

STATE OF ARIZONA  
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DEPT. OF INSURANCE

**REPORT OF TARGET MARKET CONDUCT EXAMINATION**

**OF**

**AMERICAN FAMILY MUTUAL INSURANCE COMPANY**

**NAIC #19275**

**AS OF**

**December 31, 2007**

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**JANICE K. BREWER**  
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**CHRISTINA URIAS**  
Director of Insurance

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Honorable Christina Urias  
Director of Insurance  
State of Arizona  
2910 North 44<sup>th</sup> Street  
Suite 210, Second Floor  
Phoenix, Arizona 85108-7256

Dear Director Urias:

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

**AMERICAN FAMILY MUTUAL INSURANCE COMPANY**  
**NAIC #19275**

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

The examination covered the period of January 1, 2004 through December 31, 2007.

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

Sincerely yours,

A handwritten signature in cursive script that reads "Helene I. Tomme".

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



## FOREWORD

This targeted market conduct examination report of American Family Mutual Insurance Company (herein referred to as, "AFMIC", 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 product developed in the production of this report, are the sole property of the Department.

The examination consisted of a review of the Commercial Property and Personal Lines Underwriting and Rating business operations.

The examination reviewed the Company's compliance with ARS § 20-224(B) in the State of Arizona. The review time period consisted of four (4) years; from January 1, 2004 through December 31, 2007. The initial focus of this examination included a review of various documents, procedures and related materials to identify which policyholders residing in qualifying cities/towns in Maricopa county (Carefree, Fountain Hills and Scottsdale) did not receive the tax refund on fire insurance premiums, pursuant to A.R.S. § 20-224.

Therefore, the target examination includes policy types with various "fire only" exposures and a review of commercial lines (commercial property, mono line property limited to Business Key Policies [BKP], including Builders' Risk [BR], Business Owners Policy [BOP], Contractor's Package Policies [CPP]) and personal line policies (homeowners, dwelling fire and mobile homeowners).

The original scope of the examination included an actual rating review of the various commercial and personal lines of businesses (LOB) outlined above, however, the Department determined that a self-audit by the Company would be acceptable to identify which

policyholders did not receive the fire premium tax credit. The Department monitored the Company's self-audit test results.

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 examination of the Company covered the period of January 1, 2004 through December 31, 2007 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 9.

File sampling during the review was based on the Company's self-audit test results of the three (3) cities/towns identified above. 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 form use will not be met if any exception is identified.

The Examiners did no manual testing or random sampling of the commercial and personal lines files. The Company completed a self-audit of its commercial and personal lines populations and determined which files qualified for the fire premium tax credit and gave the results to the Examiner to monitor.

## **EXAMINATION REPORT SUMMARY**

The examination revealed one (1) compliance issue that resulted in 362 exceptions due to the Company's failure to comply with statutes and rules that govern all insurers operating in Arizona. This issue was found in the only section of Company operations examined. The following is a summary of the Examiners' findings:

### **Underwriting and Rating (Fire only exposure)**

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

- The Company failed to include the fire premium tax credit on 147 commercial and 215 personal lines files for a total of 362 policyholders/insureds residing in qualifying cities/towns.

**UNDERWRITING AND RATING**

**Commercial lines:**

The self-audit identified the following exceptions: 71 Business Key Policies (BKP) and 13 Builders Risk policies (BR) out of a population of 963; 18 Contractors' Package Policies (CPP) out of a population of 171 and 45 Business Owners' Policies (BOP) out of a population of 2,255. The Examiner reviewed all exceptions identified by the self-audit which included a total of 147 commercial lines files from a total population of 3,389.

**Personal lines:**

The self-audit identified the following exceptions: 215 homeowners' policies out of a population of 19,070; -0- Dwelling Fire policies out of a population of 2,017 and -0- mobile homeowners' policies out of a population of 160. The Examiner reviewed all exceptions identified by the self-audit which included a total of 215 personal lines files from a total population of 21,247.

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

**The following Underwriting and Rating Standard was met:**

#	STANDARD	Regulatory Authority
2	Company's underwriting practices are not unfairly discriminatory. The Company adheres to applicable statutes, rules and regulations and regulated company guidelines in the selection of risks.	A.R.S. § 20-224, 20-385, 20-400.01, and 20-448

**The following Underwriting and Rating Standard failed:**

#	STANDARD	Regulatory Authority
1	The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company's rating plan	A.R.S. §§ 20-224, 20-341 through 20-385 and 20-400.01

**Fire Premium Tax Credit** – The Company failed to apply the AZ Fire Premium Tax Credit to 71 Business Key policies, 13 Builders Risk policies, 18 Contractors Package policies, 45 Business Owners' policies and 215 Homeowners' policies for a total of 362 policies residing in qualifying cities/towns in Maricopa county; an apparent violation of A.R.S. § 20-224.

**Total of Self-Audit Test Results  
January 1, 2004 through December 31, 2007**

<b>Commercial Lines</b>	<b>Population Reviewed</b>	<b>Checks or Credit on statements</b>	<b>Amounts</b>
<b>Totals</b>	<b>3,389</b>	<b>147</b>	<b>\$ 1,544.76</b>

<b>Personal Lines</b>	<b>Population Reviewed</b>	<b>Checks or Credit on statements</b>	<b>Amounts</b>
<b>Totals</b>	<b>21,247</b>	<b>215</b>	<b>\$ 1,168.30</b>

<b>Grand Totals</b>	<b>24,636</b>	<b>362</b>	<b>\$ 2,713.06</b>
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**Self-audit Test Result Detail by LOB and city/town**

**COMMERCIAL LINES:**

**BUSINESS KEY POLICIES (BKP) and BUIDERS' RISK POLICIES (BR)**

Failed to apply the AZ Fire Premium Tax Credit

A.R.S. § 20-224

<b>City/Town</b>	<b>Population</b>	<b>Sample</b>	<b># of Exceptions</b>	<b>Amount of Refund or Credit</b>	<b>% to Sample</b>
BKP Carefree	20	20	8	\$71.00	
BKP Fountain Hills	90	90	30	\$389.00	
BKP Scottsdale	853	853	33	\$219.00	
BR-Carefree	0	0	3	\$191.00	
BR-Fountain Hills	0	0	6	\$215.00	
BR-Scottsdale	0	0	4	\$60.00	
<b>BKP &amp; BR Totals</b>	<b>963</b>	<b>963</b>	<b>84*</b>	<b>\$1,145.00</b>	<b>9%</b>

**A 9% error ratio does not meet the Standard; therefore, a recommendation is warranted.**

\* Number of Exceptions (71 BKP + 13 BR = 84).

**CONTRACTORS' PACKAGE POLICIES (CCP)**

Failed to apply the AZ Fire Premium Tax Credit

A.R.S. § 20-224

City/Town	Population	Sample	# of Exceptions	Amount of Refund or Credit	% to Sample
CCP Carefree	8	8	2	\$2.00	
CCP Fountain Hills	27	27	11	\$30.00	
CCP Scottsdale	136	136	5	\$90.00	
<b>CCP Totals</b>	<b>171</b>	<b>171</b>	<b>18</b>	<b>\$122.00</b>	<b>11%</b>

A 11% error ratio does not meet the Standard; therefore, a recommendation is warranted.

**BUSINESS OWNERS' POLICIES (BOP)**

Failed to apply the AZ Fire Premium Tax Credit

A.R.S. § 20-224

City/Town	Population	Sample	# of Exceptions	Amount of Refund or Credit	% to Sample
BOP-Carefree	30	30	7	\$11.00	
BOP-Fountain Hills	168	168	15	\$92.20	
BOP-Scottsdale	2,057	2,057	23	\$174.56	
<b>BOP Totals</b>	<b>2,255</b>	<b>2,255</b>	<b>45</b>	<b>\$277.76</b>	<b>2%</b>

A 2% error ratio meets the Standard.

Commercial Lines	Population Reviewed	# of Exceptions	Amount
<b>Totals</b>	<b>3,389</b>	<b>147</b>	<b>\$ 1,544.76</b>

**PERSONAL LINES:**

**HOMEOWNERS' POLICIES (HO)**  
Failed to apply the AZ Fire Premium Tax Credit  
A.R.S. § 20-224

City/Town	Population	Sample	# of Exceptions	Amount of Refund or Credit	% to Sample
HO-Carefree	215	215	215*	\$1,168.30	
HO-Fountain Hills	542	542	0	\$ -	
HO-Scottsdale	18,266	18,266	0	\$ -	
HO-Misc	47	47	0	\$ -	
<b>HO Totals</b>	<b>19,070</b>	<b>19,070</b>	<b>215</b>	<b>\$1,168.30</b>	<b>1%</b>

A 1% error ratio meets the Standard.

**DWELLING FIRE POLICIES (DF)**  
Failed to apply the AZ Fire Premium Tax Credit  
A.R.S. § 20-224

City/Town	Population	Sample	# of Exceptions	Amount of Refund or Credit	% to Sample
DF-Carefree	1	1	0	\$ -	
DF-Fountain Hills	1,954	1,954	0	\$ -	
DF-Paradise Valley	2	2	0	\$ -	
DF-Scottsdale	61	61	0	\$ -	
<b>DF Totals</b>	<b>2,017</b>	<b>2,017</b>	<b>0</b>	<b>\$ -</b>	<b>0%</b>

**MOBILE HOMEOWNERS' POLICIES (MHO)**  
Failed to apply the AZ Fire Premium Tax Credit  
A.R.S. § 20-224

City/Town	Population	Sample	# of Exceptions	Amount of Refund or Credit	% to Sample
MHO-Carefree	0	0	0	\$ -	
MHO-Fountain Hills	0	0	0	\$ -	
MHO-Paradise Valley	0	0	0	\$ -	

City/Town	Population	Sample	# of Exceptions	Amount of Refund or Credit	% to Sample
MHO-Scottsdale	160	160	0	\$ -	
<b>MHO Totals</b>	<b>160</b>	<b>160</b>	<b>0</b>	<b>\$ -</b>	<b>0%</b>

Personal Lines	Population Reviewed	# of Exceptions	Amounts
<b>Totals</b>	<b>21,247</b>	<b>215</b>	<b>\$ 1,168.30</b>

Recommendation #1

Within 90 days of the filed date of this report provide the Department with documentation that Company procedures are in place to ensure that the premium tax credit is applied to all qualified commercial and personal lines insureds in the cities of Carefree and Fountain Hills, AZ (Scottsdale no longer qualified after 07/01/2005). Also, have procedures in place to ensure that any changes in the eligibility of cities/ towns for the premium tax credit be updated by the Company and included in subsequent filings. Submit all amended rate filings to the Department for approval.

*Subsequent Events: During the course of the Phase I Examination, the Company agreed with the Examiner's review of its self-audit. The self-audit results identified policy files in which the Company failed to give the appropriate fire premium tax credit to 147 commercial and 215 personal lines policies for a total of 362 policyholders/insureds.*

*During the review the Company refunded all monies due policyholders. The Company either credited the insured's current statement with the return premium or if the policyholder was no longer with the company, issued refund checks. All refunds were accompanied by an approved letter of explanation stating, in part, "The refund was generated as a result of an audit requested by the Arizona Department of Insurance".*

*A total of \$1,544.76 was refunded on 147 commercial lines policies and \$1,168.30 was refunded on 215 homeowners' policies for a grand total of \$2,713.06. The Company advised that it had corrected the programming errors in its commercial lines rating systems and amended its personal lines filings to include the city of Carefree. Although the Company submitted evidence of correcting its personal lines rate filings, the Company should provide supporting evidence (ie. work order or testing results, etc.) that all programming errors in its commercial lines rating system have been corrected.*

**SUMMARY OF FAILED STANDARDS**

<b>EXCEPTIONS</b>	<b>Rec. No.</b>	<b>Page No.</b>
<b>UNDERWRITING AND RATING</b>		
<u>Standard #1</u> The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company's rating plan.	1	13

**SUMMARY OF PROPERTY AND CASUALTY STANDARDS**

**Underwriting and Rating**

<b>#</b>	<b>STANDARD</b>	<b>PAGE</b>	<b>PASS</b>	<b>FAIL</b>
1	The rates charged for the policy coverage are in accordance with filed rates (if applicable) or the Company's rating plan. (A.R.S. §§ 20-224, 20-341 through 20-385 and 20-400.01)	9		X
2	Company's underwriting practices are not unfairly discriminatory. The Company adheres to applicable statutes, rules and regulations and regulated company guidelines in the selection of risks. (A.R.S. § 20-224, 20-385, 20-400.01, and 20-448)	9	X	