

**REPORT OF  
MARKET CONDUCT EXAMINATION  
OF**

**FARMERS' AND MECHANICS' MUTUAL  
INSURANCE COMPANY**  
Lititz, Pennsylvania

**AS OF  
October 8, 2003**

**COMMONWEALTH OF PENNSYLVANIA**



**INSURANCE DEPARTMENT  
MARKET CONDUCT DIVISION**

**Issued: November 20, 2003**

# FARMERS' AND MECHANICS' MUTUAL INSURANCE COMPANY

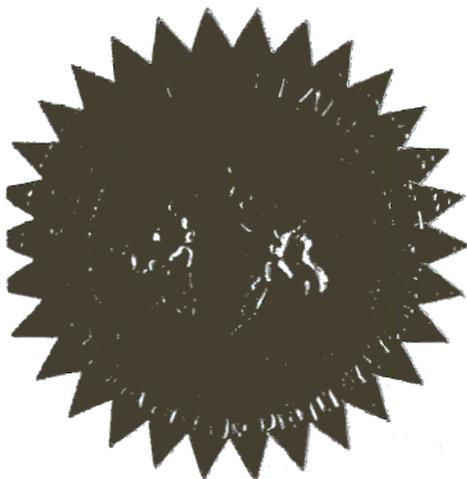
## TABLE OF CONTENTS

Order		
I.	Introduction.....	1
II.	Scope of Examination.....	3
III.	Company History/Licensing.....	5
IV.	Underwriting Practices and Procedures.....	7
V.	Underwriting	
	A. Property.....	8
	B. Commercial Property.....	10
VI.	Rating	
	A. Homeowners.....	14
	B. Dwelling Fire.....	15
VII.	Claims.....	19
VIII.	Forms.....	21
IX.	Advertising.....	22
X.	Consumer Complaints.....	23
XI.	Licensing.	
XII.	Recommendations....	
XIII.	Company Response.....	

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

BEFORE THE INSURANCE COMMISSIONER  
OF THE  
COMMONWEALTH OF PENNSYLVANIA

IN RE:

FARMERS' & MECHANICS'  
MUTUAL INSURANCE COMPANY  
Route 87  
Forksville, PA 18616

VIOLATIONS:

Sections 5(a)(4), 5(a)(9), 5(a)(9)(iii),  
and 5(a)(11) of the Unfair Insurance  
Practices Act, Act of July 22, 1974,  
P.L. 589, No. 205 (40 P.S. §§1171.5)

Sections 3(a)(2) and 3(a)(5) of the Act  
of July 3, 1986, P.L. 396, No. 86 (40  
P.S. §§ 3403)

Section 506.1 of the Insurance  
Company Law, Act of May 17, 1921,  
P.L. 682, No. 284 (40 P.S. § 636.1)

Section 4 of the Casualty and Surety  
Rate Regulatory Act, Act of June 11,  
1947, P.L. 538, No. 246 (40 P.S.  
§ 1008.4)

Title 31, Pennsylvania Code, Section  
146.6

Respondent.

Docket No. MC02-10-026

CONSENT ORDER

AND NOW, this 20<sup>th</sup> day of *November*, 2003, 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' & Mechanics' Mutual Insurance Company, and maintains its address at Route 87, Forksville, Pennsylvania 18616.
- (b) A market conduct examination of Respondent was conducted by the Insurance Department covering the period from January 1, 2002 through December 31, 2002.
- (c) On October 8, 2003, the Insurance Department issued a Market Conduct Examination Report to Respondent.

(d) A response to the Examination Report was provided by Respondent on October 29, 2003.

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

(i) Section 5(a)(4) of the Unfair Insurance Practices Act, No. 205 (40 P.S. § 1171.5), which prohibits entering into any agreement to commit, or by 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;

(ii) Section 5(a)(9) of the Unfair Insurance Practices Act, No. 205 (40 P.S. § 1171.5), which prohibits cancelling 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 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 hazard 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 shall be

effective unless a written notice of cancellation or refusal to renew is received by the insured;

- (iii) Section 5(a)(9)(iii) of the Unfair Insurance Practices Act, No. 205 (40 P.S. § 1171.5), which requires that a cancellation notice shall state the specific reason or reasons of the insurer for cancellation;
- (iv) Section 5(a)(11) of the Unfair Insurance Practices Act, No. 205 (40 P.S. § 1171.5), which requires a complete record of all complaints received during the preceding four years;
- (v) Section 3(a)(2) of Act 86 (40 P.S. § 3403), which requires that a nonrenewal notice be forwarded directly to the named insured or insureds at least 60 days in advance of the effective date of termination;
- (vi) Section 3(a)(5) of Act 86 (40 P.S. § 3403), which requires that a midterm cancellation or nonrenewal notice shall state the specific reasons for the cancellation or nonrenewal. The reasons shall identify the condition, factor or loss experience which caused the midterm cancellation or nonrenewal. The notice shall provide sufficient information or data for the insured to correct the deficiency;

- (vii) Section 506.1 of the Insurance Company Law, No. 284 (40 P.S. § 636.1), which provides (a) Basic property insurance shall be continued 180 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 premium for the coverage is paid;
- (viii) Section 4 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, and
- (ix) Title 31, Pennsylvania Code, Section 146.6 states that if an investigation cannot be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected.

#### 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 5(a)(4), 5(a)(9), 5(a)(9)(ii) and 5(a)(11) of the Unfair Insurance Practices Act, No. 205 (40 P.S. § 1171.5) are punishable by the following, under Section 9 of the Unfair Insurance Practices Act (40 P.S. § 1171.9):
- (i)** cease and desist from engaging in the prohibited activity;
  - (ii)** suspension or revocation of the license(s) of Respondent.
- (c)** In addition to any penalties imposed by the Commissioner for Respondent's violations of the Unfair Insurance Practices Act (40 P.S. §§ 1171.1 – 1171.5), the Commissioner may, under Sections 10 and 11 of the Unfair Insurance Practices Act (40 P.S. §§ 1171.10, 1171.11) file an action in which the Commonwealth Court may impose the following civil penalties:
- (i)** for each method of competition, act or practice which the company knew or should have known was in violation of the law, a penalty of not more than five thousand dollars (\$5,000.00);

[REDACTED]

(ii) for each method of competition, act or practice which the company did not know nor reasonably should have known was in violation of the law, a penalty of not more than one thousand dollars (\$1,000.00).

(d) Respondent's violations of Sections 3(a)(2) and 3(a)(5) of Act 86 (40 P.S. §§ 3403), 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 Section 506.1 of the Insurance Company Law, No. 284 (40 P.S. § 636.1) are punishable by the following, under 40 Purdon's Statutes, Section 637, by one or more of the following causes of action:

(i) Suspend or revoke the license of such offending person or entity.

(ii) Refuse for a period not to exceed one year, to issue a new license to such offending person or entity.

(iii) Impose a penalty of not more than \$1,000 for each act in violation.

(iv) Any person or entity which willfully issues contracts of fire insurance contrary to Sections 506 of this act shall be guilty of a misdemeanor.

(f) Respondent's violations of Section 4 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.

(g) Respondent's violations of Title 31, Pennsylvania Code, Section 146.6 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 cited 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 Five Thousand Dollars (\$5,000.00) 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, 1311 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.

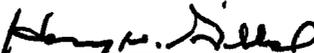
8. In any such enforcement proceeding, Respondent may contest whether a breach of the provisions of this Order has occurred but may not contest the Findings of Fact and Conclusions of Law contained herein.

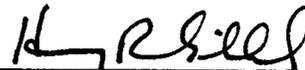
9. Respondent hereby expressly waives any relevant statute of limitations and application of the doctrine of laches for purposes of any enforcement of this Order.

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' & MECHANICS' 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' and Mechanics' Mutual Insurance Company's office located in Forksville, Pennsylvania, from June 23, 2003, through June 27, 2003. Subsequent review and follow-up was conducted in the office of the Pennsylvania Insurance Department.

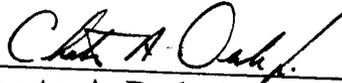
Pennsylvania Market Conduct Examination Reports generally note only those items to which the Department, after review, takes exception. However, the Examination Report may include management recommendations addressing areas of concern noted by the Department, but for which no statutory violation was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

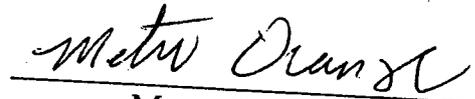
The undersigned participated in this examination and in preparation of this Report.



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



Constance L. Arnold  
Market Conduct Examiner



Metro Orange  
Market Conduct Examiner

## **II. SCOPE OF EXAMINATION**

The Market Conduct Examination was conducted on Farmers' and Mechanics' Mutual Insurance Company, hereinafter referred to as "Company," at their office located in Forksville, 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 January 1, 2002, through December 31, 2002, 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 nonrenewals, midterm cancellations, 60-day cancellations.
  - 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 Property
  - Underwriting – Appropriate and timely notices of nonrenewals, midterm cancellations, 60-day cancellations and renewals.
4. Claims
5. Forms
6. Advertising

## II. SCOPE OF EXAMINATION

The Market Conduct Examination was conducted by Farmers and Merchants Mutual Insurance Company hereinafter referred to as "Company" at their office located in Forksville, Pennsylvania. The examination was conducted pursuant to Sections 903, 904, 403, and 404 of the Insurance Department Act and covered the experience period of January 1, 2000 through December 31, 2002, 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:

### Personal Lines Property

Underwriting: Appropriate and timely notices of nonrenewals, midterm cancellations, 60-day cancellations

Rating: Proper use of all classification and rating plans and procedures.

### Dwelling

Rating: Proper use of all classification and rating plans and procedures.

### Commercial Property

Underwriting: Appropriate and timely notices of nonrenewals, midterm cancellations, 60-day cancellations and renewals

## 4. Claims

CLAIMS

Advertising

Complaints

**8** Licensing

### **III. COMPANY HISTORY AND LICENSING**

Farmers' and Mechanics' Mutual Insurance Company commenced business on April 28, 1877, as Farmers' and Mechanics Mutual Insurance Company of Sullivan County, under the laws of Pennsylvania.

A resolution was adopted in 1887 to extend the Company writing territory to all parts of the county except the boroughs of Laporte, Dushore, Bernice, Sonestown, Muncy Valley, and Eagles Mere.

A resolution was adopted effective January 1, 1976, for all new and renewal contracts to be issued as non-assessable policies.

The Company changed their name to Farmers' & Mechanics' Mutual Insurance Company in 1983. The same year, the Company received approval to write homeowner, mobile homeowner, and farmowner contracts and to increase their standard deductible to \$100.00.

The Company affiliated with Lititz Mutual Insurance Company of Lititz, PA on July 19, 1999.

The merger of Union Mutual Insurance Company of Westmoreland County into Farmers' and Mechanics' Mutual Insurance Company was effective January 1, 2001.

### **LICENSING**

Farmers' and Mechanics' Mutual Insurance Company's Certificate of Authority to write business in the Commonwealth was issued on April 28, 1877. The Company

is licensed in Pennsylvania. The Company's 2002 annual statement reflects Direct Written Premium for all lines of business in the Commonwealth of Pennsylvania as \$3,133,644. Premium volume related to the areas of this review were: Fire \$723,079; Farm owners' Multiple Peril \$189,344; Homeowners' Multiple Peril \$1,853,330; Inland Marine \$47,008.

#### **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, mobile homeowners, inland marine 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 violation was noted.

*1 Violation 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 required supporting business for liability coverage.

## **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.

From the universe of 60 homeowner policies, which were cancelled within the first 60 days of new business, 28 files were selected for review. All 28 files selected were received and reviewed. No violations were noted.

#### **2. Midterm Cancellations**

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

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 711 personal lines property policies, which were cancelled midterm during the experience period, 127 files were selected for review. The property policies consisted of homeowners, tenant homeowners, owner occupied dwelling fire and inland marine. All 127 files requested were received and reviewed. No violations were noted.

### 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 26 personal lines property policies, which was nonrenewed during the experience period, was selected for review. The property policies consisted of homeowners, tenant homeowners, inland marine and boat owners. All 26 files requested were received and reviewed. The 20 violations were based on 20 files, resulting in an error ratio of 77%.

The following findings were made:

#### *18 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 18 violations were the result of policies nonrenewed for an improper reason.

*2 Violations Act 205, Section 5(a)(9)(iii) [40 P.S. §1171.5(a)(9)(iii)]*  
Requires that a cancellation notice shall state the specific reason or reasons of the insurer for cancellation. The 2 violations were due to nonrenewal notices being issued that did not provide a specific reason for the nonrenewal.

## **B. Commercial 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 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 60<sup>th</sup> day unless the policy provides for a longer period of notification.

The universe of 34 commercial property policies, which was cancelled within the first 60 days, was selected for review. The commercial property files consisted of commercial fire, tenant occupied dwelling fire and farm owners. All 34 files selected were received and reviewed. No violations were noted.

## 2. Midterm Cancellations

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

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 406 commercial property policies, which were cancelled during the experience period, 65 files were selected for review. The commercial property files consisted of commercial fire, tenant occupied dwelling fire and farm owners. All 65 files selected were received and reviewed. No violations were noted.

## 3. Nonrenewals

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

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 10 commercial property policies identified as nonrenewals by the Company was selected for review. The commercial property policies consisted of tenant occupied dwelling fire and farm owners. All 10 files selected were received and reviewed. The 5 violations were based on 5 files, resulting in an error ratio of 50%.

The following findings were made:

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

Requires that a nonrenewal notice be forwarded directly to the named insured or insureds at least 60 days in advance of the effective date of the termination. The 4 files noted were absent any evidence this requirement was complied with.

*1 Violation Act 86, Section 3(a)(5) [40 P.S. §3403(a)(5)]*

Requires that a 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 file noted was absent any evidence this requirement was complied with.

4. 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.

## V. UNDERWRITING

### **A. Personal Line Property**

#### 60-Day Cancellations

A 60-day cancellation is considered to be a 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 75, the Unfair Insurance Practices Act, Section 5(1)(7)(b) and 40 Pa.C.S. § 10101(a)(7)(i) which prohibits an insurer from cancelling a policy for discriminatory reasons and Title 17, Pennsylvania Code, Section 17.109(b) which requires an insurer who cancels a policy within the first 60 days to provide at least 30 days notice of the termination.

From the universe of 60 homeowner policies which were cancelled within the first 60 days of new business, 100 were selected for review. All 28 files selected were received and reviewed. No violations were noted.

#### 2. Midterm Cancellations

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

The primary purpose of this review was to determine personal lines compliance with Act 75, the Unfair Insurance Practices Act, Section 5(1)(9)(b) and 75 Pa.C.S. § 5001 which establishes the conditions under which a policy may be cancelled and the form requirements of the cancellation notice.

the universe of personal lines property policies, which were cancelled during the experience period, files selected for review. The property policies consisted of homeowners, tenant homeowners, upland dwell, fire, inland marine. All 27 files requested were received and reviewed. No violations were noted.

### Nonrenewals

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

The primary purpose of the review was to determine personal lines compliance with Act 2009-10, Unfair Insurance Practices Act, Section 5(a)(9) [4 P.S. 1-15(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 personal lines property policies, which were nonrenewed during the experience period, files selected for review. The property policies consisted of homeowners, tenant homeowners, inland marine and boat owners. All 26 files requested were received and reviewed. The 20 violations were based on files, with an error rate of 77%.

The following findings were made:

#### *18 Violations Act 2009-10, Section 5(a)(9) [4 P.S. 1-15(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 policy unless the policy was

ed in h terial srepresentation; fraudien  
statements omissions or concealmen f fact material to the  
acceptance of the risk to the hazard assumed by the  
company; th been bstan al change increas  
hazard the risk assumed y the company subsequent to  
the date th po y ed th substantial  
increase hazards insured agat ce y reason f willful or  
egi gen acts the red; th sured as  
failed to pay premi hen due for other reasons  
appro ed by th Commission The vic were th  
result of poncies nonrenewed improper reason

*viol tio Act 2 5, Secti 5(a)(9) P 1 5(a)(9) (ii )*  
Requires tha on no shal state the specific  
reason or reasons f the insurer for cancellati The  
vic we onrene ou be ig d tha  
di not provide specific reason for or nonrenewal.

## B. Commercial Property

### 60-Day Cancellations

**A** 60-day **cancellation** is considered to be ty poli which cancelled  
within th first 60 days of the incep date of the policy.

The primary purpose of the review was to determine mp iance with Ac  
86 ecu 7 40 407, hich requi insurer who cancels  
policy that is effec than 60 days provide days noti of  
term tion ter than the 60 day nl the po y provides fo ger  
period f notification.

The universe of 34 commercial property policies, which was cancelled within the first 60 days selected for review. The commercial property files consisted of commercial fire, tenant-occupied dwelling fire and farm owners. All 34 files selected were received and reviewed. No violations were noted.

#### Midterm Cancellations

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

The purpose of the review was to determine compliance with Act 8, Section 403402, which prohibits cancellation except for specified reasons and Section 40340, which establishes the requirements which must be met regarding the form and content of the cancellation notice.

The universe of 406 commercial property policies, which were cancelled during the experience period, were selected for review. The commercial property files consisted of commercial fire, tenant-occupied dwelling and farm owners. All files selected were received and reviewed. No violations were noted.

#### Nonrenewals

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

The review was conducted to determine compliance with Act 16, Section 40 P.S. 40, which establishes the requirements that must be met regarding the form and content of the nonrenewal notice.

The reverse of commercial property policies identified nonrenewals by the Company selected for review. The commercial property policies consisted of tenant occupied dwelling fire and farm owners. A total of 10 files selected were received and reviewed. The violations were based on the file resulting in an error rate of 50%.

The following findings were made:

*Violation Act Sect 3(a)(2) [40 P.S. §340. (a)(2)]*

Requires that nonrenewal notice be forwarded directly to the named insured insureds at least 60 days in advance of the effective date of the termination. The 4 files noted were absent any evidence this requirement was complied with.

*Violation Act Section 3(a)(5) [40 P.S. §340.3(a)(5)]*

Requires that 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 and data for the insured to correct the deficiency. The file noted was absent any evidence this requirement was complied with.

#### **4. 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 1,563 commercial property policies, which were renewed during the experience period, 100 files were selected for review. The commercial property policies consisted of commercial fire, farm owners, tenant occupied dwelling fire and commercial inland marine policies. All 100 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 3,198 commercial property files identified as declinations by the Company, 100 files were selected for review. All 100 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 2,013 homeowner policies written as new business without surcharges during the experience period, 100 files were selected for review. All 100 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 3,233 homeowner policies written as renewals without surcharges during the experience period, 100 files were selected for review. All 100 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 due to an improper rating group, which resulted in an overcharge of \$27.

## **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 1,169 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. The 45 violations were based on the universe of 1,169 which resulted in an error ratio of 4%.

The following findings were made:

*45 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. An error was discovered in the rating process on all policies with a seasonal factor and a protective device credit. From the universe of 1,169 dwelling fire policies written as new business, 45 policies were affected. The Company's computer system applies a seasonal factor of 1.5 and a protective device credit of 5%, while the filed and

approved seasonal factor should be 1.6 and protective device credit should be 2%. This resulted in undercharges of \$676.

## 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 is 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 834 dwelling fire policies renewed during the experience period, 50 files were selected for review. All 50 files selected were received and reviewed. The 675 violations were based on the universe of 834, which resulted in an error ratio of 81%.

The following findings were made:

*675 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

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accordance with filings or rates, which are in effect at the time of issue. An error was discovered in the rating process on all policies with a seasonal factor and a protective device credit. From the universe of 834 dwelling fire policies renewed during the experience period, 675 policies were affected. The Company's computer system applies a seasonal factor of 1.5 and a protective device credit of 5%, while the filed and approved seasonal factor should be 1.6 and protective device credit should be 2%. This resulted in undercharges of \$7,895.

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

The following findings were made:

#### *3 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 the time. If the investigation cannot be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected. The 3 violations noted were absent any evidence this requirement was complied with.

#### **B. Dwelling Fire Claims**

From the universe of 86 dwelling fire claims reported during the experience period, 25 files were selected for review. All 25 files selected were received and reviewed. No violations were noted.

### **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)] and Act 6 of 1990 [75 Pa. CS §1827] which requires all insurers to provide an insurance fraud notice on all applications for insurance, all claims forms and all renewals of coverage. 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 provided 6 pieces of advertising, which included magazine ads and a pamphlet. The Company does not advertise over the Internet. 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 17 consumer complaints received during the experience period and provided all consumer complaint logs requested. All 17 complaints reported were selected for review. All 17 files selected were received 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 findings were 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 file noted contained an improper reason to nonrenew the policy.

*1 Violation Act 205, Section 5(a)(9)(iii) [40 P.S. §1171.5(a)(9)(iii)]*

Requires that a cancellation notice shall state the specific reason or reasons of the insurer for cancellation. The violation was due to a cancellation notice being issued that did not provide a specific reason for the cancellation.

*1 Violation 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 the named insured or until the sale of the property.

*1 Violation Act 205, Section 5(a)(11) [40 P.S. §1171.5(a)(11)]*

Requires an insurer to maintain a complete record of all the complaints, which it has 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 time it took to process each complaint. The violation noted was the result of the Company not maintaining a complete complaint record. The complaint record did not classify the complaint by line of business.

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The following synopsis reflects the nature of the 17 complaints that were reviewed.

- 13 Cancellation/Nonrenewal
- 4 Claims Related

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17

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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. No violations were noted.

## **XII. RECOMMENDATIONS**

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

1. The Company must review Act 205, Section 5 [40 P.S. §1171.5] to ensure that violations relative to property nonrenewals noted in the Report do not occur in the future.
2. 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.
3. The Company must review and re-program their computer system, to ensure policies are being rated correctly and are in compliance with Act 246, Section 4 (40 P.S. §1184) so that the violations noted in the Report do not occur in the future.
4. 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.

**XIII. COMPANY RESPONSE**



October 24, 2003

Commonwealth of Pennsylvania  
Insurance Department  
Bureau of Enforcement  
ATT: Chester A Derk, Jr., AIE, HIA  
1321 Strawberry Square  
Harrisburg, PA 17120

RE: Examination Warrant Number: 03-M22-009

Dear Mr. Derk,

The first market conduct examination for Farmers' and Mechanic's Mutual Insurance Company has been beneficial to the staff at F&M. The entire experience was a learning tool for improvements on office procedure techniques.

Recommendation #1 - the company's issuance of an offertory letter to owner occupied risk exposure where the writing agent no longer represents the company with the notice was believed to be acceptable. Upon receipt of notice of our error in 2002, steps were implemented to correct the violation. The implementation of offertory letter with re-assigned owner occupied renewal contracts was initiated.

Recommendation #2 - the single premium overcharge due to a typographical error was corrected/endorsed on July 23, 2003, copies attached.

Recommendation #3 - the undercharge of seasonal dwelling rating due to a computer system error was corrected/re-programmed on July 23, 2003. The corrected premium due was waived for the policy year in which the underrating occurred. A periodic internal system audit has been established to verify/confirm correct computer system rating.

Recommendation #4 - the company issued revised manuals effective August 1, 2003, stating the underwriting guidelines for the dwelling property and personal & premises liability rating manual with the deletion of the supporting coverage verbiage.

The staff at Farmers' & Mechanics' would like to thank the department for the professional and friendly experience of this market conduct. The examiners were extremely helpful and courteous to our small office staff. The suggestions/recommendations and support documentation provided by the examining team is truly appreciated.

Best Regards,

Henry H. Gibbel  
President & CEO

Cheryl B. Whiteley  
VP/Operations-F&M