

REPORT ON
MARKET CONDUCT EXAMINATION

of the

NATIONAL INTERSTATE INSURANCE COMPANY
Richfield, Ohio

BY REPRESENTATIVES OF THE
NORTH CAROLINA DEPARTMENT OF INSURANCE

as of

January 16, 2009

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Raleigh, North Carolina
January 16, 2009

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

Honorable Mary Jo Hudson
Director of Insurance
Ohio Department of Insurance
2100 Stella Court
Columbus, Ohio 43215

Honorable Commissioners:

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

**NATIONAL INTERSTATE INSURANCE COMPANY
(NAIC #32620)**

NAIC Exam Tracking System Exam Number: NC170-M32
Richfield, Ohio

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 National Interstate 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 examination commenced on September 22, 2008 and covered the period of January 1, 2005 through December 31, 2007 with analyses of certain operations of the Company being conducted through January 12, 2009. 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, underwriting and rating, 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.

EXECUTIVE SUMMARY

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

Policyholder Treatment – Use of unfiled privacy forms.

Underwriting and Rating – Commercial automobile: rating errors; use of unfiled forms and rates. Commercial Inland Marine: use of unfiled forms and rates. Commercial General Liability: applications accepted from a producer who was not appointed, incorrect ISO rating editions used, rating errors, incorrect minimum premium charged.

Terminations – General Liability cancellations: notices did not provide at least 15 days notice of termination; notices did not provide a precise reason for termination. Commercial automobile nonrenewals: notices did not provide at least 45 days notice of nonrenewal. General liability nonrenewals: incomplete file documentation.

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 “Helpful Links.”

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

Privacy of Financial and Health Information

The Company provided privacy of financial and health information documentation for the examiners' review. The Company exhibited policies and procedures in place so that nonpublic personal financial or health information is not disclosed unless the customer or consumer has authorized the disclosure. The Company was found to be compliant with the provisions of NCGS 58-39-25, 58-39-26, and 58-39-27; however, the Company was deemed to be in apparent violation of the provisions of NCGS 58-3-150(a) as its Privacy of Financial and Health Information notice was not filed with and approved by the Department.

UNDERWRITING AND RATING

Overview

The Company's marketing philosophy in North Carolina focuses primarily on commercial lines. The Company provided the examiners with listings of the following types of active policies for the period under examination:

1. Commercial Automobile
2. Commercial Inland Marine
3. General Liability
4. Workers' Compensation

A random selection of 123 policies was made from a total population of 1,714. 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.

Commercial Automobile

The Company provided a listing of 1,641 active commercial automobile policies issued during the period under examination. Fifty policies were randomly selected and received for review.

The Company's commercial automobile coverages were written utilizing manual and deviated rates. Policies were written on an annual 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. All policy files contained sufficient documentation to support the Company's classification of the risk.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) as 1 policy reviewed (2.0 percent error ratio) contained multiple rating/filing errors. The errors consisted of the following:

- An unfiled loss cost multiplier was applied to Uninsured/Underinsured Motorists coverage, Uninsured Motorist Property Damage coverage, and Medical Payments coverage.
- An unfiled deviation was applied.
- An incorrect territory was used.

The errors resulted in premium undercharges to the insureds.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) as the rates used on 20 policies reviewed (40.0 percent error ratio) had not been filed with and/or approved by the Department. The errors consisted of the following:

- One policy had an effective date prior to the approval date of the rate filing.
- An unfiled Vacation Liability rate for the \$50,000 limit was used on 18 policies.
- Unfiled physical damage rates were used on 1 policy.

The errors resulted in 2 premium undercharges and 18 premium overcharges to the insureds. At the request of the examiners, refunds in the amount of \$18 were issued by the Company for the overcharges. As a result of the incorrect Vacation Liability rate charged, the Department requested the Company to conduct a self-audit in that area. The Company identified an additional 3,494 policies affected (excluding those that were identified by the examiners as

noted above) that resulted in refunds being made in the amount of \$3,494. The refund checks were mailed to the insureds on December 5, 2008.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(g), Title 11 of the North Carolina Administrative Code (NCAC), Chapter 10, Section 0105(a), and Rule 15.C of the Commercial Automobile Manual as it failed to submit an individual risk filing with the Department supporting the rates used on 1 policy reviewed (2.0 percent error ratio).

The Company was deemed to be in apparent violation of the provisions of NCGS 58-3-150(a) and 58-41-50(a) as various forms listed on the policy declarations page had not been filed with and approved by the Department. The Company acknowledged this was a multi-jurisdictional issue and reported the form numbers will no longer appear on the policy declarations page in all jurisdictions.

The Company was deemed to be in apparent violation of the provisions of 11 NCAC 19.0102(a) and 19.0106(a)(3) as it was unable to provide a copy of the form filing for the policy declarations page and application.

Commercial Inland Marine

The Company provided a listing of 30 active commercial inland marine policies issued during the period under examination. All policies were selected and received for review.

The Company's commercial inland marine policies were written on an annual basis. Risk placement was determined by the Company's underwriting guidelines and the underwriter.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(a)(b), 11 NCAC 10.1102(11)(a), and 10.1201(a)(c) as rates/rules/forms had not been filed with and approved by the Department.

General Liability

The Company provided a listing of 38 active general liability policies issued during the period under examination. All policies were selected and received for review.

The Company's commercial general liability coverages were written utilizing manual and deviated rates. Policies were written on an annual 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 apparent violation of the provisions of NCGS 58-33-40(h) as 18 applications reviewed (47.4 percent error ratio) were accepted from a producer who was not appointed.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) and 11 NCAC 10.1604(b)(2) as 16 policies (42.1 percent error ratio) were rated using the incorrect Insurance Services Office (ISO) rate filing editions. The rating errors resulted in premium overcharges to the insureds. At the request of the examiners, refunds in the amount of \$4,973.00 were issued by the Company for the overcharges. As a result of the incorrect premium calculations in applying the ISO edition rates, the examiners requested the Company to conduct a self audit in this area. The Company identified an additional 40 policies affected (excluding those that were reviewed by the examiners as noted above) that resulted in refunds being made in the amount of \$8,052.41. The refund checks were mailed to the insureds December 29, 2008. The Company acknowledged the ISO filing edition date issue impacted some policies issued in Florida. The Company has identified and corrected all affected policies. The errors resulted in premium undercharges to the insureds.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) as 8 policies reviewed (21.1 percent error ratio) contained multiple rating errors. The rating errors consisted of the following:

- Incorrect schedule debit was applied on 2 policies.
- Charged incorrect liability premiums for limits issued on 4 policies.
- Incorrect rates applied on 3 policies.

The rating errors resulted in 1 premium undercharge and 7 premium overcharges to the insureds. At the request of the examiners, refunds in the amount of \$539.00 were issued by the Company for the overcharges.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) and Rule 8 of the Commercial Lines Manual as 6 policies reviewed (15.8 percent error ratio) were charged premiums over the policy minimum. The rating errors resulted in premium overcharges to the insureds. At the request of the examiners, refunds in the amount of \$2,509.00 were issued by the Company for the overcharges. As a result of the incorrect minimum premium charged, the examiners requested the Company to conduct a self audit in this area. The Company identified an additional 9 policies affected (excluding those that were reviewed by the examiners as noted above) that resulted in refunds being made in the amount of \$3,895.00. The refund checks were mailed to the insureds on December 29, 2008.

Workers' Compensation

The Company provided a listing of 5 active workers' compensation policies issued during the period under examination. All policies were selected and received for review.

The Company's workers' compensation coverages were written utilizing manual and deviated rates. Policies were written on an annual 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. All policy files contained sufficient documentation to support the Company's classification of the risk. All premiums charged were deemed correct.

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. The review focused on the following lines of business:

1. Commercial Automobile
2. Commercial Inland Marine
3. General Liability
4. Workers' Compensation

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 1,155 policies were terminated during the period under examination. The examiners randomly selected 109 terminations for review.

Commercial Automobile Cancellations

Fifty cancelled commercial automobile policies were randomly selected and received for review from a population of 1,049.

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	32	64.0
Nonpayment of premium	11	22.0
Coverage rewritten	5	10.0
Underwriting reasons	2	4.0
Total	50	100.0

The Company was not required to issue cancellation notices for 37 of the cancellations reviewed as these policies were cancelled at the request of the insured or the coverage was rewritten. Cancellation notices for the remaining 13 policies stated the specific reason for cancellation.

The Company was reminded of Rule 11 of the Commercial Automobile Manual as the return premium for 2 policies reviewed (4.0 percent error ratio) was calculated incorrectly. The errors resulted in understatement of refunds to the insureds. At the request of the examiners, the Company issued additional refunds in the amount of \$17.00. The remaining premium refunds were deemed correct. The Company issued the refunds in a timely manner.

The final area of this review encompassed documentation of the policy file. All policy files reviewed contained sufficient documentation to support the action taken by the Company. The Company sent the North Carolina Notice of Termination Form (FS-4) to the North Carolina Division of Motor Vehicles (DMV) when liability coverages were cancelled. The Company was deemed to be in compliance with the provisions of NCGS 20-309(e).

Commercial Inland Marine Cancellations

The Company reported that no commercial inland marine policies were cancelled during the period under examination.

General Liability Cancellations

All cancelled general liability policies were selected and received for review from a population of 8.

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	4	50.0
Finance company request	2	25.0
Nonpayment of premium	1	12.5
Underwriting reasons	1	12.5
Total	8	100.0

The Company was not required to issue cancellation notices for 6 of the cancellations reviewed as these policies were cancelled at the request of the insured or finance company.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-15(b) and the policy termination provisions as 1 cancellation notice (12.5 percent error ratio) was not issued at least 15 days prior to the cancellation date of the policy and 1 cancellation notice (12.5 percent error ratio) did not state the precise reason for cancellation.

All premium refunds were deemed correct. The Company issued the refunds in a timely manner.

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

Workers' Compensation Cancellations

The Company reported that no workers' compensation policies were cancelled during the period under examination.

Commercial Automobile Nonrenewals

Fifty nonrenewed commercial automobile policies were randomly selected and received for review from a population of 97.

The reason for nonrenewal was deemed valid for all policies reviewed. The review revealed the following reason for nonrenewal.

Reason for Nonrenewal	Number of Policies	Percentage
Underwriting reasons	50	100.0
Total	50	100.0

The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-20(b) as 16 nonrenewal notices (32.0 percent error ratio) were not issued at least 45 days prior to the nonrenewal date of the policy.

The Company was reminded of the provisions of 11 NCAC 19.0102(a), 19.0104, and 19.0106(a)(4)(h) as 4 files reviewed (8.0 percent error ratio) did not contain a copy of the nonrenewal notice.

The Company was reminded of the provisions of NCGS 58-41-20(e) as 1 nonrenewal notice (2.0 percent error ratio) did not state the precise reason for nonrenewal.

The final area of this review encompassed documentation of the policy file. All files reviewed contained sufficient documentation to support the action taken by the Company. The Company sent the FS-4 to the DMV when liability coverages were nonrenewed. The Company was deemed to be in compliance with the provisions of NCGS 20-309(e).

Commercial Inland Marine Nonrenewals

The Company reported that no commercial inland marine policies were nonrenewed during the period under examination.

General Liability Nonrenewals

One nonrenewed general liability policy was selected and received for review from a population of 1.

The reason for nonrenewal was deemed valid for the policy reviewed. The review revealed the following reason for nonrenewal.

Reason for Nonrenewal	Number of Policies	Percentage
Underwriting reasons	1	100.0
Total	1	100.0

The Company was deemed to be in apparent violation of the provisions of 11 NCAC 19.0102(a), 19.0104, and 19.0106(a)(4)(h) as 1 file (100 percent error ratio) did not contain a copy of the nonrenewal notice.

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

Workers' Compensation Nonrenewals

The Company reported that no workers' compensation policies were nonrenewed during the period under examination.

SUMMARY

The Market Conduct examination revealed the following:

1. Policyholder Treatment

- a. The Company was deemed to be in apparent violation of the provisions of NCGS 58-3-150(a) as its Privacy of Financial and Health Information notice was not filed with and approved by the Department.

2. Underwriting and Rating

- a. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) as 2.0 percent of the active commercial automobile policies reviewed contained multiple rating/filing errors.
- b. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) as the rates used on 40.0 percent of the active commercial automobile policies reviewed had not been filed with and approved by the Department.
- c. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(g), 11 NCAC 10.0105(a), and Rule 15.C of the Commercial Automobile Manual as it failed to submit an individual risk filing with the Department supporting the rates used on 2.0 percent of the active commercial automobile policies reviewed.
- d. The Company was deemed to be in apparent violation of the provisions of NCGS 58-3-150(a) and 58-41-50(a) as various forms listed on the commercial automobile policy declarations page had not been filed with and approved by the Department.
- e. The Company was deemed to be in apparent violation of the provisions of 11 NCAC 19.0102(a) and 19.0106(a)(3) as it was unable to provide a copy of the form filing for the commercial automobile policy declarations page and application.
- f. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(a)(b), 11 NCAC 10.1102(11)(a), and 10.1201(a)(c) as commercial inland marine rates/rules/forms had not been filed with and approved by the Department.
- g. The Company was deemed to be in apparent violation of the provisions of NCGS 58-33-40(h) as 47.4 percent of the general liability applications reviewed were accepted from a producer who was not appointed.
- h. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) and 11 NCAC 10.1604(b)(2) as 42.1 percent of the active general liability policies reviewed were rated using the incorrect ISO rate filing editions.
- i. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) as 21.1 percent of the active general liability policies reviewed were rated incorrectly.

- j. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-50(f) and Rule 8 of the Commercial Lines Manual as 15.8 percent of the active general liability policies were charged premiums over the policy minimum.

3. Terminations

- a. The Company was reminded of Rule 11 of the Commercial Automobile Manual as the return premium was calculated incorrectly on 4.0 percent of the cancelled commercial automobile policies reviewed.
- b. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-15(b) and the policy termination provisions as the cancellation notice for 12.5 percent of the cancelled general liability policies reviewed was not issued at least 15 days prior to the termination date.
- c. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-15(b) as the cancellation notice for 12.5 percent of the cancelled general liability policies reviewed did not state the precise reason for cancellation.
- d. The Company was deemed to be in apparent violation of the provisions of NCGS 58-41-20(b) as the nonrenewal notice for 32.0 percent of the nonrenewed commercial automobile policies reviewed was not issued at least 45 days prior to the termination date.
- e. The Company was reminded of the provisions of 11 NCAC 19.0102(a), 19.0104, and 19.0106 (a)(4)(h) as 8.0 percent of the nonrenewed commercial automobile files reviewed did not contain a copy of the nonrenewal notice sent to the insured.
- f. The Company was reminded of the provisions of NCGS 58-41-20(e) as the nonrenewal notice for 2.0 percent of the nonrenewed commercial automobile policies reviewed did not state the precise reason for nonrenewal.
- g. The Company was deemed to be in apparent violation of the provisions of 11 NCAC 19.0102(a), 19.0104, and 19.0106 (a)(4)(h) as 100 percent of the nonrenewed general liability files reviewed did not contain a copy of the nonrenewal notice to the insured.

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 58-3-150	Forms to be approved by Commissioner.
NCGS 58-33-40	Appointment of agents.
NCGS 58-39-25	Notice of insurance information practices.

<u>Statute/Rule</u>	<u>Title</u>
NCGS 58-39-26	Federal privacy disclosure notice requirements.
NCGS 58-39-27	Privacy notice and disclosure requirement exceptions.
NCGS 58-41-15	Certain policy cancellations prohibited.
NCGS 58-41-20	Notice of nonrenewal, premium rate increase, or change in coverage required.
NCGS 58-41-50	Policy form and rate filings; punitive damages; data required to support filings.
NCGS 20-309	Motor vehicle registration.
11 NCAC 10.0105	Manuscript or Individual Risk Filings.
11 NCAC 10.1102	Applicability.
11 NCAC 10.1201	General Requirements.
11 NCAC 10.1604	Supplementary Rating Information.
11 NCAC 19.0102	Maintenance of Records.
11 NCAC 19.0104	Policy Records.
11 NCAC 19.0106	Records Required for Examination.

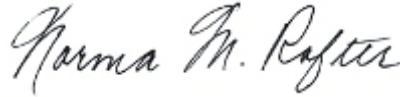
CONCLUSION

An examination has been conducted on the market conduct affairs of National Interstate Insurance Company for the period January 1, 2005 through December 31, 2007 with analyses of certain operations of the Company being conducted through January 12, 2009. 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 policyholder treatment, underwriting and rating, and terminations.

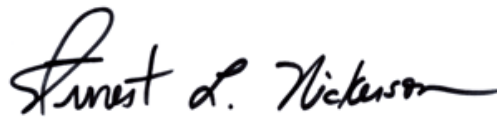
In addition to the undersigned, James P. McQuillan, CPCU and Letha Lombardi, North Carolina Market Conduct Examiners, participated in this examination.

Respectfully submitted,

Handwritten signature of Norma M. Rafter in cursive script.

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.

Handwritten signature of Ernest L. Nickerson in cursive script.

Ernest L. Nickerson, FLMI, ACS, AIRC, ARM, RHU
Deputy Commissioner
Market Regulation Division
State of North Carolina