

REPORT ON

MARKET CONDUCT EXAMINATION

of the

DISCOVERY INSURANCE COMPANY

Kinston, North Carolina

BY REPRESENTATIVES OF THE

NORTH CAROLINA DEPARTMENT OF INSURANCE

as of

September 18, 2012

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Raleigh, North Carolina
September 18, 2012

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, a compliance examination has been made of the market conduct activities of

DISCOVERY INSURANCE COMPANY (NAIC #22635)
NAIC Exam Tracking System Exam Number: NC299-M10
Kinston, North Carolina

hereinafter generally referred to as the Company, at the North Carolina Department of Insurance (Department) office located at 11 S. Boylan Avenue, Raleigh, North Carolina. A report thereon is respectfully submitted.

FOREWORD

This examination reflects the North Carolina insurance activities of Discovery Insurance Company. The examination is, in general, a report by exception. Therefore, much of the material reviewed will not be contained in this written report, as reference to any practices, procedures, or files that manifested no improprieties were omitted.

SCOPE OF EXAMINATION

This compliance examination commenced on June 11, 2012 and covered the period of January 1, 2011 through December 31, 2011 with analyses of certain operations of the Company being conducted through September 14, 2012. This action was taken due to previous examination findings referenced in the Market Conduct Report of February 19, 2010.

The examination was arranged and conducted by the Department. It was made in accordance with Market Regulation standards established by the Department and procedures established by the National Association of Insurance Commissioners (NAIC) and accordingly included tests of policyholder treatment, marketing, underwriting practices and terminations.

It is the Department's practice to cite companies in apparent violation of a statute or rule when the results of a sample show errors/noncompliance at or above the following levels: 0 percent for consumer complaints, sales and advertising, producers who were not appointed and/or licensed, and the use of forms and rates/rules that were neither filed with nor approved by the Department; 7 percent for claims; and 10 percent for all other areas reviewed. When errors are detected in a sample, but the error rate is below the applicable threshold for citing an apparent violation, the Department issues a reminder to the company.

Previous Examination Findings

A general examination covering the period January 1, 2006 through December 31, 2008 was performed on the Company and a report dated February 19, 2010 was issued. The general examination report identified concerns in the areas of policyholder treatment,

marketing, underwriting practices and terminations. Specific previous violations relating to these areas are listed within the appropriate sections of the report. Deficiencies noted in the previous examination report that did not exceed the Department's error tolerance thresholds were cited as reminders and may not appear as specific violations in this examination report. Any reminders which have not been sufficiently addressed by the Company, may be cited again in this examination report and thus may not appear in the "previous findings" as related to that particular section, but were an overall concern in the previous examination.

EXECUTIVE SUMMARY

This market conduct examination revealed concerns with Company procedures and practices in the following areas:

Consumer Complaints – incomplete complaint register, untimely response to Departmental inquiries, NAIC company code and/or official name and mailing address was not included on responses to the Department.

Policy Forms and Filings – use of unfiled application for private passenger automobile.

Underwriting Practices – applications accepted from producers who were not properly appointed and/or licensed.

Terminations – failure to issue the North Carolina Notice of Termination form (FS-4) to the Division of Motor Vehicles (DMV) for private passenger automobile cancellations.

Specific violations related to each area of concern are noted in the appropriate section of this report. All North Carolina General Statutes and rules of the North Carolina Administrative Code 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."

This examination identified various non-compliant practices, some of which may extend to other jurisdictions. The Company is directed to take immediate corrective action to demonstrate its ability and intention to conduct business in North Carolina according to its insurance laws and regulations. When applicable, corrective action for other jurisdictions should be addressed.

All unacceptable or non-compliant practices may not have been discovered or noted in this report. Failure to identify or criticize improper or non-compliant business practices in North Carolina or in other jurisdictions does not constitute acceptance of such practices. Examination report findings that do not reference specific insurance laws, regulations, or bulletins are presented to improve the Company's practices and ensure consumer protection.

POLICYHOLDER TREATMENT

Consumer Complaints

The Company's complaint handling procedures were reviewed to determine adherence to Company guidelines and compliance with applicable North Carolina statutes and rules.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of Title 11 of the North Carolina Administrative Code, (NCAC), Chapter 19, Section 0103 as 4.0 percent of the consumer complaints were not listed on the Company's complaint register.
- The Company was deemed to be in apparent violation of the provisions of 11 NCAC 1.0602 as the responses to 2.0 percent of the Departmental inquiries reviewed were in excess of the 7 calendar day requirement of this rule.
- The Company was deemed to be in apparent violation of the provisions of 11 NCAC 4.0123 as the responses to 26.0 percent of the Departmental inquiries reviewed did not include its National Association of Insurance Commissioners code.

The Consumer Services Division of the Department provided a listing of 47 complaints received during the period under examination. All complaints were selected and received for

review. The current examination revealed the following:

- The Company was again deemed to be in apparent violation of the provisions of 11 NCAC 19.0103 as 1 of the consumer complaints (2.1 percent error ratio) was not listed on the Company's complaint register.
- The Company was again deemed to be in apparent violation of the provisions of 11 NCAC 1.0602 as the responses to 3 of the Departmental inquiries reviewed (6.4 percent error ratio) were in excess of the 7 calendar day requirement of this rule.
- The Company was again deemed to be in apparent violation of the provisions of 11 NCAC 4.0123 as the responses to 7 of the Departmental inquiries reviewed (14.9

percent error ratio) did not include its NAIC company code and/or official name and mailing address.

The Company's response to each complaint was deemed to be appropriate to the circumstances. The average response time for the complaints was 2.8 calendar days. A chart of the Company's response time follows:

Service Days	Number of Files	Percentage of Total
1 - 7	44	93.6
8 - 14	3	6.4
Total	47	100.0

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 previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of 11 NCAC 10.1201(c) as its private passenger automobile declarations page had not been filed with and approved by the Department.

The current examination revealed the following:

- The Company was deemed to be in compliance with the provisions of 11 NCAC 10.1201(c) as its private passenger automobile declarations page was filed with and approved by the Department.
- The Company was deemed to be in apparent violation of the provisions of 11 NCAC 10.1201(c) as its private passenger automobile application was not filed with and approved by the Department.

Producer Licensing

The Company's procedures for appointment and termination of its producers were reviewed to determine compliance with the appropriate North Carolina statutes and rules.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of 11 NCAC 6A.0412(2) as background checks were not performed on 100 percent of the producers reviewed.
- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-56(d) as notification of termination was not sent to 92.0 percent of the terminated producers reviewed.

Fifty appointed and 50 terminated producer files were randomly selected and received for review from populations of 115 and 63, respectively. **The current examination revealed the following:**

- The Company was reminded of the provisions of 11 NCAC 6A.0412(2) as 1 file reviewed (2.0 percent error ratio) contained no evidence that a background check was performed.
- The Company was reminded of the provisions of NCGS 58-33-56(d) as notification of termination was not sent to 1 of the terminated producers reviewed (2.0 percent error ratio).

UNDERWRITING PRACTICES

Private Passenger Automobile

The Company's underwriting practices and procedures for active private passenger automobile policies were reviewed to determine adherence to Company guidelines and compliance with applicable North Carolina statutes and rules, policy provisions and the applicable rules of the Personal Automobile Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-40 as 18.0 percent of the private passenger automobile applications reviewed were accepted from a producer who was not appointed.
- The Company was deemed to be in apparent violation of the provisions of 11 NCAC 10.0602(a)(2) as proper consent to rate procedures were not followed on 44.0 percent of the active private passenger automobile files reviewed.

The Company provided a listing of 15,085 private passenger automobile policies issued during the period under examination. One hundred policies were randomly selected and received for review. **The current examination revealed the following:**

- The Company was again deemed to be in apparent violation of the provisions of NCGS 58-33-40 as the producers were not properly appointed by the Company for 9 of the active files reviewed (9.0 percent error ratio).
- The Company was reminded of the provisions of 11 NCAC 10.0602(a)(2) as proper consent to rate procedures were not followed on 3 of the active files reviewed (3.0 percent error ratio).
- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-5 and 58-33-26 as 1 of the applications reviewed (1.0 percent error ratio) was accepted from a producer who was not licensed.
- The Company was reminded of the provisions of NCGS 58-2-185 as the policy declaration page for 9 of the active policies reviewed (9.0 percent error ratio) incorrectly stated no premium was charged for Uninsured/Underinsured Motorist coverage
- The Company was reminded of the provisions of NCGS 58-37-35(l) and Rule 3 of the North Carolina Personal Automobile Manual as 3 of the active policies reviewed (3.0 percent error ratio) were rated incorrectly. The rating errors consisted of the following:
 - 1 policy was rated using an incorrect physical damage symbol.
 - 2 policies were rated using an incorrect territory.

The rating errors resulted in 3 premium undercharges to the insureds. The remaining premiums charged were deemed correct.

TERMINATIONS

Private Passenger Automobile Cancellations

The Company's cancellation procedures for private passenger automobile policies were reviewed to determine adherence to Company guidelines and compliance with applicable North Carolina statutes and rules, policy provisions and the applicable rules of the North Carolina Personal Automobile Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of NCGS 20-309(e) and 20-309.2 as the North Carolina Notice of Termination Form was not submitted to the North Carolina Division of Motor Vehicles for 12.0 percent of the cancelled private passenger automobile policies reviewed.

The Company provided a listing of 13,034 private passenger automobile policies cancelled during the period under examination. One hundred policies were randomly selected and received for review. **The current examination revealed the following:**

- The Company was again deemed to be in apparent violation of the provisions of NCGS 20-309 and 20-309.2 as the FS-4 was not submitted to the DMV when liability coverages were cancelled for 12 policies reviewed (12.0 percent error ratio).

Workers' Compensation Cancellations and Nonrenewals

The Company's cancellation and nonrenewal procedures for workers' compensation policies were reviewed to determine adherence to Company guidelines and compliance with applicable North Carolina statutes and rules, policy provisions and the applicable rules of the National Council on Compensation Insurance Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of NCGS 58-36-100 as the return premium was calculated incorrectly on 33.3 percent of the cancelled workers' compensation policies reviewed.
- The Company was deemed to be in apparent violation of the provisions of NCGS 58-36-110(b) as the nonrenewal notice for 16.7 percent of the nonrenewed workers' compensation policies reviewed was not issued at least 45 days prior to the termination date.

The Company advised the examiners that no workers' compensation policies were cancelled or nonrenewed during the period under examination.

SUMMARY

This compliance examination was undertaken to review and update the status of issues referenced in the Market Conduct Report of February 19, 2010. The current examination revealed the following:

1. Policyholder Treatment

- a. The Company was again deemed to be in apparent violation of the provisions of 11 NCAC 19.0103 as 2.1 percent of the consumer complaints were not listed on the Company's complaint register.

- b. The Company was again deemed to be in apparent violation of the provisions of 11 NCAC 1.0602 as the responses to 6.4 percent of the Departmental inquiries reviewed were in excess of the 7 calendar day requirement of this rule.
- c. The Company was again deemed to be in apparent violation of the provisions of 11 NCAC 4.0123 as the responses to 14.9 percent of the Departmental inquiries reviewed did not include its National Association of Insurance Commissioners code and/or official name and mailing address.

2. Marketing

- a. The Company was deemed to be in apparent violation of the provisions of 11 NCAC 10.1201(c) as its private passenger automobile application was not filed with and approved by the Department.
- b. The Company was reminded of the provisions of 11 NCAC 6A.0412(2) as 2.0 percent of the appointed producer files reviewed contained no evidence that a background check was performed.
- c. The Company was reminded of the provisions of NCGS 58-33-56(d) as notification of termination was not sent to 2.0 percent of the terminated producers reviewed.

3. Underwriting Practices

- a. The Company was again deemed to be in apparent violation of the provisions of NCGS 58-33-40 as the producers were not properly appointed by the Company for 9.0 percent of the active private passenger automobile files reviewed.
- b. The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-5 and 58-33-26 as 1.0 percent of the active private passenger automobile applications reviewed were accepted from a producer who was not licensed.
- c. The Company was reminded of the provisions of NCGS 58-37-35(l) and Rule 3 of the North Carolina Personal Automobile Manual as 3.0 percent of the active private passenger automobile policies reviewed were rated incorrectly.
- d. The Company was reminded of the provisions of NCGS 58-2-185 as 9.0 percent of the active private passenger automobile policies reviewed displayed an incorrect Uninsured/Underinsured Motorist coverage premium on the policy declarations page.
- e. The Company was reminded of the provisions of 11 NCAC 10.0602(a)(2) as proper consent to rate procedures were not followed on 3.0 percent of the active private passenger automobile files reviewed.

4. Terminations

- a. The Company was again deemed to be in apparent violation of the provisions of NCGS 20-309 and 20-309.2 as the North Carolina Notice of Termination Form was not submitted to the North Carolina Division of Motor Vehicles for 12.0 percent of the cancelled private passenger automobile policies reviewed.

TABLE OF STATUTES AND RULES

<u>Statute/Rule</u>	<u>Title</u>
NCGS 20-309	Motor vehicle registration.
NCGS 20-309.2	Insurer shall notify Division of actions on insurance policies.
NCGS 58-2-131	Examinations to be made; authority, scope, scheduling, and conduct of examinations.
NCGS 58-2-185	Record of business kept by companies and agents; Commissioner may inspect.
NCGS 58-33-5	License required.
NCGS 58-33-26	General license requirements.
NCGS 58-33-40	Appointment of agents.
NCGS 58-33-56	Notification to Commissioner of termination.
NCGS 58-36-100	Prospective loss costs filings and final rate filings for workers' compensation and employers' liability insurance.
NCGS 58-36-110	Notice of nonrenewal, premium rate increase, or change in workers' compensation insurance coverage required.
NCGS 58-37-35	The Facility; functions; administration.
11 NCAC 1.0602	Insurance Companies' Response to Departmental Inquiries.
11 NCAC 4.0123	Use of Specific Company Name in Responses.
11 NCAC 6A.0412	Appointment of Agent: Responsibility of Company.
11 NCAC 10.0602	Consent to Rate Procedures: Rate Bureau Coverages.
11 NCAC 10.1201	General requirements.
11 NCAC 19.0103	Complaint Records.

CONCLUSION

An examination has been conducted on the market conduct affairs of Discovery Insurance Company for the period January 1, 2011 through December 31, 2011 with analyses of certain operations of the Company being conducted through September 14, 2012.

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 Company operations in the areas of policyholder treatment, marketing, underwriting practices and terminations.

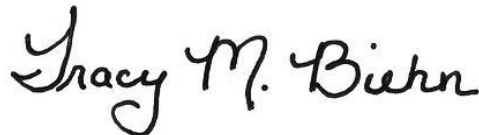
In addition to the undersigned, Kelvin A. Owens, a North Carolina Market Conduct Examiner, participated in this examination.

Respectfully submitted,



Norma M. Rafter, CPCU
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, LPCS, MBA
Deputy Commissioner
Market Regulation Division
State of North Carolina