

**REPORT OF
MARKET CONDUCT EXAMINATION
OF**

FRIENDS COVE MUTUAL INSURANCE COMPANY

Bedford, Pennsylvania

**AS OF
June 14, 2004**

COMMONWEALTH OF PENNSYLVANIA



**INSURANCE DEPARTMENT
MARKET CONDUCT DIVISION**

Issued: June 30, 2004

FRIENDS COVE MUTUAL INSURANCE COMPANY

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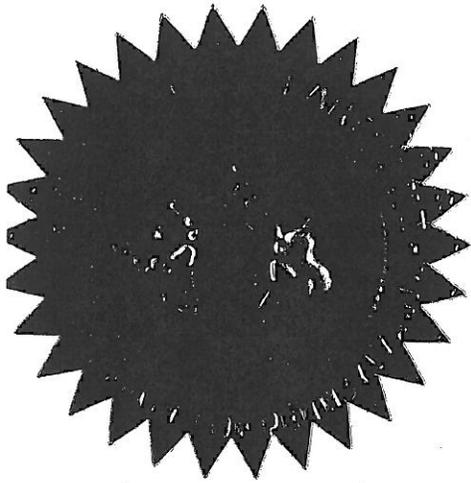
ORDER

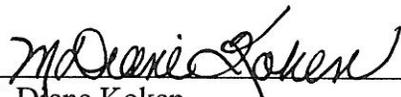
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BEFORE THE INSURANCE COMMISSIONER
OF THE
COMMONWEALTH OF PENNSYLVANIA

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
Insurance Commissioner

Friends Cove Mutual Insurance Company

Docket No.
MC04-06-098

Market Conduct Examination as of the
close of business on June 14, 2004

ORDER

A market conduct examination of Friends Cove Mutual Insurance Company was conducted in accordance with Article IX of the Insurance Department Act, 40 P.S. § 323.1, *et seq.*, for the period July 1, 2002 through June 30, 2003. The Market Conduct Examination Report disclosed exceptions to acceptable company operations and practices. Based on the documentation and information submitted by Respondent, the Department is satisfied that Respondent has taken corrective measures pursuant to the recommendations of the Examination Report.

It is hereby ordered as follows:

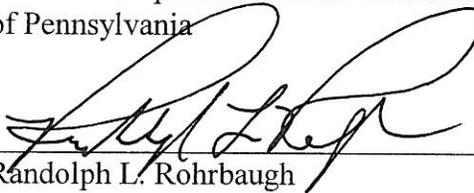
1. The attached Examination Report will be adopted and filed as an official record of this Department. All findings and conclusions resulting from the review of the Examination Report and related documents are contained in the attached Examination Report.
2. Respondent shall comply with Pennsylvania statutes and regulations.

3. Respondent shall comply with all recommendations contained in the attached Report.

4. 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.

The Department, pursuant to Section 905(e)(1) of the Insurance Department Act (40 P.S. § 323.5), will continue to hold the content of the Examination Report as private and confidential information for a period of thirty (30) days from the date of this Order.

BY: Insurance Department of the Commonwealth
of Pennsylvania



Randolph L. Rohrbaugh
Deputy Insurance Commissioner

(June 30, 2004)

I. INTRODUCTION

The market conduct examination was conducted at Friends Cove Mutual Insurance Company's offices located in Bedford, Pennsylvania from May 3, 2004, to May 14, 2004. Subsequent review and follow-up was conducted in the office of the Pennsylvania Insurance Department.

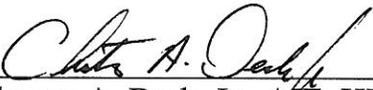
Pennsylvania Market Conduct Examination Reports generally note only those items to which the Department, after review, takes exception. However, the Examination Report may include management recommendations addressing areas of concern noted by the Department, but for which no statutory violation was 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%.

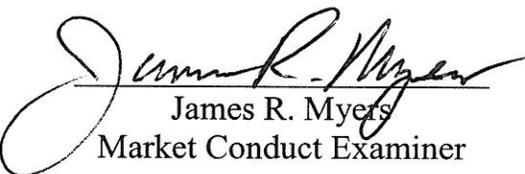
Throughout the course of the examination, Company officials were provided with status memoranda, which referenced specific policy numbers with citation to each section of law violated. Additional information was requested to clarify apparent violations. An exit conference was conducted with Company personnel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

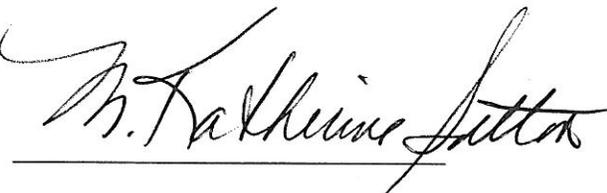
The undersigned participated in this examination and in preparation of this Report.



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



James R. Myers
Market Conduct Examiner



M. Katherine Sutton
Market Conduct Examiner

II. SCOPE OF EXAMINATION

The Market Conduct Examination was conducted on Friends Cove Mutual Insurance Company, hereinafter referred to as “Company,” at their office located in Bedford, 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, 2002, through June 30, 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. Personal Lines Property

- Underwriting – Appropriate and timely notices of nonrenewal, mid-term cancellations, 60-day cancellations and declinations.
- Rating – Proper use of all classification and rating plans and procedures.

2. Dwelling Fire

- Rating – Proper use of all classification and rating plans and procedures.

3. Commercial Lines Property

- Underwriting – Appropriate and timely notices of nonrenewal, mid-term cancellations, 60 day cancellations and declinations.

4. Claims

5. Forms

6. Advertising

7. Complaints

8. Licensing

III. COMPANY HISTORY AND LICENSING

Friends Cove Mutual Insurance Company was founded in Bedford County, Pennsylvania, in 1877. Originally known as Friends Cove Farmer's Mutual Fire Insurance Company, the Company was located in Charlesville, PA. The Company initially sold assessable policies, with the last assessment levied in October 1943. In 1958 the charter was broadened to include multiple-line coverage, and changed to non-assessable policies. The Company name later became Friends Cove Mutual Insurance Company. In 1963, upon completion of a new building, the home office moved to its current location in Bedford, PA

LICENSING

Friends Cove Mutual Insurance Company's Certificate of Authority to write business in the Commonwealth was issued on January 2, 1878. The Company is licensed in Pennsylvania only. The Company's 2002 annual statement reflects Direct Written Premium for all lines of business in the Commonwealth of Pennsylvania as \$2,601,987. Premium volume related to the areas of this review were: Fire and Allied Lines \$631,584; Homeowners' Multiple Peril \$1,930,048; and Inland Marine \$40,355.

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 homeowners, dwelling fire and commercial lines. 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:

2 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 Company requires supporting coverage to write mono line commercial liability insurance and mono line inland marine for scheduled personal property.

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 90 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, mobile homeowners and owner occupied dwelling fire. All 90 files requested were received and reviewed. The 2 violations noted were based on 2 files, resulting in error ratio of 2%.

The following findings were made.

2 Violations Act 205, Section 5(a)(9)(iii) [40 P.S. §1171.5(a)(9)(iii)]

Prohibits cancellation or refusal to renew by any person shall be effective unless a written notice of cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. The notice

shall state the specific reason or reasons of the insurer for cancellation or refusal to renew.

AND

Title 31, PA Code, §59.6(1)(2)

Requires that notices of cancellation or refusal to renew shall meet the following requirements: The reason given for cancellation or refusal to renew shall be clear and complete. If the reason is a material misrepresentation, fraudulent statement, omission or concealment of fact material to the acceptance of the risk, or to the hazard assumed by the company, made by the insured, the insurer shall specify what statements, omissions or concealments it relied on for its action; and if the reason is a substantial change or increase in hazard, the insurer shall specify the changes or increased hazards it relied on for its actions. The violations noted were for failure to provide a specific reason for cancellation.

2. Mid-term Cancellations

A mid-term cancellation is any policy termination that occurs at any time other than the twelve-month policy 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 cancellation notice.

From the universe of 812 personal lines property policies, which were cancelled mid-term during the experience period, 327 files were selected for review. The property policies consisted of homeowners, tenant homeowners, mobile homeowners, inland marine, and owner occupied dwelling fire. All 327 files requested were received and reviewed. Of the 327 files reviewed, 3 were identified as nonrenewals and 15 were identified as 60 day cancellations. The 9 violations noted were based on 9 files, resulting in an error ratio of 3%.

The following findings were made:

3 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. No cancellation or refusal to renew by any person shall be effective unless a written notice of 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 noted were for improper reasons for cancellation.

3 Violations Act 205, Section 5(a)(9)(iii) [40 P.S. §1171.5(a)(9)(iii)]

Prohibits cancellation or refusal to renew by any person shall be effective unless a written notice of cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. The notice shall state the specific reason or reasons of the insurer for cancellation or refusal to renew. The violations noted were for failure to provide a specific reason for cancellation.

2 Violations Insurance Company Law, Section 506.1 [40 P.S. §635.1]

After-Death Continuation of Basic Property Insurance. (a) Basic property insurance shall be continued one hundred and eighty days after the death of the named insured on the policy or until the sale of the property, whichever event occurs first provided that the premiums for the coverage are paid. The Company did not provide continuation of coverage 180 days after the date of death of the named insured or until the sale of the property.

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

Requires a written notice of nonrenewal must be forwarded to the named insured at least 60 days in advance of the effective date of termination. The violation noted was for failure to provide 60 days notice of nonrenewal.

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 3 personal lines property policies, which were nonrenewed during the experience period, was selected for review. The property files consisted of non-owner occupied dwelling policies. According to Company officials, the coding of the policies was in error. The policies therefore fell under Act 86 regulation rather than Act 205. All 3 files requested 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, Unfair Insurance Practices Act, Section 5(a)(7)(iii) [40 P.S. §1171.5(a)(7)(iii)], discriminatory reasons.

From the universe of 41 personal lines property applications reported as declined during the experience period, 33 files were selected for review. The files consisted of homeowners, owner occupied dwelling fire, and mobile homeowners. All 33 files requested were received and reviewed.

The 2 violations noted were based on 2 files, resulting in an error ratio of 6%.

1 Violation Act 205, Section 4 [40 P.S. §1171.4] Unfair methods of Competition and Unfair or Deceptive Acts or Practices Prohibited – No person shall engage in this State in any trade practice which is defined or determined to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.

AND

Act 205, Section 5(a)(7)(iii) [40 P.S. §1171.5(a)(7)(iii)] - “Unfair Methods of Competition” and “Unfair or Deceptive Acts or Practices” in the business of insurance means: (7) Unfairly discriminating by means of: (iii) making or permitting any unfair discrimination between individuals of the same class and essentially the same hazard with regard to underwriting standards and practices or eligibility requirements by reason of race, religion, nationality or ethnic group, age, sex, family size, occupation, place of residence, or marital status. The terms “underwriting standards and practices” or “eligibility rules” do not include the promulgation of rates if made or promulgated in accordance with the appropriate rate regulatory act of this Commonwealth and regulations promulgated by the Commissioner pursuant to such act. The violation noted was due to the Company refusing to write based on the location of the property.

1 Violation Insurance Department Act, Section 903(a) [40 P.S. §323.3]
Requires every company or person subject to examination in accordance with this act must keep all books, records, accounts, papers, documents and any or all computer or other recordings relating to its property, assets, business and affairs in such manner and for such time periods as the Department in its discretion, may require in order that its authorized representatives may ascertain whether the company or person has complied with the laws of the Commonwealth. The violation noted was for failure to provide supporting documentation for declining an application.

B. Commercial Property

1. 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 defines unfair methods of competition and unfair or deceptive acts or practices.

The universe of 33 commercial lines applications reported as declined during the experience period was selected for review. The files consisted of tenant occupied dwelling fire, commercial package, and commercial fire applications. All 33 files requested were received and reviewed. The violation noted was based on 1 file, resulted in an error ratio of 3%

1 Violation Act 205, Section 4 [40 P.S. §1171.4] Unfair methods of Competition and Unfair or Deceptive Acts or Practices Prohibited – No person shall engage in this State in any trade practice which is defined or determined to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.

AND

Act 205, Section 5(a)(7)(iii) [40 P.S. §1171.5(a)(7)(iii)] - “Unfair Methods of Competition” and “Unfair or Deceptive Acts or Practices” in the business of insurance means: (7) Unfairly discriminating by means of: (iii) making or permitting any unfair discrimination between individuals of the same class and essentially the same hazard with regard to underwriting standards and practices or eligibility requirements by reason of race, religion, nationality or ethnic group, age, sex, family size, occupation, place of residence, or marital status. The terms “underwriting standards and practices” or “eligibility rules” do not include the promulgation of rates if made or promulgated in accordance with the appropriate rate regulatory act of this Commonwealth and regulations promulgated by the Commissioner pursuant to such act. The violation noted was due to the company refusing to write based on the location of the property.

2. 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 24 property policies cancelled within the first 60 days of inception was selected for review. The policies consisted of commercial fire, commercial packages and tenant occupied dwelling fire. All 24 files selected were received and reviewed. No violations were noted.

3. Mid-term Cancellations

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

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.

From the universe of 145 commercial property policies cancelled during the experience period, 70 files were selected for review. The commercial property files consisted of commercial packages, commercial fire, and

tenant occupied dwelling fire. All 70 files were received and reviewed. The 2 violations noted were based on 2 files, resulting in an error ratio of 3%.

2 Violations Act 86, Section 3(a)(5) [40 P.S. §3403(a)(5)]

Requires that a midterm cancellation notice shall state the specific reasons for cancellation. The reasons shall identify the condition, factor or loss experience, which caused the cancellation. The notice shall provide sufficient information or data for the insured to correct the deficiency. The violations noted were the result of not providing a specific reason for cancellation.

4. 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 Company reported no policies were nonrenewed during the experience period.

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 140 commercial property policies identified by the Company as renewals during the experience period, 50 files were selected for review. The policies consisted of commercial packages. All 50 files selected were received and reviewed. No violations were noted.

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.

Homeowners - New Business Without Surcharges

From the universe of 1,867 homeowner policies written as new business without surcharges during the experience period, 75 files were selected for review. All 75 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 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.

Homeowners – Renewals Without Surcharges

From the universe of 4,262 homeowner policies renewed without surcharges during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed. No violations were noted.

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.

From the universe of 432 dwelling fire policies written as new business during the experience period 50 files were selected for review. All 50 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 938 dwelling fire policies renewed during the experience period, 50 files were selected for review. All 50 files selected were received and reviewed. The 2 violations noted were based on 2 files, resulting in an error ratio of 4%.

2 Violations Act 246, The Casualty and Surety Rate Regulatory Act, Sections 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 incorrect rating. This resulted in an undercharge of \$1.00 on one file and an overcharge of \$1.00 on one file.

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 284 homeowner claims reported during the experience period, 75 files were selected for review. All 75 files selected were received and reviewed. The 8 violations noted were based on 7 files, resulting in an error ratio of 9%.

The following findings were made:

6 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 violations noted were the result of the Company not providing the claimant with 30 day or 45 day status letters.

2 Violations Title 31, PA Code, Section 146.7

The 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. The violations noted were the result of the Company's acceptance of claims more than 15 working days after the receipt of proper proofs of loss.

B. Dwelling Fire Claims

The universe of 23 dwelling fire claims reported during the experience period was selected for review. All 23 files selected were received and reviewed. The 5 violations noted were based on 5 files, resulting in an error ratio of 22%.

The following findings were made:

5 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 violations noted were the result of the Company not providing the claimant with 30 day or 45 day status letters.

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. C.S. §4117(k)(1)] and Act 6 of 1990 [75 Pa. C.S. §1822] which requires all insurers to provide an insurance fraud notice on all applications for insurance, all claims forms and all renewals of coverage.

The following findings were made.

2 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 claims 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.” The

violations noted were for failure to have a fraud statement on
Proof of Loss claim forms.

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 provided 45 pieces of advertising, which included brochures, magazine ads, direct mailing material, and promotional items. Internet advertising was also 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 9 consumer complaints received during the experience period and provided all consumer complaint logs requested. All 9 files 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.

The following finding was made:

1 Violation 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 violation was the result of using an improper reason to cancel a policy.

The following synopsis reflects the nature of the 9 complaints that were reviewed.

• 5	Cancellation/Nonrenewal	56%
• 2	Claims Related	22%
• 2	Premium Related	22%
<hr/>		<hr/>
9		100%

XI. LICENSING

In order to determine compliance by the Company and its agency force with the licensing requirements applicable to Section 605 (40 P.S. §235) and Section 623 (40 P.S. §253) of the Insurance Department Act, the Company was requested to furnish a list of all active agents during the experience period and a listing of all agents terminated during the experience period. Underwriting files, applications, agency contracts and commission statements were also checked to verify proper licensing and appointment.

The following findings were made:

*2 Violations Insurance Department Act, Section 605 (40 P.S. §235)
Appointment.*

- (a) No agent shall do business on behalf of any entity without a written appointment from that entity.
- (b) All appointments shall be obtained by procedures established by the Insurance Department's regulations.
- (c) Insurance entities authorized by law to transact business in this Commonwealth shall, from time to time as determined by the Insurance Department, certify to the Insurance Department the names of all agents appointed by them.
- (d) Each appointment fee, both new and renewal shall be paid in full by the entity appointing the agent.

The following producers were found to be writing policies and were not found in the Insurance Department records as having an appointment by the Company.

Allen Ross Agency, Inc

Thomas Boyd Young

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 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 regarding status letters and claim acceptance as noted in the Report do not occur in the future.
2. The Company must ensure all agents, agencies and brokers are properly licensed and appointed, as required by Section 605 (40 P.S. §235) and Section 623 (40 P.S. §253) of the Insurance Department Act, prior to accepting any business from an agent or broker.
3. The Company must review Act 205, Section 5(a) [40 P.S. §1171.5(a)] to ensure that violations regarding the need for supporting coverage, requirements for cancellation notices, and refusals to write, as noted in the Report, do not occur in the future.
4. The Company must reinforce its internal underwriting controls to ensure that notices of cancellation provided to the named insured meet the requirements of Act 86, Section 3 (40 P.S. §3403).
5. The Company must review Title 31, PA Code, 59.6 to ensure that violations regarding reasons allowed for cancellation or refusal to renew, as noted in the Report, do not occur in the future.

6. The Company must review Insurance Company Law, Section 506.1 regarding the cancellation of property insurance after the death of the named insured to ensure that basic property coverage is maintained at least 180 days.

7. The premium overcharge noted in the rating section of this report must be refunded to the insured and proof of such refund must be provided to the Insurance Department within 30 days of the report issue date.

XIII. COMPANY RESPONSE



500 East Pitt Street PO Box 646
Bedford, PA 15522

Mr. Chester A. Derk, Jr., AIE, HIA
Market Conduct Division Chief
Commonwealth of Pennsylvania
Insurance Department
Bureau of Enforcement
Market Conduct Division
1321 Strawberry Square
Harrisburg, PA 17120

June 21, 2004

Dear Mr. Derk:

Subject: Examination Warrant Number 03 M22 033

The following reply is submitted in response to your letter dated June 14, 2004, regarding the Market Conduct Examination, covering the period of July 1, 2002 through June 30, 2003.

Problem areas identified in the market conduct examination are understood and steps have been taken to ensure the company remains in compliance with the Insurance Departments regulations.

Attached are the corrective actions that Friends Cove Mutual Insurance Company has taken.

I thank you for the opportunity to review and improve our Company practices, as well as the valuable information we received from your staff.

Sincerely,

A handwritten signature in black ink, appearing to read "Donald W. DeArment", written in a cursive style.

Donald W. DeArment, CPCU
President/CEO

Enclosure

DWD/mmb

FRIENDS COVE MUTUAL INSURANCE COMPANY'S RESPONSE TO EXAMINATION 03 M22 033

1. 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 regarding status letters and claim acceptance as noted in the Report do not occur in the future.

-- Procedural changes have been made, Claim adjusters have begun to issue a 30 day and 45 day open claim status letter in every applicable case, with a copy retained in our file. Claim adjusters will use a Proof of Loss form, which contains the Pennsylvania fraud statement. Claim Adjusters will take action within 15 days after receiving a signed Proof of Loss or other information requested of the insured. That action is either to pay the claim, acknowledge to the insured that it will be paid, or to deny the claim and explain the reason for denial. Programming has also been added to our software system to ensure status letters are mailed on a timely basis.

2. The Company must ensure all agents, agencies and brokers are properly licensed and appointed, as required by Section 605 (40 P.S. §235) and Section 623 (40 P.S. §253) of the Insurance Department Act, prior to accepting any business from an agent or broker.

--All licenses are verified annually with each agency to ensure their active status. Underwriters are required to verify that each new application submission is signed or initialed by an agent properly licensed with Friends Cove Mutual Insurance Company.

3. The Company must review Act 205, Section 5 (a) [40 P.S. §1171.5(a)] to ensure that violations regarding the need for supporting coverage, requirements for cancellation notices, and refusals to write, as noted in the Report, do not occur in the future.

-- Friends Cove Mutual will stand by the Department's decision of not requiring supporting coverage. Our Underwriting Guide has been reissued to remove reference to supporting coverage requirements.

--Procedural changes have been established to ensure the requirements for cancellation notices and refusals to write are in compliance with the Insurance Department regulations. A detailed reason for cancellation will be stated clearly and specifically on the notice of cancellation/refusal to renew. If referring to a previous risk improvement recommendation letter, we will either restate each requirement or indicate that the letter is attached, and include it with each copy of the cancellation notice (to insured, additional insured, agent, and mortgagees). If the cancellation is due to underwriting guidelines, these guidelines will be stated.

--If the risk is being rejected a detailed reason will be stated clear, complete and non-discriminatory. And documentation will be logged in our Company Declination file.

4. The Company must reinforce its internal underwriting controls to ensure that notice of cancellation provided to the named insured meet the requirements of Act 86, Section 3 (40 P.S. §3403).

--Friends Cove Mutual is now complying with Act 86, Section 3 (40 P.S. §3403). All underwriters have been made aware of the required timeframes and are processing Notices of Cancellation in a timely manner.

5. The Company must review Title 31, PA Code, 59.5 to ensure that violations regarding reasons allowed for cancellation or refusal to renew, as noted in the Report, do not occur in the future.

--This matter was reviewed immediately with the underwriting staff to ensure that reasons for cancellation or refusal to renew are to be stated clear, complete and non-discriminatory. A specific reason will now be referenced on every cancellation notice issued.

6. The Company must review Insurance Company Laws, Section 506.1 regarding the cancellation of property insurance after the death of the named insured to ensure that basic property coverage is maintained at least 180 days.

--This matter was reviewed immediately with underwriting staff to ensure that continuation of coverage is offered in compliance with regulations. Friends Cove Mutual Insurance Company will continue basic property insurance for at least 180 days following notification of death of the named insured.

7. The premium overcharge noted in the rating section of this report must be refunded to the insured and proof of such refund must be provided to the Insurance Department within 30 days of the report issue date.

--We agreed with the Department's findings. We overcharged on a policy due to a promulgation error in the fire base premium computer calculation program. The error has been corrected in our rating system; the correct base premium has been hard coded. Overcharged premium is being returned to the policyholder. Proof of such is under separate cover en route to the Insurance Department.