

REPORT ON
MARKET CONDUCT EXAMINATION

of the

FIRST MUTUAL INSURANCE COMPANY

Smithfield, North Carolina

BY REPRESENTATIVES OF THE
NORTH CAROLINA DEPARTMENT OF INSURANCE

as of

July 25, 2011

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Raleigh, North Carolina
July 25, 2011

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

**FIRST MUTUAL INSURANCE COMPANY
(NAIC #43877)**

NAIC Exam Tracking System Exam Number: NC170-M110
Smithfield, NC

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

FOREWORD

This examination reflects the North Carolina insurance activities of First Mutual 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 20, 2011 and covered the period of January 1, 2010 through December 31, 2010 with analyses of certain operations of the Company being conducted through July 22, 2011. This action was taken due to previous examination findings referenced in the Market Conduct Report of March 12, 2009.

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 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, 2005 through December 31, 2007 was performed on the Company and a report dated March 12, 2009 was issued. The general examination report identified concerns in the areas of underwriting and rating 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 a concern with Company procedures and practices in the following area:

Underwriting and Rating – producers not properly appointed for farmowners, commercial inland marine, and personal inland marine.

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 "NCDOI 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.

UNDERWRITING PRACTICES

Homeowners

The Company's underwriting and rating practices and procedures for active homeowners 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 Company's Homeowners Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-40(h) as 14.0 percent of the new business applications reviewed were accepted from a producer not appointed by the Company.
- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-5 and NCGS 58-33-40(h) as 2.0 percent of the new business applications reviewed were accepted from a producer not licensed in the State of North Carolina and not appointed by the Company

The Company provided a listing of 151 active homeowners policies issued during the period under examination. Fifty policies were randomly selected and received for review. **The**

current examination revealed the following:

- The Company was deemed to be in compliance with the provisions of NCGS 58-33-40 as the producers were properly appointed for all of the active homeowner files reviewed.
- The Company was deemed to be in compliance with the provisions of NCGS 58-33-5 and NCGS 58-33-40 as the producers were properly licensed in the State of North Carolina and properly appointed by the Company for all active homeowner files reviewed.

Dwelling Fire

The Company's underwriting and rating practices and procedures for active dwelling fire 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 Company's Dwelling Fire Manual.

The previous examination revealed the following:

- Thirty-four percent of the active dwelling fire policies reviewed were not rated in accordance with the Company's rate structure.

The Company provided a listing of 6 active dwelling fire policies issued during the period under examination. All were selected and received for review. **The current examination revealed the following:**

- All policies reviewed were rated correctly.

Farmowners

The Company's underwriting and rating practices and procedures for active farmowners 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 Company's Farmowners Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-40(h) as 8.0 percent of the farmowners new business applications reviewed were accepted from a producer not appointed by the Company.

The Company provided a listing of 23 active farmowners policies issued during the period under examination. All policies 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 NCGS 58-33-40 as the producer was not properly appointed by the Company for 1 of the farmowners active files reviewed (4.3 percent error ratio).

Commercial Inland Marine

The Company's underwriting and rating practices and procedures for active commercial inland marine 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 Company's Commercial Inland Marine Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-40(h) as 12.0 percent of the commercial inland marine new business applications reviewed were accepted from a producer not appointed by the Company.

The Company provided a listing of 44 active commercial inland marine policies issued during the period under examination. All policies 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 NCGS 58-33-40 as the producer was not properly appointed by the Company for 1 of the commercial inland marine active files reviewed (2.3 percent error ratio).

Personal Inland Marine

The Company's underwriting and rating practices and procedures for active personal inland marine 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 Company's Personal Inland Marine Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-40(h) as 10.0 percent of the personal inland marine new business applications reviewed were accepted from a producer not appointed by the Company.

The Company provided a listing of 16 active personal inland marine policies issued during the period under examination. All policies 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 NCGS 58-33-40 as the producer was not properly appointed by the Company for 1 of the personal inland marine files reviewed (6.3 percent error ratio).

TERMINATIONS

Commercial Inland Marine Cancellations

The Company's cancellation procedures for commercial inland 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 Company's Commercial Inland Marine Manual.

The previous examination revealed the following:

- The Company was deemed to be in apparent violation of the policy termination provisions as the return premium for 40.0 percent of the cancellations reviewed was calculated pro rata in lieu of short rate for insured request cancellations.

The Company provided a listing of 43 commercial inland marine policies that were cancelled during the period under examination. All policies were selected and received for review. **The current examination revealed the following:**

- The Company was deemed to be in compliance with the policy termination provisions as the return premium for all insured request cancellations was calculated short rate.

SUMMARY

This compliance examination was undertaken to review and update the status of issues referenced in the Market Conduct Report of March 12, 2009. The current examination revealed the following:

1. Underwriting and Rating

- a. The Company was again deemed to be in apparent violation of the provisions of NCGS 58-33-40 as the producer was not properly appointed by the Company for 4.3 percent of the active farmowners files reviewed.
- b. The Company was again deemed to be in apparent violation of the provisions of NCGS 58-33-40 as the producer was not properly appointed by the Company for 2.3 percent of the active commercial inland marine files reviewed.
- c. The Company was again deemed to be in apparent violation of the provisions of NCGS 58-33-40 as the producer was not properly appointed by the Company for 6.3 percent of the active personal inland marine files reviewed.

TABLE OF STATUTES AND RULES

<u>Statute/Rule</u>	<u>Title</u>
NCGS 58-2-131	Examinations to be made; authority, scope, scheduling, and conduct of examinations.
NCGS 58-33-5	License required.

NCGS 58-33-40

Appointment of agents.

CONCLUSION

A compliance examination has been conducted on the market conduct affairs of First Mutual Insurance Company for the period January 1, 2010 through December 31, 2010 with analyses of certain operations of the Company being conducted through July 22, 2011. The Company's response to this report, if any, is available upon request.

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 underwriting and rating and terminations.

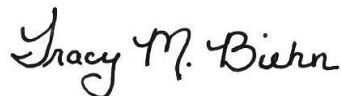
In addition to the undersigned, Gary Jones , North Carolina Market Conduct Examiner, participated in this examination and in the preparation of this report.

Respectfully submitted,



Bill George, AIS
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 Biehn, LPCS, MBA
Deputy Commissioner
Market Regulation Division
State of North Carolina