

Discovery Insurance Company

Kinston, North Carolina

Combined Examination Report

Part I - Report on Limited-Scope Examination

Part II – Report on Market Conduct Examination

Discovery Insurance Company

Kinston, NC

Report on Limited-Scope Examination

As of December 31, 2015

Discovery Insurance Company

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Discovery Insurance Company
Report on Limited-Scope Examination

Honorable Wayne Goodwin
Commissioner of Insurance
State of North Carolina
Raleigh, North Carolina

Sir:

Pursuant to your instructions and in accordance with Section (“§”) 58-2-131 of the General Statutes of North Carolina (“GS”), the North Carolina Department of Insurance (“Department”) conducted a limited-scope examination of **Discovery Insurance Company** (“Company”) as of December 31, 2015. The Department’s last full-scope examination was as of December 31, 2010. This limited-scope examination was performed to address specific areas based on the Department’s review and analysis of the Company’s 2015 Annual Statement.

This examination was performed in accordance with auditing standards established by the Department. The purpose of this examination was to review specific aspects of the Company’s 2015 Annual Statement as specified in the Scope of the Examination on page 4. The scope of this examination was not comprehensive, but included a limited review of the Company’s practices and procedures, its corporate and accounting records, details of certain transactions, and an evaluation of certain assets and liabilities reported as of December 31, 2015. This report is not intended to communicate all matters of importance for an understanding of the Company’s financial condition as of December 31, 2015. Therefore, the findings and conclusions contained within this report are based solely on the work performed on the specific areas of concern and are provided in the Summary of Examination Objectives and Findings on page 5.

Respectfully submitted,



Ke Xu, CPA, CFE
Chief Financial Examiner
Agile Enterprise Section
Financial Evaluation Division
North Carolina Department of Insurance

April 29, 2016

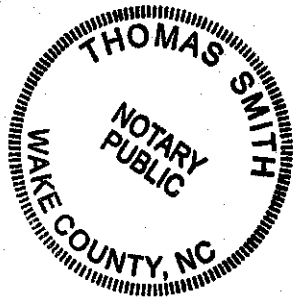
STATE OF NORTH CAROLINA
COUNTY OF WAKE

Venus Ang, Supervising Examiner, North Carolina Department of Insurance, being first, duly sworn, deposes and says that this report on examination, subscribed by her, is true and correct to the best of her knowledge and belief.

Signature: V. Ang Date: 6/28/2016
Venus Ang

Sworn and subscribed before me this 28 day of June, 2016.

Notary Public Signature: [Signature] Notary Public Seal:



Discovery Insurance Company
Report on Limited-Scope Examination
As of December 31, 2015

1. Company Background

The Company was incorporated in North Carolina on September 30, 1993. It was originally licensed to only write workers compensation insurance business as authorized by GS § 58-7-15. In 1995, the Company amended its articles of incorporation to write property and casualty insurance business as authorized by GS § 58-7-15. In 2011, the Company discontinued writing workers compensation business. Currently, the Company only provides substandard private passenger auto liability and auto physical damage coverage to its policyholders.

2. Appointed Actuary

Every property and casualty insurance company doing business in this State, unless otherwise exempted by the Commissioner, shall annually submit the opinion of an appointed actuary and an actuarial opinion summary in accordance with GS § 58-10-150 and GS § 58-10-155. Actuarial opinions regarding the Company's reserves for loss and loss adjustment expenses were issued by an appointed actuary for the examination period. The appointed actuary evaluated the reserves of the losses and loss adjustment expenses provided by the Company for reasonableness and consistency. According to the actuarial opinion, the Company's reserves for losses and loss adjustment expenses met the requirements of the insurance laws of North Carolina; were consistent with reserves computed in accordance with accepted actuarial standards and principles; and made a reasonable provision for all loss and loss adjustment expense obligations of the Company.

3. Scope of the Examination

The scope of this examination was limited to the following areas relative to the 2015 Annual Statement:

- a) Cash and Investments
- b) Premiums and Underwriting
- c) Claims and Reserves
- d) Financial Reporting

4. Examination Procedures

The examination procedures performed during this examination included the following:

- 1) Review and verification of supporting documentation for reported balances;
- 2) Substantive testing of underlying data and transactions;
- 3) Analytical procedures and recalculation of account balances;
- 4) Review of the Company's underwriting practice and procedures;
- 5) Review of the Company's contracts and agreements;
- 6) Actuarial review of the Company's reserves by the Department's Actuarial Services Division;
- 7) Other examination procedures deemed necessary to meet the established objectives.

Discovery Insurance Company
Report on Limited-Scope Examination
As of December 31, 2015

5. Summary of Examination Objectives and Findings

a) Cash and Investments

- 1) Examination Objective: To verify that the Company's investment transactions were properly reviewed and approved by the Board of Directors ("Board").

Findings: We were unable to obtain evidence of the Board's authorization or approval of investment activities for 2014 and 2015. The Company is directed to comply with the GS § 58-7-168 and provide evidence of proper approval of its investment transactions.

- 2) Examination Objective: To verify that the Company's investment portfolio and strategy are appropriately structured to generate a positive cash flow to support its operation.

Findings: No adverse findings were noted.

- 3) Examination Objective: To verify that investment transactions were recorded accurately and properly in the Company's 2015 Annual Statement.

Findings: No adverse findings were noted.

b) Premiums and Underwriting

- 1) Examination Objective: To verify that appropriate underwriting and pricing guidelines were established by the Company.

Findings: No adverse findings were noted.

- 2) Examination Objective: To verify that premiums receivable totaling \$7,207,250 reported in the Company's Annual Statement as of December 31, 2015, are being collected on a timely basis.

Findings: No adverse findings were noted.

- 3) Examination Objective: To verify that uncollected premiums and agent balances totaling \$1,935,778 and deferred premiums totaling \$5,271,472 reported in the Company's Annual Statement as of December 31, 2015, were properly recorded.

Findings: No adverse findings were noted.

- 4) Examination Objective: To review whether a premium deficiency reserve was warranted and properly recorded in the Company's Annual Statement as of December 31, 2015.

Findings: No adverse findings were noted.

c) Claims and Reserves

- 1) Examination Objective: To verify the existence and validity of claims data and to review the appropriateness of claims payment process.

Findings: No adverse findings were noted.

- 2) Examination Objective: To verify that internal controls are in place mitigate the risk of fraudulent claims.

Findings: No adverse findings were noted.

- 3) Examination Objective: To verify that paid claims totaling \$34,333,311 were complete and accurate as reported in the Company's 2015 Annual Statement.

Discovery Insurance Company
Report on Limited-Scope Examination
As of December 31, 2015

Findings: No adverse findings were noted.

- 4) Examination Objective: To verify the reasonableness and adequacy of losses and loss adjustment expenses, totaling \$2,758,718 and \$1,559,849, respectively, reported in the Company's 2015 Annual Statement.

Findings: No adverse findings were noted.

d) Financial Reporting

- 1) Examination Objective: To verify that the reinsurance recoverable of \$600,000 from the North Carolina Reinsurance Facility ("NCRF") was properly reported in the Company's Annual Statement as of December 31, 2015.

Findings: We were unable to obtain sufficient evidence to support the reinsurance recoverable from the NCRF. As such, the \$600,000 reinsurance recoverable from NCRF should be non-admitted as of December 31, 2015. The Company is directed to comply with GS § 58-2-165(c) and the Statement of Statutory Accounting Principles No. 62R to ensure accurate financial reporting in all future filings with the Department. Refer to the examination adjustment in Appendix A for details.

6. Subsequent Events

In 2016, the Company received approximately \$380,000 in restitution as a result of the criminal prosecution of a former employee for embezzlement. The case was officially closed in November 2015.

On May 16, 2016, the Company filed an amendment to its 2015 Annual Statement to non-admit the \$600,000 reinsurance recoverable.

Discovery Insurance Company
Report on Limited-Scope Examination
Appendix A- Impact of Examination Adjustments

7. Summary of Examination Adjustments

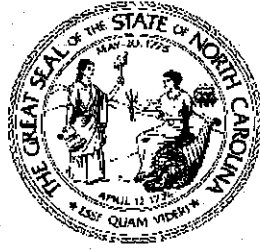
	As of December 31, 2015			
	Net Admitted Assets	Liabilities	Surplus	Net Income/Loss
<u>As originally reported to the Department</u>	\$ 24,098,245	12,787,092	11,311,153	359,605
a. Amounts recoverable from reinsurers	(600,000)			
b. Change in nonadmitted assets			(600,000)	
Total	(600,000)	-	(600,000)	-
<u>As adjusted</u>	\$ 23,498,245	12,787,092	10,711,153	359,605

- a. To reduce amounts recoverable from reinsurers. Refer to Finding 2.d)1) related to Financial Reporting.
- b. To reduce surplus related to adjustment a.

Discovery Insurance Company
Report on Limited-Scope Examination
Appendix B – Report Distribution

Stuart Lindley, President
604 North Queen Street
Kinston, NC 28501

Glenn S. Gannett, Chief Financial Officer
604 North Queen Street
Kinston, NC 28501



Report on
Market Conduct Examination

of

Discovery Insurance Company
Kinston, NC

by Representatives of the
North Carolina Department of Insurance

as of

April 26, 2016

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Raleigh, North Carolina
April 26, 2016

Honorable Wayne Goodwin
Commissioner of Insurance
Department of Insurance
State of North Carolina
Dobbs Building
430 N. Salisbury Street
Raleigh, North Carolina 27603

Honorable Commissioner:

Pursuant to your instructions and in accordance with the provisions of North Carolina General Statute (NCGS) 58-2-131 through 58-2-134, a target examination has been made of the market conduct activities of

Discovery Insurance Company (NAIC #22635) NAIC
Exam Tracking System Exam Number: NC-NC299-5
Kinston, NC

hereinafter generally referred to as the Company, at the Company's regional office located at 604 N. Queen Street, Kinston, North Carolina, and at the North Carolina Department of Insurance (Department) office located at 11 S. Boylan Avenue, Raleigh, North Carolina. A report thereon is respectfully submitted.

SCOPE OF EXAMINATION

The Department conducted a target examination of the Company. This examination commenced on March 21, 2016, and covered the period of July 1, 2013, through June 30, 2015, with analyses of certain operations of the Company being conducted through April 25, 2016. All comments made in this report reflect conditions observed during the period of the examination.

This examination was performed in accordance with auditing standards established by the Department and procedures established by the National Association of Insurance Commissioners (NAIC). The scope of this examination was not comprehensive, but included a limited review of the Company's practices and procedures in marketing and claims. The findings and conclusions contained within the report are based solely on the work performed and are referenced within the appropriate sections of the examination report.

It is the Department's practice to cite companies in violation of a statute or rule when the results of a sample show errors/noncompliance that fall outside certain tolerance levels. The Department applied a 0 percent tolerance level for the use of forms and rates/rules that were neither filed with nor approved by the Department and 3 percent for claims, and 5 percent for all other areas reviewed. Sample sizes were generated using Audit Command Language (ACL) software. The Department utilized a 95% Confidence Level to determine the error tolerance level.

EXECUTIVE SUMMARY

This market conduct examination revealed concerns with the Company's procedures and practices in the following area:

Marketing – Use of a form not filed with the North Carolina Rate Bureau and approved by the Department.

Specific violations are noted in the appropriate section of this report. All North Carolina General Statutes cited in this report may be viewed on the North Carolina Department of

Insurance Web site www.ncdoi.com, by clicking "INSURANCE DIVISIONS" then "Legislative Services".

All statutory violations may not have been discovered or noted in this report. Failure to identify statutory violations in North Carolina or in other jurisdictions does not constitute acceptance of such violations.

MARKETING

Policy Forms and Filings

Policy forms and filings for the Company were reviewed to determine compliance with appropriate North Carolina statutes and rules.

The Company is in violation of the provisions of NCGS 58-36-55 as the Statement of No Other Drivers form has not been filed with the North Carolina Rate Bureau and approved by the Department.

CLAIMS PRACTICES

Overview

The Company's claims practices were reviewed to determine compliance with the appropriate North Carolina statutes and rules and policy provisions. The review encompassed physical damage and third party property damage claims. Two hundred sixty-two claims were randomly selected from a population of 18,682.

Physical Damage Claims

A random selection of 131 paid physical damage claims were made from a total population of 13,855. The claim files were reviewed to determine compliance with the provisions of NCGS 58-63-15(11) for timeliness of payment, supporting documentation, and accuracy of payment.

The following type of claim was reviewed and the average payment time is noted in calendar days:

Type of Claim	Payment Time
Physical damage	12.8

All payments issued by the Company were deemed to be accurate. Deductibles were correctly applied and depreciation taken was reasonable. All claim files reviewed to determine compliance with NCGS 58-63-15(11) contained documentation to support the Company's payments. The documentation consisted of appraisals, estimates, repair bills, or inventory listings.

Third Party Property Damage Claims

A random selection of 131 paid third party property damage claims were made from a total population of 4,827. The claim files were reviewed to determine compliance with the provisions of NCGS 58-63-15(11) for timeliness of payment, supporting documentation, and accuracy of payment.

The following type of claim was reviewed and the average payment time is noted in calendar days:

Type of Claim	Payment Time
Third party property damage	14.5
All payments issued by the Company were deemed to be accurate. All claim files reviewed	

to determine compliance with NCGS 58-63-15(11) contained documentation to support the Company's payments. The documentation consisted of appraisals, estimates, repair bills, or inventory listings.

COMMENTS, RECOMMENDATIONS, AND DIRECTIVES

The Company was instructed to submit their Statement of No Other Drivers form to the North Carolina Rate Bureau to be filed with the Department. The Company has advised they will discontinue use of this form and are in the process of implementing a software program that will assist in the identification of undisclosed drivers.

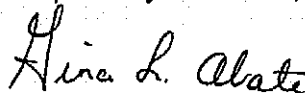
CONCLUSION

An examination has been conducted on the market conduct affairs of Discovery Insurance Company for the period July 1, 2013, through June 30, 2015, with analyses of certain operations of the Companies being conducted through April 26, 2016.

This examination was conducted in accordance with the North Carolina Department of Insurance and the National Association of Insurance Commissioners Market Regulation Handbook procedures, including analyses of the Company's operations in the areas of marketing and claims practices.

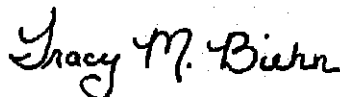
In addition to the undersigned, Patricia Murphy, MCM, North Carolina Market Conduct Examiner, participated in this examination.

Respectfully submitted,



Gina Abate, MCM
Examiner-In-Charge
Market Regulation Division
State of North Carolina

I have reviewed this examination report and it meets the provisions for such reports prescribed by this Division and the North Carolina Department of Insurance.



Tracy M. Biehn, MBA, MCM, LPCS
Deputy Commissioner Market
Regulation Division State of North
Carolina