resulting in an error ratio of 7%.

The following findings were made:

1 Violation Title 31, Pa. Code, Section 146.6

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. The

violation noted was due to failure to provide status letters to the claimants.

2 Violations Title 31, Pa. Code, Section 146.7(a)(1)

Within 15 working days after receipt by the insurer or properly executed proofs of loss, the first-party claimant shall be advised of the acceptance or denial of the claim by the insurer. The 2 violations noted resulted from failure to accept or deny the claim within the required time.

1 Violation Title 31, Pa. Code, Section 146.5(a)

Every insurer, upon receiving notification of a claim, shall, within ten working days, acknowledge the receipt of such notice unless payment is made within such period of time. If an acknowledgment is made by means other than writing, an appropriate notation of such acknowledgment shall be made in the claim file of the insurer and dated. Notification given to an agent of an insurer shall be notification to the insurer, dating from the time the insurer receives notice. The Company did not acknowledge the claim within 10 working days.

VIII. 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 (40 P.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. No violations were noted.

IX. ADVERTISING

The Company was requested to provide copies of all advertising, sales material and internet advertisements in use during the experience period.

The purpose of this review was to determine compliance with Act 205, Section 5 [40 P.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, Pennsylvania Code, Section 51.2(c) and Section 51.61.

The Company's only method of advertising is the Internet. The Company's Internet site was reviewed. No violations were noted.

X. CONSUMER COMPLAINTS

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 Company identified 13 consumer complaints received during the experience period and provided all consumer complaint logs requested. All 13 complaints reported, were selected and reviewed.

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 to maintain a complete record of all complaints received during the preceding four years. This record shall indicate 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. No violations were noted.

The following synopsis reflects the nature of the 13 complaints that were reviewed.

• 11	Cancellation/Nonrenewal	85%
• 2	Claims Related	15%
<hr/>		<hr/>
13		100%

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.

The following findings were made:

*6 Violations Insurance Department Act, No. 147, Section 671-A (40 P.S. §310.71)
Effective 06/04/2003*

(a) Representative of the insurer – An insurance producer shall not act on behalf of or as a representative of the insurer unless the insurance producer is appointed by the insurer. An insurance producer not acting as a representative of an insurer is not required to be appointed.

(b) Representative of the consumer – An insurance producer acting on behalf of or representing an insurance consumer shall execute a written agreement with the insurance consumer prior to representing or acting on their behalf that:

(1) Delineate the services to be provided; and

(2) Provide full and complete disclosure of the fee to be paid to the insurance producer by the insurance consumer.

(c) Notification to Department – An insurer that appoints an insurance producer shall file with the Department a notice of appointment. The notice shall state for which companies within the

insurer's holding company system or group the appointment is made.

(d) Termination of appointment – Once appointed, an insurance producer shall remain appointed by an insurer until such time as the insurer terminates the appointment in writing to the insurance producer or until the insurance producer's license is suspended, revoked or otherwise terminated.

(e) Appointment fee – An appointment fee of \$12.50 will be billed annually to the insurer for each producer appointed by the insurer during the preceding calendar year regardless of the length of time the producer held the appointment with the insurer. The appointment fee may be modified by regulation.

(f) Reporting – An insurer shall, upon request, certify to the Department the names of all licensees appointed by the insurer.

The following producers were found to be writing policies but were not found in Insurance Department records as having an appointment.

F. P. Troha Insurance
Higgins Associates
Kratzer Insurance, Inc.
Tobash Insurance Agency
Barrick & Associates, Inc.
Peter Alexander Risk Management

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 premium overcharges noted in the homeowner rating section of this report must be refunded to the insureds and proof of such refunds must be provided to the Insurance Department within 30 days of the report issue date.
2. The Company must review Act 246, Section 4(a) and (h) [40 P.S. §1184] and take appropriate measures to ensure the homeowner rating violations listed in the report do not occur in the future.
3. The Company must review Act 205, Section 5(a)(4) [40 P.S. §1171.5(a)(4)] to ensure that the violation relative to supporting coverage noted in the Report does not occur in the future.
4. The Company must review Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)] to ensure compliance with cancellation and nonrenewal notice requirements so that the violations noted in the Report do not occur in the future.
5. The Company must review and revise internal control procedures to ensure compliance relative to commercial cancellation and nonrenewal requirements of Act 86, Sections 3, 4 and 7 [40 P.S. §§3403, 3404 and 3407], so that the violations noted in the Report do not occur in the future.

6. The Company must reinforce its internal underwriting controls to ensure that notices of premium increase are provided to the named insured and meet the requirements of Act 86, Section 1 (40 P.S. §3401).

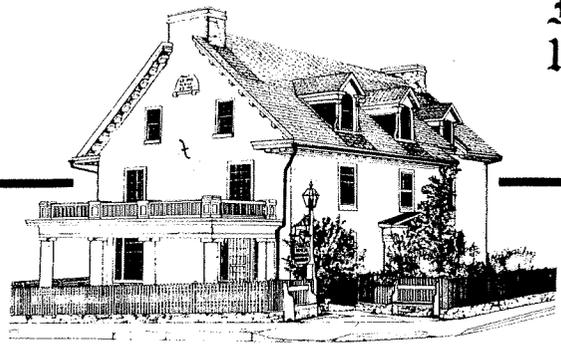
7. The Company should review and revise internal control procedures to ensure compliance with the claims handling requirements of Title 31, Pennsylvania Code, Chapter 146, Unfair Claims Settlement Practices so that the violations relating to status letters, claim acceptance and denials as noted in the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

8. The Company must ensure all producers are properly appointed, as required by Section 671-A [40 P.S. §310.71] of the Insurance Department Act No. 147, prior to accepting any business from any producer.

XIII. COMPANY RESPONSE

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FARMERS' MUTUAL INSURANCE COMPANY



April 18, 2005

Chester A Derk Jr., AIE,HIA
Market Conduct Division Chief
Pennsylvania Insurance Department
1321 Strawberry Square
Harrisburg, Pa 17120

RE: Farmers Mutual Insurance Company
Warrant Number: 04-M19-016

Dear Mr. Derk:

This will serve as the Company's response to the recommendations listed in your Report of Examination dated March 23, 2005.

1. During the examination period the Company brought the substance of this recommendation to the attention of the examiners. The Company was already in the process of addressing this recommendation. Refunds are being processed and will be completed as renewals are processed and credits provided to policyholders. Cancelled or nonrenewed policy credits are being processed as the monthly renewals are run, and specific refunds are issued.
2. Act 246, Section 4(a) and (h) [40 P.S. 1184] have been reviewed and have been addressed by the Company.
3. The Company has reviewed Act 205, Section 5 (a)(4)[P.S. 1171.5(a)(4)] and revisions to our manual have been made and are being distributed to our agency force.
4. Act 205, Section 5(a)(9)[40 P.S. 1171.5(a)(9)] has been reviewed to ensure compliance with cancellation and non renewal notices requirements.
5. Act 86, Sections 3, 4 and 7[40 P.S. 3403, 3404 and 3407] have been reviewed and internal control procedures enhanced to ensure compliance to commercial cancellation and nonrenewal requirements.

6. The Company had provided notice of premium increases per Act 86 Section 1 [40 P.S. 3401] in the years prior to the recent examination, as discussed during the exit summaries. Internal staffing problems, in some manner, led to the recommendation concerning Act 86 compliance. New procedures are in place to either send premium increase notices in accordance with Act 86, or issue and send the renewal declarations in accordance with Act 86.
7. Claims handling requirements of title 31 Pennsylvania Code, Chapter 146, Unfair Claims Practices have been reviewed. Several of the violations that were noted, occurred during hurricane Isabel in 2003, at which time we were without a claim representative employee. A new claims diary procedure is being developed to assist in adherence to the Unfair Claims Practices.
8. The Company has been contracted with Sircon since the beginning of 2004. We have properly appointed all the producers as noted in this recommendation except for one that no longer represents the Company and has no active policies.

The experience of the Examination was beneficial to the entire staff and the policyholders of Farmers' Mutual. Thank you and your staff for their efforts in this examination. The recommendations have been taken seriously and we will strive to provide our policyholders the most compliant service available.

Sincerely,



Thomas S. Inch
President