



REPORT ON
MARKET CONDUCT EXAMINATION

of the

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY
Bloomington, Illinois

BY REPRESENTATIVES OF THE
NORTH CAROLINA DEPARTMENT OF INSURANCE

as of

July 16, 2012

TABLE OF CONTENTS

SALUTATION	1
FOREWARD.....	2
SCOPE OF EXAMINATION.....	2
EXECUTIVE SUMMARY.....	2
EXAMINATION OVERVIEW	3
Purpose of Examination	3
Policies and Coverages Subject to the Refund Procedures	3
Policies and Coverages Not Subject to the Refund Procedures.....	3
Premium to be Refunded	4
Time Frame for Refund Payment	4
Escrow Account	4
Amount of Refund	5
Method of Payment.....	5
Delivery to Policyholders	6
Unclaimed Refunds.....	6
REFUND ANALYSES	6
AREAS OF CONCERN.....	8
TABLE OF STATUTES AND RULES.....	8
CONCLUSION	8

Raleigh, North Carolina
July 16, 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 Andrew Boron
Director of Insurance
Department of Insurance
State of Illinois
320 W. Washington Street
Springfield, Illinois 62767

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 North Carolina private passenger automobile business of

STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY (NAIC #25178)
NAIC Exam Tracking System Exam Number: NC170-M106
Bloomington, Illinois

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

FOREWARD

This examination reflects the North Carolina insurance activities of State Farm Mutual Automobile 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 29, 2011 and covered the period of January 1, 2009 through October 31, 2009 with analyses of certain refund procedures of the Company being conducted through July 9, 2012. All comments made in this report reflect conditions observed during the period of the examination.

This examination was arranged and conducted by the Department. It was made in accordance with Market Conduct standards established by the Department and procedures established by the National Association of Insurance Commissioners (NAIC) and accordingly included tests of the Company's refund procedures associated with the 2008 Private Passenger Automobile Rate Filing Case (2008 Rate Filing Case).

EXECUTIVE SUMMARY

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

Private Passenger Automobile – the Company understated refunds for 2,541 policy records due to incorrectly offsetting the policyholder refund of one policy by a negative refund of another policy, overlooking interest when determining if refunds exceeded the \$5.00 threshold for reimbursement, a systems error which prevented refunds from printing, rounding errors and calculation errors.

Specific violations related to each area of concern 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 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.

EXAMINATION OVERVIEW

Purpose of Examination

This examination was undertaken to verify the Company's refund procedures associated with the 2008 Rate Filing Case. The procedures for the 2008 Rate Filing Case were the result of a settlement reached between the Commissioner of Insurance, State of North Carolina and the North Carolina Rate Bureau (Bureau).

Policies and Coverages Subject to the Refund Procedures

Policies and coverages to which these procedures apply are non-fleet private passenger automobile (including motorcycle liability) policies and coverages subject to the jurisdiction of the Bureau and non-fleet private passenger automobile (including motorcycle liability) policies and coverages ceded to the North Carolina Reinsurance Facility (Facility) that are "clean risks" as defined in the provisions of NCGS 58-37-35(l) effective beginning January 1, 2009 through October 31, 2009 for new and renewal policies.

Policies and Coverages Not Subject to the Refund Procedures

For the 2008 Rate Filing Case, these procedures do not apply to "consent to rate" policies or coverages issued or renewed pursuant to the provisions of NCGS 58-36-30(b) ("consent to rate") or to "other than clean risk" policies or coverages, as defined in the provisions of NCGS 58-37-35(l), ceded to the Facility.

Premium to be Refunded

The 2008 Settlement Agreement and Consent Order called for the following, "...the premium to be refunded on each policy shall be the difference between the total premium per policy collected on each policy (after consideration of all deviations applicable to each policy and all unpaid premium specifically applicable to each policy) and the total premium per policy that would have been collected on each policy using the rates by coverage resulting from the Settlement Agreement and Consent Order with respect to the 2008 Rate Filing Case." The term "premium" shall not include interest, installment payment charges, or recoupment/allocation surcharges (including loss and clean risk surcharges). Neither dividends nor unpaid premium attributable to policies other than private passenger automobile were to be used to offset the refund amount.

Time Frame for Refund Payment

No refunds were to have been delivered or mailed to policyholders prior to May 1, 2010. For companies that wrote only six month policies, refunds were to have been made during the period beginning May 1, 2010 and ending July 31, 2010. For companies that wrote both six month policies and twelve month policies, refunds on policies that expired prior to May 1, 2010 could have been made during the period beginning May 1, 2010 and ending July 31, 2010. Refunds on all policies not refunded during the period beginning May 1, 2010 and ending July 31, 2010 were to have been made during the period beginning November 1, 2010 and ending January 31, 2011. All refunds were to have been delivered or mailed to policyholders on or before January 31, 2011.

Escrow Account

All monies for the refunds were to be taken from an escrow account established prior to the settlement in accordance with the provisions of NCGS 58-36-25. The Company escrowed all funds associated with the 2008 Rate Filing Case by utilizing an existing escrow account.

Amount of Refund

The amount of refund on a policy was to be the portion of premium as determined above, plus simple interest at the rates described below on such premium from the effective date of each policy through April 30, 2010 on policies refunded during the May 1, 2010 through July 31, 2010 refund period and through October 31, 2010 on policies refunded during the period November 1, 2010 through January 31, 2011 refund period. Interest was to accrue at the annual rate of 6.25 percent prior to July 16, 2009 (the period that premium was escrowed pending judicial review pursuant to G.S. 58-36-25(b)) and at the annual rate of 3.25 percent on and after July 16, 2009 (the period that the premium was to be escrowed pursuant to agreement of the parties under the Settlement Agreement and Consent Order).

In making the calculations required under these procedures, each company was allowed to apply the premium rounding rule it applies in the ordinary course of its business.

If a policyholder had multiple policies for which refunds were to be calculated, each policy was to be treated separately in determining if any refund was due on such policy. Refund amounts of \$5.00 or less (including interest) were not required by statute to be refunded to the policyholder.

Method of Payment

Refunds were to be paid by check(s) or draft(s) payable to the policyholder or policyholders. For policyholders whose premiums were paid by a premium finance company, the refund checks or drafts were to be mailed to the premium finance company.

Each company had the option to accumulate all refunds due an individual policyholder into one check or draft or to issue separate checks or drafts for each policy on which a refund was due. All refund checks were issued through State Farm Mutual Automobile Insurance Company.

Delivery to Policyholders

Refunds were to be mailed or delivered to the named policyholder or policyholders at the address shown on the policy record for which a refund was made or at such other address the company, in good faith, determined and believed to be more current.

The Company indicated that in addition to the above, it utilized the following procedures for returned checks:

- The policy master record was reviewed for a more current address.
- Client searches were conducted to locate a more recent address for the customer.
- The agent was contacted for assistance in resolving address discrepancies.
- If an address change was received, the address was changed and the refund re-sent.
- If the policyholder was unable to be located, the check was destroyed and the destroy date was noted on the premium history screen of the policy master record.

Returned checks not falling into one of the categories listed above were considered undeliverable.

Unclaimed Refunds

The Company must maintain unclaimed funds and escheat those funds to the North Carolina Treasury Department as stipulated under the provisions of NCGS 4-116B.

REFUND ANALYSES

The Department implemented procedures to test Company data for compliance with the 2008 Settlement Agreement and Consent Order. Areas tested included premium refund calculations using Company methodologies and timeliness of refund.

Records were submitted in a specified layout. Tests were then conducted utilizing a software tool, Audit Command Language (ACL). The examiners summarized these records to verify the totals against the Company checks issued.

The following tables indicate information reported by the Company and the examiners.

Refund Data Reported by Company

Company Name	NAIC Company Number	Refund Procedures Implementation Date	Refund Completion Date	Total Number of Policies Subject to Refund (a)	Total Refund Dollars Excluding Interest	Total Refund Interest Dollars	Total Refund Dollars	Uncollected Premium (b)	Grand Total Refund Dollars (c)
State Farm Mutual Automobile Insurance Company	25178	5/4/2010	7/29/2010	90,789	\$3,569,516.31	\$125,918.11	\$3,695,434.42	\$0.00	\$3,695,434.42
TOTAL				90,789	\$3,569,516.31	\$125,918.11	\$3,695,434.42	\$0.00	\$3,695,434.42

Population Data Testing Criteria

Testing Using ACL or Sampling	Records Used in Testing	Population of Transactions Provided by Companies	Policies After Combining Transactions (a)	Policies Reviewed Using Company Methodology
ACL	100%	14,692,216	1,030,639	1,030,639

Examination Findings

Company Name	NAIC Company Number	Refund Completion Date	Actual Number of Refunds Made (a)	Actual Dollar Amount of Refunds Made (c)	Number of Returned Checks Subject to Escheat	Actual Dollar Amount of Returned Checks Subject to Escheat	Number of Policy Records in Error (d)	Additional Refund Due Excluding Penalty Interest	Penalty Interest	Grand Total Refund Dollars
State Farm Mutual Automobile Insurance Company	25178	12/14/2010	90,827	\$3,694,696.71	12,908	\$327,979.86	2,541	\$31,337.51	\$2,506.93	\$3,728,541.15
TOTAL			90,827	\$3,694,696.71	12,908	\$327,979.86	2,541	\$31,337.51	\$2,506.93	\$3,728,541.15

(a) The Company reported policies, inclusive of all policy terms, that received a refund. The difference is due to the numbers reported prior to the data compiled for the examination.

(b) The Company did not include uncollected premium in its refund calculations.

(c) The difference is due to certain duplicate policies applied for refund data reported by the Company.

(d) Inclusive of all policy terms.

AREAS OF CONCERN

The review of the Company's private passenger automobile policies subject to the 2008 Rate Filing Case revealed the following relative to its refund procedures:

The Company incorrectly offset the policyholder refund of one policy by a negative refund of another policy, resulting in 1,369 underpayments in the amount of \$20,797.08. The Company incorrectly overlooked interest when determining if 971 refunds exceeded the \$5.00 threshold for reimbursement to the policyholder, resulting in underpayments in the amount of \$7,739.95. An unknown systems error prevented 94 refunds from printing, resulting in underpayments in the amount of \$2,462.11. Rounding errors resulted in 99 underpayments in the amount of \$224.15. Errors in the calculation of 8 refunds resulted in underpayments in the amount of \$114.22.

The Company was deemed to be in apparent violation of the provisions of NCGS 58-36-25(b) and the provisions stipulated in the Settlement Agreement and Consent Order for the 2008 Rate Filing Case.

The Company was given the opportunity to refund the monies. The examiners informed the Company that penalty interest must be calculated at an annual interest rate of 8.0 percent. The Company refunded \$33,844.44 (including penalty interest) to all affected policyholders by May 11, 2012.

TABLE OF STATUTES AND RULES

<u>Statute/Rule</u>	<u>Title</u>
NCGS 4-116B	North Carolina Unclaimed Property Act.
NCGS 58-2-131	Examinations to be made; authority, scope, scheduling, and conduct of examinations.
NCGS 58-36-25	Appeal of Commissioner's order.
NCGS 58-36-30	Deviations.
NCGS 58-37-35	The Facility; functions; administration.


CONCLUSION

An examination has been conducted on the refund procedures utilized by State Farm Mutual Automobile Insurance Company relative to the 2008 Private Passenger Automobile Rate

Filing Case. This examination referenced the period January 1, 2009 through October 31, 2009 with analyses referencing certain refund procedures through July 9, 2012. The Company's response to this report, if any, is available upon request.

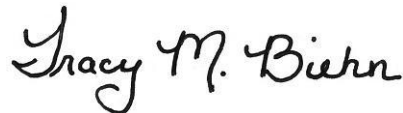
This examination was conducted in accordance with the North Carolina Department of Insurance and the National Association of Insurance Commissioners Market Regulation Handbook procedures.

Respectfully submitted,

A handwritten signature in black ink that reads "James P. McQuillan". The signature is written in a cursive style with a large, looped initial "J".

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.

A handwritten signature in black ink that reads "Tracy M. Biehn". The signature is written in a cursive style with a large, looped initial "T".

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