REPORT OF TARGET MARKET CONDUCT EXAMINATION

OF

21st CENTURY INSURANCE COMPANY OF THE SOUTHWEST

NAIC #10245

AS OF

December 31, 2011

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Department of Insurance
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GERMAINE L. MARKS
Acting Director

Honorable Germaine L. Marks
Acting Director
State of Arizona
2910 North 44th Street
Suite 210, Second Floor
Phoenix, Arizona 85018-7269

Dear Acting Director Marks:

Pursuant to your instructions and in conformity with the provisions of the Insurance Laws and Rules of the State of Arizona, a desk examination has been made of the market conduct affairs of the:

21st Century Insurance Company of the Southwest
NAIC #10245

The above examination was conducted by Helene I. Tomme, CPCU, CIE, Market Examinations Supervisor, Examiner-in Charge, and Linda L. Hofman, AIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner and Christopher G. Hobert, CIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner.

The examination covered the period of January 1, 2010 through December 31, 2011.

As a result of that examination, the following Report of Examination is respectfully submitted.

Sincerely yours,

Helene I. Tomme, CPCU, CIE
Market Examinations Supervisor
Market Oversight Division

AFFIDAVIT

STATE OF ARIZONA)
) ss.
County of Maricopa)

Helene I. Tomme, CPCU, CIE being first duly sworn, states that I am a duly appointed Market Examinations Examiner-in-Charge for the Arizona Department of Insurance. That under my direction and with my participation and the participation of Linda L. Hofman, AIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner and Christopher G. Hobert, CIE, MCM, FLMI, AIRC, CCP, Market Conduct Senior Examiner on the Examination of 21st Century Insurance Company of the Southwest, hereinafter referred to as the "Company" was performed at the office of the Arizona Department of Insurance. A teleconference meeting with appropriate Company officials in Wilmington, Delaware was held to discuss this Report, but a copy was not provided to management as the Examination was incomplete and had not yet been finalized. The information contained in this Report, consists of the following pages, is true and correct to the best of my knowledge and belief and that any conclusions and recommendations contained in and made a part of this Report are such as may be reasonably warranted from the facts disclosed in the Examination Report.

Helene I. Tomme, CPCU, CIE
Market Examinations Supervisor
Market Oversight Division

Subscribed and sworn to before me this 24th day of July, 2012.

Elizabeth L. Sickinger
Notary Public

My Commission Expires Jan. 17, 2013

ELIZABETH L. SICKINGER
NOTARY PUBLIC
MARICOPA COUNTY, ARIZONA
My Comm. Expires Jan. 17, 2013

FOREWORD

This targeted market conduct examination report of the 21st Century Insurance Company of the Southwest (herein referred to as, "Southwest", or the "Company"), was prepared by employees of the Arizona Department of Insurance (Department) as well as independent examiners contracting with the Department. A market conduct examination is conducted for the purpose of auditing certain business practices of insurers licensed to conduct the business of insurance in the state of Arizona. The Examiners conducted the examination of the Company in accordance with Arizona Revised Statutes (A.R.S.) §§ 20-142, 20-156, 20-157, 20-158 and 20-159. The findings in this report, including all work products developed in the production of this report, are the sole property of the Department.

The examination consisted of a review of the following Private Passenger Auto (PPA) business operations:

1. Complaint Handling
2. Marketing and Sales
3. Producer Compliance
4. Underwriting and Rating
5. Cancellations and Non-Renewals
6. Claims Processing

Certain unacceptable or non-complying practices may not have been discovered in the course of this examination. Additionally, findings may not be material to all areas that would serve to assist the Director.

Failure to identify or criticize specific Company practices does not constitute acceptance of those practices by the Department.

SCOPE AND METHODOLOGY

The examination of the Company was conducted in accordance with the standards and procedures established by the National Association of Insurance Commissioners (NAIC) and the Department. The market conduct examination of the Company covered the period of January 1, 2010 through December 31, 2011 for business reviewed. The purpose of the examination was to determine the Company's compliance with Arizona's insurance laws, and whether the Company's operations and practices are consistent with the public interest. This examination was completed by applying tests to each examination standard to determine compliance with the standard. Each standard applied during the examination is stated in this report and the results are reported beginning on page 8.

In accordance with Department procedures, the Examiners completed a Preliminary Finding ("Finding") form on those policies, claims and complaints not in apparent compliance with Arizona law. The finding forms were submitted for review and comment to the Company representative designated by Company management to be knowledgeable about the files. For each finding the Company was requested to agree, disagree or otherwise justify the Company's noted action.

The Examiners utilized both examinations by test and examination by sample. Examination by test involves review of all records within the population, while examination by sample involves the review of a selected number of records from within the population. Due to the small size of some populations examined, examinations by test and by sample were completed without the need to utilize computer software.

File sampling was based on a review of underwriting and claim files that were systematically selected by using Audit Command Language (ACL) software and computer data files provided by the Company. Samples are tested for compliance with standards established by the NAIC and the Department. The tests applied to sample data will result in an exception ratio, which determines whether or not a standard is met. If the exception ratio found in the sample is, generally less than 5%, the standard will be considered as "met." The standard in the areas of procedures and forms use will not be met if any exception is identified.

HISTORY OF THE COMPANY

(Provided by the Company)

The Company was incorporated on December 20, 1995 as a stock property and casualty insurance company in the State of Arizona. At the time of formation, the Company's name was 20th Century Insurance Company of Arizona. The Company was licensed by the Arizona Department of Insurance effective June 26, 1996.

Effective November 1, 1999, the Company changed its name to 21st Century Insurance Company of Arizona.

The Company was licensed in Texas on December 16, 2004. Redomestication to Texas from Arizona was approved under Texas Commissioner's Order No. 04-1270, dated December 31, 2004. As part of the redomestication, the Company changed its name to 21st Century Insurance Company of the Southwest.

Currently, the Company is licensed in 23 states and the District of Columbia.

PROCEDURES REVIEWED WITHOUT EXCEPTION

The Examiners review of the following Company departments[1] or functions indicates that they appear to be in compliance with Arizona statutes and rules:

Complaint Handling	Marketing and Sales
Producer Compliance	Underwriting and Rating

EXAMINATION REPORT SUMMARY

The examination identified 4 compliance issues that resulted in 12 exceptions due to the Company's failure to comply with statutes and rules that govern all insurers operating in Arizona. These issues were found in two (2) of the six (6) sections of Company operations examined. The following is a summary of the Examiner's findings:

Cancellation and Non Renewals

In the area of Cancellations and Non Renewals, one (1) compliance issue is addressed in this Report as follows:

- The Company failed to provide a compliant Summary of Rights, on three (3) PPA non renewals to its policyholders/insureds non renewed for an adverse underwriting decision.

Claims Processing

In the area of Claims Processing, three (3) compliance issues are addressed in this Report as follows:

- The Company failed to specify the length of time the authorization remains valid (shall be no longer than the duration of the claim) on two (2) claim authorization forms.

[1] If a department name is listed there were no exceptions noted during the review.

- The Company failed to advise the individual or a person authorized to act on behalf of the individual that they are entitled to receive a copy of the authorization form on two (2) claim authorization forms.
- The Company failed to correctly calculate and pay the appropriate tax, license registration and/or air quality fees on five (5) PPA first party total loss settlements, which resulted in additional payments of $590.90 (including interest).

FACTUAL FINDINGS

RESULTS OF PREVIOUS MARKET CONDUCT EXAMINATIONS

The Company did not have any Market Conduct Examinations in the prior five (5) years.

CANCELLATIONS AND NON-RENEWALS

Private Passenger Automobile (PPA):

The Examiners reviewed 50 PPA cancellation files for non-payment of premium out of a population of 1,577 and 9 PPA non renewals out of a population of 9. This cancellation, non renewal and declination review included a total sample size of 59 PPA files from a total population of 1,586.

All cancellation and nonrenewal files reviewed were to ensure compliance with Arizona Statutes and Rules.

The following Cancellation and Non Renewal Standard was met:

#	STANDARD	Regulatory Authority
2	Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory.	A.R.S. §§ 20-191, 20-443, 20-448, 20-1631, 20-1632, 20-1632.01, 20-1651 through 20-1656

The following Cancellation and Non Renewal Standard failed:

#	STANDARD	Regulatory Authority
1	Declinations, Cancellations and Non-Renewals shall comply with state laws and company guidelines including the Summary of Rights to be given to the policyholder and shall not be unfairly discriminatory.	A.R.S. §§ 20-448, 20-2108, 20-2109, 20-2110

Cancellation and Nonrenewal, Standard #1 – failed

Preliminary Finding 001 – Summary of Rights – The Examiners identified three (3) PPA non renewals for an adverse underwriting decision. These notices failed to provide a compliant Summary of Rights language to its policyholders, an apparent violation of A.R.S. §§ 20-2108, 20-2109 and 20-2110.

PRIVATE PASSENGER AUTOMOBILE
Summary of Findings – Standard 1 File Review
Failed to Provide Compliant Summary of Rights
A.R.S. §§ 20-2108, 20-2109 and 20-2110

Population	Sample	# of Exceptions	% to Sample
9	3	3	100%

A 100% error ratio does not meet the Standard; therefore, a recommendation is warranted

Recommendation #1

Within 90 days of the filed date of this Report provide the Department with documentation that Company procedures are in place so that a compliant Summary of Rights is sent with all cancellation, non renewal or declination notices that involve an adverse underwriting decision by the Company.

CLAIMS PROCESSING

Private Passenger Automobile (PPA):

The Examiners reviewed 100 PPA claims closed without payment from a population of 406; 100 PPA paid claims from a population of 729; 71 total loss PPA claims out of a population of 117 and 65 PPA subrogation claims out of a population of 80. This claims review included a total sample size of 336 PPA claim files from a total population of 1,332.

All claim files reviewed were to ensure compliance with Arizona Statutes and Rules.

The Following Claim Standards were met:

#	STANDARD	Regulatory Authority
1	The initial contact by the Company with the claimant is within the required time frame.	A.R.S. § 20-461, A.A.C. R20-6-801
2	Timely investigations are conducted.	A.R.S. § 20-461, A.A.C. R20-6-801
4	Claim files are adequately documented in order to be able to reconstruct the claim.	A.R.S. §§ 20-461, 20-463, 20-466.03, A.A.C. R20-6-801
6	The Company uses reservation of rights and excess of loss letters, when appropriate.	A.R.S. § 20-461, A.A.C. R20-6-801
7	Deductible reimbursement to insured upon subrogation recovery is made in a timely and accurate manner.	A.R.S. §§ 20-461, 20-462, A.A.C. R20-6-801
8	The Company responds to claim correspondence in a timely manner.	A.R.S. § 20-461, 20-462, A.A.C. R20-6-801
9	Denied and Closed Without Payment claims are handled in accordance with policy provisions and state law.	A.R.S. §§ 20-461, 20-462, 20-463, 20-466, 20-2110, A.A.C. R20-6-801
10	No insurer shall fail to fully disclose to first party insureds all pertinent benefits, coverages or other provisions of an insurance policy or insurance contract under which a claim is presented.	A.A.C. R20-6-801
11	Adjusters used in the settlement of claims are properly licensed.	A.R.S. §§ 20-321 through 20-321.02

The following Claim Standards failed:

#	STANDARD	Regulatory Authority
3	The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations.	A.R.S. §§ 20-461, 20-466.03, 20-2106, A.A.C. R20-6-801
5	Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations.	A.R.S. §§ 20-268, 20-461, 20-462, 20-468, 20-469 and A.A.C. R20-6-801

Claims Processing Standard #3 – failed

Preliminary Finding-002– Disclosure Authorization Forms- Claims – The Examiners identified three (3) claim authorization forms (shown in the table below) where the Company failed to:

- specify the authorization remains valid for no longer than the duration of the claim; and
- advise the individual or a person authorized to act on behalf of the individual that they are entitled to receive a copy of the authorization form.

These forms fail to comply with A.R.S. § 20-2106 (8)(b) and (9) and represent four (4) violations of the statute. The following table summarizes these authorization form findings.

	Form Description / Title	Form #	Statute Provision
1	Permission to Obtain Medical Information	Unknown	9
2	Authorization For Release Of Health Information	Unknown	8b and 9
3	Authorization to Obtain Financial and Other Factual Information	Unknown	8b

CLAIM FORMS

Failed to specify the authorization remains valid for no longer than the duration of the claim
Violation of A.R.S. § 20-2106(8)(b)

Population	Sample	# of Exceptions	% to Sample
N/A	N/A	2	N/A

Any error or exception identified in the areas of a procedure or forms use does not meet the Standard; therefore a recommendation is warranted.

CLAIM FORMS

Failed to advise the individual or a person authorized to act on behalf of the individual that they are entitled to receive a copy of the authorization form

Violation of A.R.S. § 20-2106(9)

Population	Sample	# of Exceptions	% to Sample
N/A	N/A	2	N/A

Any error or exception identified in the areas of a procedure or forms use does not meet the Standard; therefore a recommendation is warranted.

Recommendation #2

Within 90 days of the filed date of this Report, provide the Department with documentation that Company procedures are in place so the authorization forms listed above include the following

- specify the authorization remains valid for no longer than the duration of the claim; and
- advises the individual or a person authorized to act on behalf of the individual that the individual or the individual's authorized representative is entitled to receive a copy of the authorization form, in accordance with the applicable state statute.

Claims Processing Standard #5 - failed

Preliminary Finding 003 –Total Loss Taxes and Fees - The Examiners identified five (5) first party total loss settlements, in which the Company failed to correctly calculate and pay appropriate tax, license registration and/or air quality fees. This is an apparent violation of A.R.S. §§ 20-461(A)(6), 20-462(A) and A.A.C. R20-6-801 (H)(1)(b).

PRIVATE PASSENGER AUTOMOBILE TOTAL LOSS CLAIMS

Failed to correctly calculate and pay appropriate tax, license registration and/or air quality fees on total loss settlements

A.R.S. §§ 20-461(A)(6), 20-462(A) and A.A.C. R20-6-801 (H)(1)(b)

Population	Sample	# of Exceptions	% to Sample
117	71	5	7%

A 7% error ratio does not meet the Standard; therefore, a recommendation is warranted

Recommendation #3

Within 90 days of the filed date of this Report provide documentation to the Department to show that the Company's procedures have been corrected to comply with Arizona Statutes and Rules when processing total loss settlements for First and Third Parties.

Also, the Company must conduct a self-audit of the remaining PPA total loss claims in 2010/2011 and provide the Department with documentation that all monies owed have been properly reimbursed including copies of all AZ Refund letters and checks (including interest) to insureds or claimants and a summary spreadsheet.

Subsequent Events: During the course of the Phase I Examination, the Company agreed with the incorrect settlement of five (5) first party total losses and made restitution payments to the parties affected in the amount of $508.74 plus $82.16 in interest for a total of $590.90. Copies of letters of explanation and payments were sent to the Department prior to completion of the Examination.

Further, the Company completed a self-audit of the remaining 42 PPA total loss files during the examination period. An additional three (3) files were identified and paid the correct taxes/fees, which resulted in restitution *of $497.60 plus $84.07 interest for a total of $581.67. Copies of letters of explanation and payments were sent to the Department prior to completion of the Examination.*

SUMMARY OF FAILED STANDARDS

EXCEPTIONS	Rec. No.	Page No.
CANCELLATIONS AND NON RENEWALS		
Standard #1 Declinations, Cancellations and Non-Renewals shall comply with state laws and company guidelines including the Summary of Rights to be given to the policyholder and shall not be unfairly discriminatory.	1	13
CLAIM PROCESSING		
Standard #3 The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations.	2	17
Standard #5 Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations.	3	18

SUMMARY OF PROPERTY AND CASUALTY STANDARDS

Complaint Handling

#	STANDARD	PAGE	PASS	FAIL
1	The Company takes adequate steps to finalize and dispose of the complaints in accordance with applicable statutes, rules, regulations and contract language. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	
2	The time frame within which the Company responds to complaints is in accordance with applicable statutes, rules and regulations. (A.R.S. § 20-461 and A.A.C. R20-6-801)	8	X	

Marketing and Sales

#	STANDARD	PAGE	PASS	FAIL
1	All advertising and sales materials are in compliance with applicable statutes, rules and regulations. (A.R.S. §§ 20-442 and 20-443)	8	X	

Producer Compliance

#	STANDARD	PAGE	PASS	FAIL
1	The producers are properly licensed in the jurisdiction where the application was taken. (A.R.S. §§ 20-282, 20-286, 20-287 and 20-311 through 311.03)	8	X	
2	An insurer shall not pay any commission, fee, or other valuable consideration to unlicensed producers. (A.R.S. § 20-298)	8	X	

Underwriting and Rating

#	STANDARD	PAGE	PASS	FAIL
1	The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company Rating Plan. (A.R.S. §§ 20-341 through 20-385)	8	X	

#	STANDARD	PAGE	PASS	FAIL
2	Disclosures to insureds concerning rates and coverage are accurate and timely. (A.R.S. §§ 20-259.01, 20-262, 20-263, 20-264, 20-266, 20-267 and 20-2110)	8	X	
3	All forms and endorsements forming a part of the contract should be filed with the director (if applicable). (A.R.S. § 20-398)	8	X	
4	All mandated disclosures are documented and in accordance with applicable statutes, rules and regulations, including, but not limited to, the Notice of Insurance Information Practices and the Authorization for Release of Information. (A.R.S. §§ 20-2104, 20-2106, 20-2110 and 20-2113)	8	X	
5	Policies and endorsements are issued or renewed accurately, timely and completely. (A.R.S. §§ 20-1120, 20-1121, 20-1632 and 20-1654)	8	X	
6	Rescissions are not made for non-material misrepresentations. (A.R.S. §§ 20-463 and 20-1109)	8	X	

Declinations, Cancellation and Non-Renewals

#	STANDARD	PAGE	PASS	FAIL
1	Declinations, Cancellations and Non-Renewals shall comply with state laws and company guidelines including the Summary of Rights to be given to the policyholder and shall not be unfairly discriminatory. (A.R.S. §§ 20-448, 20-2108, 20-2109 and 20-2110)	12		X
2	Cancellations and Non-Renewal notices comply with state laws, company guidelines and policy provisions, including the amount of advance notice required and grace period provisions to the policyholder, nonrenewal based on condition of premises, and shall not be unfairly discriminatory. (A.R.S. §§ 20-191, 20-443, 20-448, 20-1631, 20-1632, 20-1632.01, 20-1651 through 20-1656)	12	X	

Claims Processing

#	STANDARD	PAGE	PASS	FAIL
1	The initial contact by the Company with the claimant is within the required time frame. (A.R.S. § 20-461 and A.A.C. R20-6-801)	15	X	
2	Timely investigations are conducted. (A.R.S. § 20-461, and A.A.C. R20-6-801)	15	X	
3	The Company claim forms are appropriate for the type of product and comply with statutes, rules and regulations. (A.R.S. §§ 20-461, 20-466.03, 20-2106, and A.A.C. R20-6-801)	16		X
4	Claim files are adequately documented in order to be able to reconstruct the claim. (A.R.S. §§ 20-461, 20-463, 20-466.03 and A.A.C. R20-6-801)	15	X	
5	Claims are properly handled in accordance with policy provisions and applicable statutes, rules and regulations. (A.R.S. §§ 20-268, 20-461, 20-462, 20-468, 20-469 and A.A.C. R20-6-801)	16		X
6	The Company uses reservation of rights and excess of loss letters, when appropriate. (A.R.S. § 20-461 and A.A.C. R20-6-801)	15	X	
7	Deductible reimbursement to insured upon subrogation recovery is made in a timely and accurate manner. (A.R.S. §§ 20-461, 20-462 and A.A.C. R20-6-801)	15	X	
8	The Company responds to claim correspondence in a timely manner. (A.R.S. § 20-461, 20-462 and A.A.C. R20-6-801)	15	X	
9	Denied and closed without payment claims are handled in accordance with policy provisions and state law. (A.R.S. §§ 20-461, 20-462, 20-463, 20-466, 20-2110 and A.A.C. R20-6-801)	15	X	
10	No insurer shall fail to fully disclose to first party insureds all pertinent benefits, coverages, or other provisions of an insurance policy or insurance contract under which a claim is presented. (A.A.C. R20-6-801)	15	X	
11	Adjusters used in the settlement of claims are properly licensed (A.R.S. §§ 20-321 through 20-321.02)	15	X	