

STATE OF MICHIGAN

DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES



MARKET CONDUCT EXAMINATION

NUMBER 2013C-0051

March 3, 2014

*TARGETED MARKET CONDUCT EXAMINATION REPORT*

*OF*

*FARMERS MUTUAL FIRE INSURANCE COMPANY OF BRANCH  
COUNTY*

*COLDWATER, MICHIGAN*

*NAIC COMPANY CODE 33448*

*For the Period January 1, 2009 through December 31, 2012*

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## **I. EXECUTIVE SUMMARY**

Pursuant to Executive Order 2013-1, all authority, powers, duties, functions, and responsibilities of the commissioner of the Office of Financial and Insurance Regulation (Commissioner) have been transferred to the Director of the Department of Insurance and Financial Services (DIFS) (Director).

Farmers Mutual Fire Insurance Company of Branch County (the Company) is an authorized Michigan domiciled company. This examination was conducted by DIFS in conformance with the National Association of Insurance Commissioners (NAIC) *Market Regulation Handbook* (2012) (*Handbook*) and the Michigan Insurance Code, MCL 500.100 et. seq. (the Code). The scope of market conduct examination includes the Company's activities related to the handling of Cancellation, Non-Renewal and Rescission Practices for the homeowners line of business. The examination covers the period January 1, 2009 through December 31, 2012.

This summary of this targeted market conduct examination of the Company is intended to provide a high-level overview of the examination results. The body of the report provides details of the scope of the examination, findings, DIFS recommendations, and Company responses.

DIFS considers a substantive issue one in which a "finding" or violation of the Code was found to have occurred, or one in which corrective action on the part of the Company is deemed advisable.

### **Findings:**

There are a number of findings with regard to the Company's Cancellation and Non-Renewal practices, including backdating cancellations, failure to maintain complete files, and failure to mail cancellation notices in a timely fashion. The area of most concern is the lack of proper reasons on notices sent to the insured. It is a violation of MCL 500.2104(6) to fail to include a proper reason. Also noted is the failure of the Company to provide adequate notice when cancelling a policy as required by MCL 500.2123(1).

### **Recommendations:**

The Company should take the following actions to address our findings: mail all notices in a timely fashion, stop backdating cancellations, provide a clear reason on the notice why the policy has been cancelled or non-renewed, ensure that all cancellations and non-renewals are lawful under the Michigan Essential Insurance Act, MCL 500.2100 et. seq., and maintain complete files on every policy.

### **Observations:**

The examination team has two recommendations that are not connected to any specific Standard of examination. First, the Company's billing system does not recognize that a policy has been cancelled or non-renewed. Secondly, the Company does not currently use a form number system for version control. It is recommended that both of these areas be addressed.

**Company Response:**

There were seven findings listed in your report which dealt with cancellations, non-renewals, and declinations of policies, and all of these findings revealed deficiencies in the manner in which The Company recorded these functions. The Company has instituted two changes which will address all seven findings. We have created a checklist procedure which should eliminate any of these deficiencies in the future. Any time that The Company cancels a policy it is required that a copy of the properly executed checklist be attached to the policy file as well as a copy of the request form if applicable and a standardized cancellation notice, we are also preparing the same protocol for all non-renewals. I have attached copies of these checklists as well as a copy of the standardized cancellation form for your benefit.

The issue pertaining to the Administration System being able to differentiate between active or cancelled policies is being addressed by the IT firm that developed the system initially. We are also evaluating the form numbering system to address the noted deficiency in that area.

I believe that these changes appropriately address the issues that you noted in your report.

**II. OBJECTIVES, SCOPE AND METHODOLOGY**

This report is based on a targeted Market Conduct Examination of Farmers Mutual Fire Insurance Company of Branch County. The examination was conducted at the Company's home office located at 36 Division St., Coldwater, MI 49036. The contact for this exam was John Parks, President. DIFS conducted this examination in accordance with statutory authority of MCL 500.222 et seq. All Michigan laws, regulations and bulletins cited in this report may be viewed on the DIFS website at [www.michigan.gov/difs](http://www.michigan.gov/difs).

The purpose of the exam is to evaluate the compliance of the Company with applicable Michigan statutes, NAIC Guidelines and DIFS regulations.

The examination covers the period January 1, 2009 to December 31, 2012. This examination was conducted under the supervision of Regan Johnson, Director of the Market Conduct Section, and Sherry J. Bass-Pohl, Manager of the Market Conduct Unit. The on-site examination team consisted of Zachary Dillinger, MCM and David Haddad, CPCU, MCM.

This examination includes reviews of, but not limited to, the area of Cancellation, Non-Renewal and Rescission Practices for the homeowners line of business. The examination covers the period of January 1, 2009 through December 31, 2012.

The examination was called due to an analysis of complaint data and the absence of a prior market conduct examination.

The examination team sampled Company records in the area of Cancellation, Non-Renewal and Rescission Practices. The analysis and examination of these areas were conducted and measured according to the standards and practices in the NAIC *Handbook*, the applicable statutes in the Code, and the Company's internal guidelines and procedures.

Three types of review were utilized for the above standards. Certain standards were examined with a single review, and others were examined using one or more type of review. The NAIC *Handbook* calls for a random sample of 100 files when the examination population is greater than 5000. This statistical sample applies to the Company as follows:

- A. Generic Review: A standard test was applied using analysis of all files written by agents at the specific branch office for the time frame of the examination. The Company provided the general file information as a response to examiner questions.
- B. Sample Review: A “sample” review indicates that a standard was tested through direct review of a random sample of files using sampling methodology described in the NAIC *Handbook*, Chapter 14. The samples included all files within a specific subgroup. For statistical purposes, an error tolerance of 2.3 percent (2.3%) was used when reviewing annuity suitability samples. The sampling techniques used are based on a 95 percent (95%) confidence level, meaning there is 95 percent (95%) confidence that the error percentages shown in the various standards so tested are representative of the entire set of records from which it was drawn. An error rate in excess of the tolerance level in these sections of the report is indicative of a general business practice of engaging in that type of conduct. Note that the statistical error tolerance is not indicative of the actual tolerance of DIFS for deliberate or systematic error.
- C. Census Review: Marketing and sales, as well as complaint files, were not subject to the sampling procedure, as the number of relevant files did not warrant taking a sample. Therefore, every relevant marketing piece and complaint file for the examination period was reviewed by the examination team for compliance with applicable statutes, regulations and internal company guidelines.

This examination report is a report by test. The report contains a summary of pertinent information about the lines of business examined. This includes each NAIC *Handbook* source and Standard, Code citation, any examination findings detailing the non-compliant or problematic activities that were discovered during the course of the exam, the Company response proposing methods for correcting the deficiencies, and recommendation for any further action by DIFS.

### **III. COMPANY PROFILE**

Farmers Mutual Fire Insurance Company of Branch County began operations in 1863, as a Michigan domiciled company. It is a mutual company and is currently licensed to market its products in Michigan. The Company markets and sells its products through independent producers and its top lines of business are homeowners and farm owners insurance.

#### IV. EXAMINATION FINDINGS AND RECOMMENDATIONS

##### A. CANCELLATION, NON-RENEWAL AND RESCISSION PRACTICES

The examiners requested the population of new and renewal policies written in the state of Michigan for the period under review. From this population, a sample of 50 cancelled files and 50 non-renewed files was randomly selected.

File Data	Population Size	Stage 1 Sample Size	Maximum Number of Failures Permitted in Sample	Date Sample Pulled	Errors Found
Cancellations	900	50	3	8/20/2013	16
Non-Renewals	196	50	3	8/20/2013	12

**Standard 7:** Rejections and declinations are not unfairly discriminatory. NAIC Handbook, Chapter 16.

**Findings:**

Within the 50 cancelled files and 50 non-renewed files that made up the examination sample, the examination team found no evidence of discriminatory cancellation or non-renewal practices.

**Recommendations:**

There are no recommendations.

**Standard 8:** Cancellation/Nonrenewal, discontinuance and declination notices comply with policy provisions, state laws and regulated entity guidelines. NAIC Handbook, Chapter 16.

MCL 500.2104

(6) “Underwriting rules” means the written statements, guidelines, or criteria of an insurer, phrased in terms understandable to a person of ordinary intelligence, which describe the standards under which the insurer issues, refuses to issue, renews, refuses to renew, or limits coverage for automobile insurance or home insurance to persons within this state.

MCL 500.2122

(1) An insurer or agent, upon making a declination of insurance, shall inform the applicant of each specific reason for the declination. If the application or request for coverage was made in writing, the insurer or agent shall provide the explanation of reasons in writing. If the application or request for coverage was made orally, the insurer or agent may provide the applicant with an oral explanation instead of a written explanation, and shall offer to provide a written explanation if the applicant requests a written explanation within 90 days.

(2) A refusal, by an insurer or agent, to provide upon request an application form or other means of making an application or request for coverage shall be considered a declination subject to this section.

#### MCL 500.2123

(1) Except as provided in subsection (2) or (3), a termination of insurance shall not be effective unless the insurer, at least 30 days prior to the date of termination, delivers or mails to the named insured at the person's last known address a written notice of the termination. The notice shall state the effective date of termination and each specific reason for the termination.

(2) A notice of termination mailed or delivered within the first 55 days after the initial issuance of a policy may be made effective not less than 20 days after the date of mailing or delivery of the notice.

(3) A notice of termination for nonpayment of premium shall be effective as provided in the policy.

(4) A termination of insurance shall not be effective unless the termination is due to reasons which conform to the underwriting rules of the insurer for that insurance.

(5) This section shall not authorize an insurer to terminate an automobile insurance policy in violation of chapter 32.

#### **Findings:**

##### **Cancellations:**

Finding 1: Of the 50 cancelled files randomly selected by the examination team, five (5) files provided insufficient notice for cancellation. MCL 500.2123(1) requires that the cancellation notice be mailed at least 30 days prior to the effective date of the cancellation. The following files showed that the cancellation notice was mailed on or after the effective date of cancellation: 1201097, 430035, 911032, 611033 and 415030.

Finding 2: In four (4) files, it appeared that the Company retroactively cancelled the policy and then refunded the premium to the insured. This is not allowable, as it costs the Company earned premium, as well as harms the insured by potentially opening the insured to lawsuit should there have been any incidents that were incurred but not reported. These policy numbers were: 1227020, 626057, 719028 and 1223031.

Finding 3: Six (6) files failed to provide a specific reason that the policy was cancelled. For example, several policies were cancelled with the reason "Mail Came Back", which is not an allowable reason. According to MCL 500.2104(6), all cancellation notices must be written in such a way that a person of "ordinary intelligence" must be able to understand the specific reason

why the policy was terminated. The examination team finds the Company to be in violation of the Michigan Insurance Code in the following policy numbers: 513031, 415030, 116032, 508035, 1201097 and 1227020.

Finding 4: One (1) file, policy number 911032, listed an improper reason for cancellation. The listed reason was that a claim over \$5,000 was made within the first year of the policy. This file is in violation of the Michigan Essential Insurance Act, MCL 500.2100 et. seq.

**Non-Renewals:**

Finding 5: Of the 50 non-renewed files randomly selected by the examination team, nine (9) files failed to provide a specific reason that the policy was non-renewed. For example, several files were non-renewed with the stated reason of “Non-Renew”. According to MCL 500.2104(6), all cancellation and non-renewal notices must be written in such a way that a person of “ordinary intelligence” must be able to understand the specific reason why the policy was ended. The examination team finds the Company to be in violation of the Michigan Insurance Code in the following policy numbers: 304020, 425027, 723030, 1102017, 504024, 314043, 529015, 425032 and 311021.

Finding 6: In two (2) files, 1114028 and 1109023, the examination team was unable to verify if a Non-Renewal notice had been sent. If no notice was sent, this would be a violation of MCL 500.2123(1).

Finding 7: One (1) file, policy number 1212030, listed an improper reason for non-renewal. The listed reason was that two (2) claims had been made in a three (3) year period. This file appears to be in violation of MCL 500.2117(2)e.

**Recommendations:**

In order to be considered compliant with the Michigan Insurance Code, it is expected that the Company take the following corrective actions:

Finding 1: The Company must ensure that all notices of cancellation be mailed no less than 30 days prior to the effective date of the cancellation. It is vitally important that the insured be given adequate time to obtain replacement coverage.

Finding 2: The Company must not back-date cancellations. The cancellation cannot be effective prior to the date that the Company has determined a cancellation is necessary, even if a pro-rated refund of “unearned” premium is issued. To back-date would be a violation of the timely notice requirement found in MCL 500.2123(1).

Finding 3: Under MCL 500.2104(6), all cancellation notices must provide a clear reason why that policy has been cancelled. When unclear reasons are provided, the insured is forced to either accept the decision without complete information or to obtain clarification by additional contact. It is the duty of the Company to provide clarity within the notice itself. If a valid, clear reason cannot be listed, the file should not be cancelled.

Finding 4: Under the Michigan Essential Insurance Act, having a \$5,000 claim in the first year of the policy is not a valid reason for cancellation. The Company should ensure in the future that any such policy is not cancelled.

Finding 5: Under MCL 500.2104(6), all cancellation notices must provide a clear reason why that policy has been non-renewed. When unclear reasons are provided, the insured is forced to either accept the decision without complete information or to obtain clarification by additional contact. It is the duty of the Company to provide clarity within the notice itself. If a valid, clear reason cannot be listed, the file should not be non-renewed.

Finding 6: It is vital that the Company maintain complete files on every policy. Being able to prove that a valid and timely non-renewal notice was sent is required to maintain compliance with the Michigan Essential Insurance Act, MCL 500.2100 et. seq. Please be sure to maintain this proof for every file in the future.

Finding 7: Claims history is a valid reason to non-renew a homeowners policy. However, two (2) claims in a three (3) year period is not sufficient for non-renewal. According to MCL 500.2117(2)e, at least three (3) paid claims within a three (3) year period are required before non-renewal is possible, with additional requirements based on total value of the claim and the nature of the claim. It is recommended that the Company review MCL 500.2117(2)e and ensure that their underwriting practices are compliant with this section.

**Observations:**

In addition to the numbered findings above, the examination team has two (2) recommendations that are not connected to any specific finding. First, the Company's billing system does not recognize that a policy has been cancelled or non-renewed. Consequently, the system automatically generates an invoice to the insured. The Company then puts a credit for the full amount of the invoice back in to the system. This system may cause an insured to receive a bill when they no longer have insurance. This could confuse that insured into thinking that they are still covered by the Company. It is recommended that the Company correct this automatic billing system.

Secondly, the Company should put form numbers on all outgoing forms. It may be difficult to track which form should be sent when cancelling or non-renewing a policy without proper version control. In fact one (1) file, policy number 1227020, received a non-renewal notice when the policy had been cancelled. A form number system would eliminate this problem.

## **V. ACKNOWLEDGEMENT**

This examination report of Farmers Mutual Fire Insurance Company of Branch County is respectfully submitted to the Director of the Department of Insurance and Financial Services, State of Michigan.

The courteous cooperation and assistance of the officers and employees of the Company extended to the examiners during the course of the examination is hereby acknowledged.

In addition to the undersigned, David Haddad, CPCU, MCM, Market Conduct Examiner participated in the examination.

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Examiner-in-Charge  
Department of Insurance and Financial Services  
Market Conduct Section  
3/3/2014