

Report on

Market Conduct Examination

of the

Farmers Mutual Fire Insurance Company of Cleveland County

Shelby, North Carolina

by Representatives of the

North Carolina Department of Insurance

as of

June 11, 2014

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Raleigh, North Carolina
June 11, 2014

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 general examination has been made of the market conduct activities of

**Farmers Mutual Fire Insurance Company of Cleveland County
(NAIC #14019)**

NAIC Exam Tracking System Exam Number: NC299-M47
Shelby, 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 Farmers Mutual Fire Insurance Company of Cleveland County. 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 revealed no concerns were omitted.

SCOPE OF EXAMINATION

This examination commenced on February 3, 2014, and covered the period of January 1, 2008, through December 31, 2012, with analyses of certain operations of the Company being conducted through May 28, 2014. All comments made in this report reflect conditions observed during the period of the examination.

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, terminations, and claims practices.

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 at or above the following levels: 0 percent for consumer complaints, 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.

EXECUTIVE SUMMARY

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

Underwriting Practices – Dwelling Fire, Commercial Fire, and Mobile Homeowners:
Failure to include notice to the property insurance policyholder about flood, earthquake, mudslide, mudflow, and landslide insurance coverage.

Terminations – Dwelling Fire, Commercial Fire, and Mobile Homeowners: Failure to comply with policy cancellation provisions.

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 statutory violations. 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.

All statutory violations may not have been discovered or noted in this report. Failure to identify statutory violations does not constitute acceptance of such violations. Examination report findings that do not reference specific insurance laws, regulations, or bulletins are presented to improve the Company’s practices and provide consumer protection.

COMPANY OPERATIONS AND MANAGEMENT

The Company is a writer of personal and commercial property coverages. Business is produced through a captive producer. The Company currently writes in the following six contiguous counties in North Carolina: Cleveland, Rutherford, Lincoln, Gaston, Catawba, and Burke.

Direct written premium for the Company in 2012 was \$388,709. Premium writings in North Carolina between 2008 and 2012 increased approximately 6.0 percent. The charts below outline the Company’s line of business in 2012 and loss ratios for the examination period.

Line of Business	Written Premium	Percentage
Fire	\$213,790	55.0
Allied Lines	174,919	45.0
Total	\$388,709	100.0

Year	Written Premium	Earned Premium	Incurred Losses	Loss Ratio
2008	\$366,763	334,625	126,620	37.8
2009	\$359,594	364,971	383,567	105.1
2010	\$359,734	359,064	170,236	47.4
2011	\$371,586	347,964	437,568	125.8
2012	\$388,709	347,634	140,609	40.4

POLICYHOLDER TREATMENT

Consumer Complaints

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

The Company's complaint register for the period under examination was in compliance with the provisions of Title 11 of the North Carolina Administrative Code (NCAC), Chapter 19, Section 0103. The Company did not have any consumer complaints filed with the Department for the period of time subject to this examination.

MARKETING

Policy Forms and Filings

Policy forms and filings for the Company were reviewed to determine compliance with appropriate North Carolina statutes and rules. We reviewed the following lines of business:

1. Dwelling Fire
2. Mobile Homeowners
3. Commercial Fire

Policy form filings for these lines of business were made to the Department directly by the Company.

The provisions stipulated under 11 NCAC 10.1102(10)(e) exempt the Company from having to submit rate filings to the Department. The Company promulgates its own rates.

UNDERWRITING PRACTICES

Overview

The Company's marketing philosophy in North Carolina is directed to personal and commercial lines. The Company provided the examiners with listings of the following types of active policies for the period under examination:

1. Dwelling Fire
2. Mobile Homeowners
3. Commercial Fire

A random selection of 142 policies was made from a total population of 264. Each policy was reviewed for adherence to underwriting guidelines, file documentation, and premium determination. Additionally, the policies were examined to determine compliance with the appropriate North Carolina statutes and rules, policy provisions, and the applicable policy manual rules.

Dwelling Fire

The Company provided a listing of 169 active dwelling fire policies issued during the period under examination. Fifty policies were randomly selected for review.

The Company's dwelling fire coverages were written utilizing manual rates. Policies were written on a 7-year continuous renewal basis. Risk placement was determined by the Company's underwriting guidelines and the underwriter. No discrepancies were noted in the use of its underwriting guidelines.

The Company was deemed to be in violation of the provisions of NCGS 58-44-60(a) as it did not include the required notice to the property insurance policyholder about flood, earthquake, mudslide, mudflow, and landslide insurance coverage with any of the dwelling fire policies reviewed (100.0 percent error ratio).

All policy files reviewed contained sufficient documentation to support the Company's application of its rates and premiums charged.

Mobile Homeowners

The Company provided a listing of 53 active mobile homeowners policies issued during the period under examination. Fifty policies were randomly selected for review.

The Company's mobile homeowners coverages were written utilizing manual rates. Policies were written on a 7-year continuous renewal basis. Risk placement was determined by the Company's underwriting guidelines and the underwriter. No discrepancies were noted in the Company's use of its underwriting guidelines.

The Company was deemed to be in violation of the provisions of NCGS 58-44-60(a) as it did not include the required notice to the property insurance policyholder about flood, earthquake, mudslide, mudflow, and landslide insurance coverage with any of the mobile homeowners policies reviewed (100.0 percent error ratio).

All policy files reviewed contained sufficient documentation to support the Company's application of its rates and premiums charged.

Commercial Fire

The Company provided a listing of 42 active commercial fire policies issued during the period under examination. The entire population of 42 policies was selected for review.

The Company's commercial fire coverages were written utilizing manual rates. Policies were written on a 7-year continuous renewal basis. Risk placement was determined by the Company's underwriting guidelines and the underwriter. No discrepancies were noted in the use of its underwriting guidelines.

The Company was deemed to be in violation of the provisions of NCGS 58-44-60(a) as it did not include the required notice to the property insurance policyholder about flood, earthquake, mudslide, mudflow, and landslide insurance coverage with any of the commercial fire policies reviewed (100.0 percent error ratio).

All policy files reviewed contained sufficient documentation to support the Company's application of its rates and premiums charged.

TERMINATIONS

Overview

The Company's termination procedures were reviewed to determine compliance with the appropriate North Carolina statutes and rules, policy provisions, and the applicable policy manual rules. We reviewed the following lines of business:

1. Dwelling Fire
2. Mobile Homeowners
3. Commercial Fire

Special attention was placed on the validity and reason for termination, timeliness in issuance of the termination notice, policy refund (where applicable), and documentation of the policy file. A total of 227 policies were terminated during the period under examination. The examiners randomly selected 78 terminations for review.

Cancellations

Fifty cancelled policies were randomly selected for review from a population of 199.

The reason for cancellation was deemed valid for all policies reviewed. The review revealed the following reasons for cancellation:

Reason for Cancellation	Number of Policies	Percentage
Insured's request	45	90.0
Underwriting reasons	4	8.0
Nonpayment	1	2.0
Total	50	100.0

The Company was not required to issue cancellation notices for 45 of the 50 cancellations reviewed as these policies were terminated at the request of the insured. Cancellation notices for the remaining five terminated policies stated the specific reason for cancellation.

The Company was deemed to be in violation of the policy cancellation provisions as it failed to send written notice of cancellation to the mortgagee for seven policies reviewed (14.0 percent error ratio).

The Company was deemed to be in violation of the policy cancellation provisions as the return premium was calculated incorrectly for 26 cancelled policies reviewed (52.0 percent error ratio) resulting in nine overstatements of refund and 17 understatements of refund to the insureds. At the request of the examiners, the Company issued nine refunds in the amount of \$456.50. In accordance with the policy cancellation provisions, the Company also notified eight policyholders of refunds owed totaling \$42.00. The remaining premium refunds were deemed correct. The Company issued refunds in a timely manner.

As a result of the incorrect return premium calculations, the examiners requested the Company perform a self-audit in that area. The Company reviewed 144 cancelled policies, identifying 97 policies in error. Fifty-four of the errors resulted in understatement of refunds and 43 resulted in overstatement of refunds. The Company issued additional refunds for 33 cancelled policies totaling \$2,026.34 prior to the conclusion of the examination. In accordance with the policy cancellation provisions, the Company also notified 21 policyholders of refunds owed totaling \$100.55.

The final area of this review encompassed documentation of the policy file. All policy files contained sufficient documentation to support the action taken by the Company.

Nonrenewals

The entire population of 28 nonrenewed policies was selected for review.

The reasons for nonrenewal were deemed valid for the policies reviewed. The review revealed the following reason for nonrenewal:

Reason for Nonrenewal	Number of Policies	Percentage
Underwriting reasons	28	100.0
Total	28	100.0

The nonrenewal notices for the policies reviewed stated the specific reason for nonrenewal. The insured and loss payee were given proper and timely notification of nonrenewal.

The final area of this review encompassed documentation of the policy file. All policy files contained sufficient documentation to support the action taken by the Company.

Declinations/Rejections

The Company reported that no applications were declined/rejected during the period under examination.

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 paid, closed without payment, subrogated, and litigated claims.

Fifty-four claims were randomly selected for review from a population of 464.

Paid Claims

The examiners randomly selected 50 of the 460 first party property damage claims paid during the period under examination. The claim files were reviewed 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
First party property damage	4.7

All payments issued by the Company were deemed to be accurate. Deductibles were correctly applied and depreciation taken was reasonable.

The review of paid claims disclosed no violations of the provisions of NCGS 58-63-15(11).

Closed Without Payment Claims

The entire population of four closed without payment claims were selected for review. The claims were reviewed to determine if the Company's reasons for closing the claims without payment were valid.

The claim files reviewed contained documentation that supported the Company's reasons for closing the claims without payment. All reasons for denial or closing the files without payment were deemed valid. Claims were denied on an average of 13 calendar days during the examination period. The review of closed without payment claims disclosed no violations of the provisions of NCGS 58-63-15(11).

Subrogated Claims

The Company informed the examiners that it did not have any subrogated claims during the period under examination.

Litigated Claims

The Company informed the examiners that it did not have any litigated claims during the period under examination.

COMMENTS, RECOMMENDATIONS AND DIRECTIVES

The Company is directed to attach the required notice to the property insurance policyholder about flood, earthquake, mudslide, mudflow, and landslide insurance coverage to

all new dwelling fire, mobile homeowners and commercial fire policies. The Company has provided the examiners an acceptable version of the required notice.

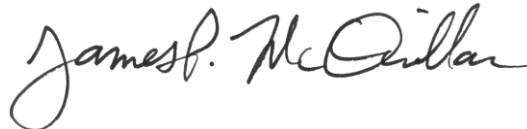
The Company is directed to refund the unearned portion of premium to the policyholder in the event of a total loss and to notify policyholders in writing that unearned premium in amounts less than \$10.00 resulting from cancellation of a policy will be refunded upon demand.

CONCLUSION

An examination has been conducted on the market conduct affairs of Farmers Mutual Fire Insurance Company of Cleveland County for the period January 1, 2008, through December 31, 2012, with analyses of certain operations of the Company being conducted through May 28, 2014. 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, terminations, and claims practices.

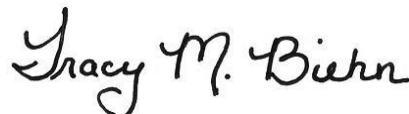
In addition to the undersigned, Gina Abate, North Carolina Market Conduct Examiner, participated in this examination.

Respectfully submitted,



James P. McQuillan, CPCU, AIT
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 Miller Biehn, LPCS, MBA
Deputy Commissioner
Market Regulation Division
State of North Carolina