OFFICE OF THE
NEW MEXICO PUBLIC REGULATION
COMMISSION
INSURANCE DIVISION

CERTIFICATE

I, Eric P. Serna, Superintendent of Insurance of the State of New Mexico, do hereby certify that the attached Report of Examination for the period ending June 30, 2003 on:

Farmers Insurance Company of Arizona
Mid-Century Insurance Company
18444 North 25th Avenue
Phoenix, Arizona 85023

Was recently completed by Nestor J. Romero, Examiner-In-Charge with the Insurance Division.

Due consideration has been given to the comments of the Examiner regarding the financial condition and business affairs as reflected in this report.

The report as of this date is hereby adopted, filed and made an official record of the Division.

In Witness Whereof, I have hereunto set my official seal On this 24th day of March, 2006 A.D.

[Signature]
Superintendent of Insurance
March 24, 2006

John Brian Braddock  
President  
Farmers Insurance Company of Arizona  
Mid-Century Insurance Company  
184444 North 25th Avenue  
Phoenix, AZ 85023

Dear Mr. Braddock

In accordance with Code Section 59A-4-11, enclosed is the adopted Report of Examination of Farmers Insurance Company of Arizona and Mid-Century Insurance Company.

The adopted report will be kept on file with the Division of Insurance and will be made available for public inspection.

If you should have any questions, please contact this office.

Sincerely,

[Signature]

Aaron Feliciano  
Chief Examiner

CC: Eric P. Serna  
Superintendent of Insurance
STATE OF NEW MEXICO
COUNTY OF BERNALILLO

Nestor J. Romero, CPA, CFE, CIE being duly sworn, upon his oath deposes and says:

That he is an examiner appointed by the Superintendent of Insurance of the State of New Mexico;

That an examination was made of the affairs of the Farmers Insurance Company of Arizona (FICOA), and Mid-Century Insurance Company (MCIC) for the period ending June 30, 2003;

That the following twenty-nine (29) pages constitute the report thereon to the State of New Mexico Division of Insurance Superintendent;

And that the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.

Nestor J. Romero, CPA, CFE, CIE
Examiner-In-Charge

Subscribed and sworn to before me this the 27TH day of March 2006.

Isabel F. Solano
(Signature)

Isabel F. Solano Notary Public
(Print Name)
in and for the State of New Mexico

My commission expires June 6, 2009
REPORT OF THE MARKET CONDUCT EXAMINATION

OF

FARMERS INSURANCE GROUP

Farmers Insurance Company of Arizona
NAIC # 3625-21598
and
Mid-Century Insurance Company
NAIC # 3625-21687

As of June 30, 2003
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June 30, 2004

Honorable Eric P. Serna  
Superintendent of Insurance  
New Mexico Department of Insurance  
Post Office Box 1269  
Santa Fe, New Mexico 87504-1269

Dear Superintendent Serna:

Pursuant to your instructions and in accordance with NMSA 1978, §59A-4-5, an examination has been made of the business affairs of the

Farmers Insurance Company of Arizona (FICOA)  
Mid-Century Insurance Company (MCIC)  
18444 North 25th Avenue  
Phoenix, Arizona 85023

(Hereinafter referred to as FICOA or MCIC or collectively as Farmers or the Company) as of June 30, 2003, and the report thereon is hereby respectfully submitted.
EXECUTIVE SUMMARY

The Examiners reviewed each of the Company's operational units related to private passenger automobile and motorcycle coverages, focusing on underwriting and rating practices, as well as its handling of cancellations and consumer complaints. Special attention was paid to the use and handling of information obtained by a claims history information exchange developed by ChoicePoint -- the Comprehensive Loss Underwriting Exchange ("CLUE") -- and to consumer credit information obtained from Trans Union and used for the purposes of determining an applicant's acceptability and premium. The Examiners found no substantial compliance issues, only minor findings were noted.

In general, as discussed in detail in this Report, the Examiners found that:

- FICOA underwriting guidelines provide specific examples of not-at-fault accidents that are acceptable for placement in the preferred company. These examples do not include all scenarios of not-at-fault accidents. Placement of the coverage in the standard company due to a not-at-fault accident causes an increase in premiums for the insured, contrary to state statutes.
- Farmers has failed to file with the Division of Insurance the numeric credit score bands that correspond to the alphabetical "FARA" code used in the rating of its automobile policies.
- MCIC has not filed its renewal discount for motorcycle coverage or included this discount as one of the enumerated discounts applicable to motorcycle coverage.
- The Company did not provide the appropriate reason for cancellations effective more than 60 days after the effective date of coverage.
FOREWORD

The Examiners conducted the examination of two companies in the Farmers Insurance Group: Farmers Insurance Company of Arizona (hereinafter "FICOA") and Mid-Century Insurance Company (hereinafter "MCIC"). Although included in the call letter, a third company, Foremost Insurance Company, was eliminated from the examination because this company does not write any personal lines automobile insurance in New Mexico. This Report will refer to the companies collectively as "Farmers" or "the Company."

This examination was conducted in accordance with New Mexico Statutes Annotated (1978), Chapter 59A, and New Mexico Administrative Code, Title 13 (hereinafter "NMSA (1978)" and "NMAC" respectively). Specifically, this examination was conducted under the authority of NMSA (1978) §§ 59A-4-1, et seq. Company personnel provided the Examiners with the information that is included in this Report of Examination. The courtesy and cooperation extended by the officers and employees of the Company are sincerely appreciated.

The EXHIBITS section of this Report contains the Exhibits referenced in the Report in bold type.

SCOPE OF EXAMINATION

The scope of this examination was limited to the Company's private passenger automobile and motorcycle coverages. This targeted examination focused on the Company's underwriting and rating practices, as well as its handling of cancellations and consumer complaints. The purpose of the
examination was to determine the Company's compliance with New Mexico's insurance laws related to the underwriting and rating of personal lines automobile coverage and to determine whether the Company's operations and practices are consistent with the public interest. Special attention was paid to the use and handling of information obtained by a claims history information exchange developed by ChoicePoint – the Comprehensive Loss Underwriting Exchange ("C.L.U.E.") – and to consumer credit information obtained from Trans Union and used for the purposes of determining an applicant's acceptability and premium. This examination covered the period from January 1, 2001 through June 30, 2003.

Independent Examiners conducted this examination pursuant to the insurance laws of the State of New Mexico, as authorized by NMSA (1978) § 59A-4-5. The Examiners performed their reviews in accordance with the procedures and guidelines established by the National Association of Insurance Commissioners ("NAIC").

Examination findings may result in administrative action by the Division. Certain unacceptable or non-complying practices may not have been discovered due to the limited scope of this examination. Failure to identify specific non-complying Company practices does not constitute acceptance by the Division.

In accordance with the Division's procedures, the Examiners completed Personal Lines File Review Sheets ("Review Sheets") on those files, forms, and/or practices that appeared to violate New Mexico insurance laws. The Review Sheets were submitted to the Company representatives designated by
the Company management as being knowledgeable about the issues raised in the Review Sheets for their review and comment.

**METHODOLOGY**

The Examiners requested, and the Company supplied, hard copy and/or electronic listings of data and information related to complaints, new business issued, cancellations, and policies with claims denied or closed without payment within 30 days of cancellation. The Company provided complaint data in hard copy and provided the policy data by CD-ROM in delimited text format.

The Examiners also requested copies of the following materials in use during the examination period:

- Underwriting and rating manuals, guides and bulletins;
- Specimen applications, policy forms and billing notices;
- Cancellation codes, automobile symbols, and rating territories;
- Advertising.

The Examiners requested and received access to the Company's Intranet and Internet web site(s) available to the Company's agents and employees. The Examiners conducted a review of these web sites, as well as [www.farmersinsurance.com](http://www.farmersinsurance.com), the web site accessible by the general public.

**Complaint Data**

The Company provided a list and original files of 185 complaints received during the examination period for the private passenger automobile line of business. The Examiners reviewed 100% of the complaint files.
Automobile and Motorcycle Policy Data

The Company produced electronic listings of automobile and motorcycle new business and cancellations processed during the examination period. The Examiners used Access to filter the data by Company code, as well as by policy effective date in the case of New Business records and cancellation effective date in the case of Cancelled records to determine that all applications were received and all cancellations were effective during the examination period. Based on the percentages of policies issued or cancelled within each calendar year of the examination period, the Examiners selected their random samples with a pro rata distribution by year. The following random samples were selected from each of the populations:

Table I – New Business Samples Selected

<table>
<thead>
<tr>
<th>File Type</th>
<th>Population</th>
<th>2001 %</th>
<th>2002 %</th>
<th>2003 %</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>FICOA Auto NB – “30/60”</td>
<td>65,789</td>
<td>37%</td>
<td>41%</td>
<td>22%</td>
<td>100</td>
</tr>
<tr>
<td>FICOA Auto NB – Standard</td>
<td>36,133</td>
<td>43%</td>
<td>37%</td>
<td>20%</td>
<td>100</td>
</tr>
<tr>
<td>FICOA Auto NB – Nonsmoker</td>
<td>1,186</td>
<td>100%</td>
<td>--</td>
<td>--</td>
<td>50</td>
</tr>
<tr>
<td>FICOA Motorcycle NB</td>
<td>3,948</td>
<td>42%</td>
<td>38%</td>
<td>20%</td>
<td>50</td>
</tr>
<tr>
<td>MCIC Auto NB – Standard</td>
<td>69,224</td>
<td>34%</td>
<td>42%</td>
<td>24%</td>
<td>100</td>
</tr>
<tr>
<td>MCIC Motorcycle NB</td>
<td>1,033</td>
<td>34%</td>
<td>46%</td>
<td>20%</td>
<td>50</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>450</strong></td>
</tr>
</tbody>
</table>

Table II – Cancelled Policy Samples Selected

<table>
<thead>
<tr>
<th>File Type</th>
<th>Population</th>
<th>2001 %</th>
<th>2002 %</th>
<th>2003 %</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>FICOA Cancelled</td>
<td>161,143</td>
<td>42%</td>
<td>40%</td>
<td>18%</td>
<td>100</td>
</tr>
<tr>
<td>MCIC Cancelled</td>
<td>91,956</td>
<td>40%</td>
<td>41%</td>
<td>19%</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>200</strong></td>
</tr>
</tbody>
</table>

1 This policy type was discontinued after November 1, 2001, although policies issued prior to that date are carried forward until canceled.
File Review Methodology

During the file review the Examiners used a proprietary Access database and Excel spreadsheets and formulas to:

- Log and track the files reviewed, as well as examination requests and findings.
- Confirm compliance with filed rating protocols;
- Calculate compliance with New Mexico insurance laws regulating timeliness;
- Perform time-study analyses.

STATUTES AND RULES CITED

The Examiners have found the Company in apparent violation of the following:

New Mexico Statutes


Administrative Rules

NMAC 13.8.4.8.

In addition, this Report makes reference to NMSA (1978) §§ 59A-4-5, 59A-4-7(B), and 59A-16-4.

HISTORY OF THE COMPANY

Farmers Insurance Group of Companies was founded in 1928 when Farmers Insurance Exchange, an automobile insurer, was formed. Farmers, a stock property and casualty company is domiciled in Los Angeles, California and operates in 41 states. FICOA and MCIC are authorized to transact business in New Mexico under the Farmers Insurance Group of Companies. The Farmers
Group is the third-largest writer of private passenger automobile, motorcycle and homeowners insurance in the country.

Farmers Insurance Group markets its products through Farmers' own employees, agents, independent contractors, and independent agents. The Farmers Group provides administrative support services to employees, agents, and independent contractors nationwide through its regional marketing and administrative offices.

FICOA was incorporated under the laws of the State of Arizona on August 22, 1969, and began operations on July 1, 1973. FICOA is authorized to transact business in two states, Arizona and New Mexico. MCIC was incorporated on December 3, 1949 under the laws of the State of California and began operations on February 17, 1953. MCIC is currently writing business in 37 of the 44 states in which it is authorized to transact insurance.

**Table III - Production and Loss Ratios/Policy Counts by Company**

**FICOA**

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2002</th>
<th>June 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written Premium</td>
<td>$99,874,188</td>
<td>$103,431,756</td>
<td>$54,715,083</td>
</tr>
<tr>
<td>Earned Premium</td>
<td>$98,911,507</td>
<td>$102,610,219</td>
<td>$53,386,611</td>
</tr>
<tr>
<td>Loss Ratio</td>
<td>61%</td>
<td>58%</td>
<td>59%</td>
</tr>
<tr>
<td>Policies In Force</td>
<td>162,607</td>
<td>163,744</td>
<td>168,628</td>
</tr>
</tbody>
</table>

**Mid-Century**

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2002</th>
<th>June 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Written Premium</td>
<td>$26,723,426</td>
<td>$32,133,206</td>
<td>$19,505,429</td>
</tr>
<tr>
<td>Earned Premium</td>
<td>$26,037,436</td>
<td>$30,396,236</td>
<td>$18,295,721</td>
</tr>
<tr>
<td>Loss Ratio</td>
<td>66%</td>
<td>63%</td>
<td>60%</td>
</tr>
<tr>
<td>Policies In Force</td>
<td>not available</td>
<td>not available</td>
<td>not available</td>
</tr>
</tbody>
</table>
SALES & MARKETING

The Company markets its automobile and motorcycle products in New Mexico through a network of independent agents. Although Farmers does not use "captive" agents, the agents' agreement requires them to write eligible business with Farmers before placing the business with any other company.

The Company's agent support web site lets the Company agents perform various tasks for themselves and their clients. A user ID assigned by the Company and password selected by the agent are required to access the web site. This nationwide site allows an agent to quote, bind, and/or endorse a policy, and track a Vehicle Identification Number ("VIN") for any type of insurance that the Company sells.

FORMS & ADVERTISING

Policy Forms

Applications for auto policies for both FICOA and MCIC are processed exclusively via an electronic application process. The process may be conducted using the Auto Policy Processing System ("APPS") and a network terminal, or by using a standard PC and the Internet-based e-Agent auto application process.

Farmers does maintain procedures for a written application process as part of its disaster recovery strategy, and the Company provided copies of its application forms for the Examiners' review. No exceptions were noted.

The Company provided and the Examiners reviewed the Company's automobile and motorcycle policy and endorsement forms in use during the examination period. The Examiners reviewed the forms for compliance with New
Mexico's mandates concerning arbitration, policy cancellation, loss settlement, and uninsured/underinsured motorist coverage. No exceptions were noted.

The Examiners confirmed that all forms provided by the Company for review had been filed with and approved by the Division.

**Billing Forms**

The Company's automobile policies renew every six months. Motorcycle coverage is generally offered with annual renewal terms. The Examiners reviewed billing/renewal notices for both automobile and motorcycle coverages. No exceptions were noted.

**Advertising**

The Examiners reviewed the advertising for compliance with New Mexico's laws concerning misrepresentation in advertising. NMSA (1978) § 59A-16-4 states in pertinent part:

No person shall make, publish, issue or circulate any estimate, illustration, circular, statement, sales presentation or comparison which:

A. misrepresents the benefits, advantages, conditions or terms of any policy;
   * * *

D. is misleading or a misrepresentation as to the financial condition of any person, or as to the reserve system upon which any life insurer operates;
   * * *

The Examiners reviewed 54 pieces of advertising in use by Farmers during the examination period. Of these, 52 items related in whole or in part to automobile insurance coverage. The Examiners reviewed the following:
### Table IV - Types of Advertising

<table>
<thead>
<tr>
<th>Type</th>
<th>Auto Only</th>
<th>Auto &amp; Other</th>
<th>Total Reviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Booklet</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Brochure</td>
<td>22</td>
<td>3</td>
<td>25</td>
</tr>
<tr>
<td>Certificate</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Mailing Insert</td>
<td>8</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td>Mail Reply Postcard</td>
<td>2</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Mobile</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Placard</td>
<td>2</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Poster</td>
<td>2</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Print ad</td>
<td>4</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Quote Form</td>
<td>0</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Sticker</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>44</strong></td>
<td><strong>8</strong></td>
<td><strong>52</strong></td>
</tr>
</tbody>
</table>

Of the 52 pieces reviewed, the Examiners identified six (11.5%) advertising pieces that used the tag line or contained the phrase “America’s first choice.” When questioned by the Examiners about the source for this claim, the Company informed the Examiners that all of the pieces have now been discontinued and remaining stock has been destroyed. Based on the Company’s decision to discontinue the use of the inappropriate tag line, the Examiners did not issue an adverse finding for the advertising pieces in question. The Company has discontinued the use of this tag line as indicated.

No other exceptions were noted.

### UNDERWRITING AND RATING

The Examiners requested copies of the Companies’ underwriting guidelines, filed rating methodologies, and rates in effect during the examination period. In particular, the Examiners requested a description of the Company’s use of C.L.U.E. reports and credit scoring in underwriting and/or the establishment of premiums.
It is important to note that Farmers assigns a unique policy number to each vehicle in the household. Farmers makes a distinction between "new business, new household" applications and "new business, existing household" applications for purposes of obtaining credit score and C.L.U.E. reports. Information for existing households is obtained from the system rather than by ordering new credit scores and C.L.U.E. reports.

**Credit Scoring**

Beginning on November 1, 2001² FICOA implemented a rating structure that included credit scoring.³ The Company uses an alphabetical code, known as a FARA code, for this purpose. "FARA" stands for Farmers Auto Risk Assessment. FARA codes are based on the mathematical model developed by Fair Isaac, which developed the proprietary model based on its research into the use of insurance bureau information as a predictor of risk.

Policies issued before November 1, 2001 are classified as "FARA" policies, while policies issued on and after that date are classified as "FARA01" policies. The corresponding FARA code assigned to a FARA policy includes potential discounts (depending on the alphabetical code assigned), but is not subject to a surcharge for the life of the policy. The code pertinent to a FARA01 policy may have a corresponding discount or surcharge, depending on the code assigned.

FARA codes derive from Farmers’ proprietary model, which converts the numeric insurance scores provided by the Fair Isaac model to the alphabetical

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² MCIC did no use credit scoring in rate setting until June 1, 2003.
The numeric insurance scores are derived from the full credit report provided by Trans Union.

The Company clarifies that, although derived from credit reports, the numeric insurance score is not a credit score as that term is generally understood. Therefore, although an individual may have a high credit score for the purpose of obtaining loans or other forms of credit, this fact will not necessarily result in a high insurance score, because the two scores consider different variables. Likewise, the Company clarifies that the insurance score is intended as a predictor of the group's likelihood of future losses, and not as a predictor of any individual's likelihood of a loss. The Company compares this to the assumption that, as a group, those with traffic citations have a higher risk of future loss, although a particular individual with a citation may not experience a future loss.

To obtain the FARA score, the client information is transmitted from the Auto Policy Processing System ("APPS") or is input by the agent to the Point of Sale ("POS") system. POS is a multifunctional system capable of acquiring various consumer reports, including among other reports the insurance credit score and the C.L.U.E. Report. Client information includes name, address, date of birth, social security number, and driver's license number.

POS transmits the pertinent information through the Business Information Analysis System ("BIAS") to Trans Union. BIAS is an interface software that

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3 Credit scores are one of several criteria used in rating the coverage. Other factors include age, rate class, tier, eligibility for established discounts, and the addition of certain surcharges.
transmits the coded request in a format Trans Union's system can read and process.

Trans Union generates a full credit report, which it passes to the Fair Isaac model contained within the Trans Union system. Once transferred to the Fair Isaac model, the credit report is not retained, except for a journal abstract. The Fair Isaac model extracts 9 to 14 selected elements, which are evaluated and used to generate the insurance score. The model also identifies up to four primary reasons for the score. The score and the reasons for the score are then passed back to Trans Union, which transmits the results via BIAS back to POS. APPS "reads" the numeric score from POS and converts the score to an alpha code based on established value bands. FARA scores range from A to Z, and are sorted into score ranges associated with various levels of discount. Four alpha codes signify that a numeric score is not available:

<table>
<thead>
<tr>
<th>Score</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>E</td>
<td>System error</td>
</tr>
<tr>
<td>I</td>
<td>Insufficient credit history to score</td>
</tr>
<tr>
<td>M</td>
<td>Multiple hits on the credit history database</td>
</tr>
<tr>
<td>N</td>
<td>No credit history on record</td>
</tr>
</tbody>
</table>

System modifications since the inception of FARA processing have eliminated "M" codes. "E" codes are automatically rerun in an effort to obtain acceptable scores.

Originally, both the "I" (Thin File) and "N" (No Hit) codes were assigned to the insured's household and received a discount factor of .86 times the base
rate. In mid-2002, however, Farmers modified this procedure with regard to the "N" code to distinguish between two groups of "No Hit" classifications:

1. Customers who are no-hits with Social Security Numbers (SSN) that have been verified by the Service Center (FARA code assignment is "N").

2. Customers who are no-hits and have not provided verification of their SSN (FARA code assignment of "1").

Under this new procedure, an individual is assigned a FARA code "1" only when FARA is ordered for the first time and a credit report cannot be found. If the individual provides documentation verifying his/her SSN, the Service Center will determine whether the information was correctly input at the time the FARA code was requested. If the information used to order the FARA code was correct, a FARA code of "N" will be assigned. The FARA code "N" carries a discount factor of .86 times the base rate. If the SSN cannot be verified by appropriate documentation, the FARA code "1" will be assigned, carrying a factor of 1.0 times the base rate.

It is noteworthy that when this new procedure was implemented, Farmers specifically addressed the issue of insureds with existing FARA codes of "N" and elected not to require these insureds to provide SSN verification to keep their "N" score with its discount factor of .86 at renewal.

Once a FARA score is assigned to a household, it remains in effect for three years unless the insured requests that a new credit score be obtained. An insured may request a new score once every 10 months. At each third year

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4 NEWS FLASH From Home Office, July 1, 2002.
renewal, Farmers orders a new FARA code for the household. The Company may also request a new FARA score under certain circumstances, such as a change in head of household or a transfer of coverage to another state.

Agents and employees are able to access the alpha codes developed from the scores returned by Trans Union, but they cannot access the numeric score itself. The numeric score is, however, maintained indefinitely in the POS system. For purposes of this examination, Farmers developed a unique program to retrieve the numeric scores of the insureds in the FICOA New Business automobile samples.

**Underwriting Manuals**

The Examiners reviewed the Company's underwriting manuals and guides to ensure the fair treatment of policyholders. Among the issues considered in this review, the Examiners paid particular attention to the use of not-at-fault accidents as a reason for assigning a particular insured to MCIC, the standard company, rather than FICOA, the preferred company. NMSA (1978) § 59A-17-7.1(A) states:

> The rates of a motor vehicle liability insurer shall not provide for an increase in the premium if based upon an accident in which the insured is not at fault in any manner as determined by either the accident report or the insurer. If the insurer determines that its insured is at fault contrary to the specific finding of an accident report that the insured is not at fault, the insurer shall reach its conclusion only after an investigation.

The use of customer selection criteria that would place an insured with the standard carrier rather than the preferred carrier based on a not-at-fault accident violates this statute because the placement results in an increase in premium.

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5 Because credit scoring was implemented in November 1, 2001, this triennial request for a new
The Company provided copies of its underwriting guidelines in force during the examination period. The Examiners have noted a description of the customer selection criteria for FICOA that poses a potential violation of NMSA (1978) § 59A-17-7.1. Of primary concern to the Examiners is the following FICOA customer selection language contained on page 201 (November 1, 2001) (Exhibit 1):

An accident shall be counted regardless of cost if it is an automobile accident involving the applicant or other operator, which results in: Damage of property including that owned by or in the care, custody or control of the operator, or bodily injury, or death to any person.

**Exception:** Accidents will not be counted if the applicant or other operator was not substantially at fault.

**Count all accidents except the following:**

1. Insured's vehicle is struck while legally parked.
2. Insured's vehicle is struck while legally stopped for traffic or traffic control devise.
3. Reimbursed by, or on behalf of, a person responsible for the accident, or has a judgment against such person.
4. Colliding with a bird or animal.

The exceptions enumerated above are too restrictive and do not consider other scenarios in which an accident may occur without fault on the part of the insured/operator. Specifically, the Examiners noted that a hit-and-run accident involving the insured's *moving* vehicle would not fall within the exceptions. For example, if the insured legally entered an intersection on a green light and was struck by a vehicle illegally entering the intersection on red, which then fled the scene, an agent may conclude that the business must be placed in MCIC because it does not fall within the enumerated exceptions. In this case, the placement would constitute a violation of NMSA (1978) § 59A-17-7.1(A) because

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score had not yet commenced during the time of the onsite examination.
the placement results in a premium increase based on an accident for which “the
insured is not at fault in any manner as determined by either the accident report
or the insurer.”

By contrast, the language used in the MCIC’s description of its point
system, provides greater flexibility in interpreting what constitutes a not-at-fault
accident:

Exceptions

Accidents will not be counted if the applicant or other operator was not at
fault in any manner. Examples include, but are not limited to, the
following circumstances:

The Insured’s vehicle struck while legally parked.

The Insured’s vehicle struck by another while legally stopped for
traffic and the insured was not convicted of a moving traffic
violation.

The Insured has been reimbursed by, or on behalf of, the person
responsible for the accident or has a judgment against such
person.

The other party received a citation and the Insured did not.

The Insured collided with a bird or animal.

Hit by a “Hit and Run” driver if the accident is reported to the
proper authorities within 24 hours.

In order to bring its underwriting guidelines into compliance with NMSA
(1978) § 59A-17-7.1(A), the Examiners recommend that FICOA revise its
underwriting practices to eliminate the use of all not-at-fault accidents as a
criterion for eligibility in its “preferred” company. The Company states that it does
underwrite in accordance with the statute and does not deny coverage in the
preferred company based on fault-free accidents. They have agreed to review
this finding with their Product Management and Underwriting departments to determine how these guidelines can be modified.

**Use of C.L.U.E. Reports**

The Examiners considered the Company's use of C.L.U.E. reports in assessing compliance with NMSA (1978) §59A-17-7.1, quoted above.

Farmers uses C.L.U.E. reports and motor vehicle reports in the underwriting of its products. These reports are obtained for all new business, new household applications. Prior to mid-2001, reports reflecting a clean driving record were not maintained in the Company's underwriting system. Since that time, all C.L.U.E. reports appear to be available for new business, new households.

The Company's eligibility criteria consider accidents and minor citations during the past 36 months and major citations during the past 60 months for purposes of acceptability. Drivers under 25 years of age are held to a higher standard for minor citations than drivers 25 and older. The standard for accidents and major citations is the same for all age groups.

From the limited samples selected for review, the Examiners found no evidence of the use of not-at-fault accidents in customer placement. Nonetheless, the potential for violation of NMSA (1978) § 59A-17-7.1 remains because of the wording of the underwriting guidelines governing customer selection for FICOA.
Rating

Filed Rates

The Examiners requested copies of the rate filings for all rating rules in use during the examination period. NMSA (1978) § 59A-17-9 states:

As to insurance subject to Chapter 59A, Article 17 NMSA 1978, other than workers' compensation insurance, every insurer shall file with the superintendent all rates and supplementary rate information and all changes and amendments thereof made by it for use in this state at least sixty days before their proposed effective date. No filing made pursuant to this section shall become effective nor shall it be used until approved or deemed approved by the superintendent in accordance with Section 59A-17-13 NMSA 1978, at which time it may be used.

Both the Company and the Division provided the filings to the Examiners. The Examiners compared both sets of documents to the rating manuals provided by the Company to confirm that all Company rating rules had been filed with and approved by the Division.

The Examiners found no rating rules or protocols that had not been filed with and approved by the Division.

Rating Procedures

Farmers provided copies of its filed rates in use during the exam period. Base rates are established by territory and are modified according to prescribed discounts and surcharges. Premiums are also modified according to the age of insured, vehicle age, and coverage purchased. In most cases, the Company rounds the premium up to the nearest 10 cents.
NEW BUSINESS ISSUED

During the examination period FICOA issued primarily three types of policies: "30/60," "Standard," and "Nonsmoker." FICOA ceased offering the nonsmoker coverage on and after November 1, 2001. Nonsmoker policies in force on that date have been carried forward and administered until terminated. FICOA also offered motorcycle insurance during the examination period.

MCIC offered standard automobile insurance and motorcycle insurance during the examination period.

The Examiners reviewed the information collected on the application at inception, and reviewed each renewal of the policy thereafter through termination or the end of the examination period (June 30, 2003), whichever first occurred. The Examiners assigned a "Primary ID" number to each file under review in order to track the review and to maintain the confidentiality of the insureds' names or other identifying information. The Examiners applied the rules and protocols contained in the Company's underwriting and rating manuals to the information contained in each policy file to determine whether the Company was applying its filed rates to all policies and in a manner that was not unfairly discriminatory to any policyholder(s).

FICOA Preferred Automobile New Business

From a population of 65,789 preferred automobile policies issued from January 1, 2001 through June 30, 2003, the Examiners selected a sample of 100 policies to review.
FICOA Standard Automobile New Business

From a population of 36,133 standard automobile policies issued from January 1, 2001 through June 30, 2003, the Examiners selected a sample of 100 policies to review. No exceptions were noted.

FICOA Nonsmoker Automobile New Business

From a population of 1,186 nonsmoker automobile policies issued from January 1, 2001 through November 1, 2001, the Examiners selected a sample of 50 policies to review. No exceptions were noted.

MCIC Standard Automobile New Business

From a population of 69,224 standard automobile policies issued from January 1, 2001 through June 30, 2003, the Examiners selected a sample of 100 policies to review. No exceptions were noted.

FICOA Motorcycle New Business

From a population of 3,948 motorcycle policies issued from January 1, 2001 through June 30, 2003, the Examiners selected a sample of 50 policies to review. No exceptions were noted.

MCIC Motorcycle New Business

From a population of 1,033 motorcycle policies issued from January 1, 2001 through June 30, 2003, the Examiners selected a sample of 50 policies to review. The Examiners issued an examination finding on 12 (24.0%) of the policies reviewed because MCIC applied a renewal discount at the insured's first renewal that was not included in the Company’s filed rating rules. This
constitutes 12 apparent violations of NMSA (1978) § 59A-17-9 for failing to use filed rates (Exhibit 2).

Farmers disagreed with this finding, indicating that it had filed the renewal discount to apply to all new business for MCIC, including motorcycle new business. The Examiners reviewed the filed rating structure for motorcycle new business and noted that the filed rates indicate that specific enumerated discounts apply to motorcycle coverage and no others (Exhibit 3). The renewal discount was not among the enumerated discounts contained in the rate filing, and as such the findings of violations on the 12 files are justified. The Company states that it has submitted an amendatory filing for the discount in May 2004.

CANCELLATIONS

Cancelled Policy Review

The review of the Company’s termination practices was conducted to determine the accuracy and promptness of the Company’s premium refunding, as well as compliance with timeliness and content requirements for notices of termination. NMAC 13.8.4.8 states in pertinent part:

B. If a policy of insurance has been in effect for sixty (60) days or more, an insurer may cancel the policy only for one or more of the following reasons:
   (1) the policy was obtained through material misrepresentation, fraudulent statements, omissions or concealment of fact material to the acceptance of the risk or to the hazard assumed by the insurer;
   (2) willful and negligent acts or omission by the insured have substantially increased the hazards insured against;
   (3) revocation or suspension of driver’s license of the named insured or other operator who either resides in the same household or customarily operates the vehicle; or
   (4) the named insured presented a claim based on fraud or material misrepresentation.

C. An insurer, to affect such cancellation, shall mail or deliver to the insured a written notice stating the reason for such cancellation and stating when, not less
than fifteen (15) days after the mailing or delivery, the cancellation shall be effective. Provided, however, an insurer may eliminate the reason for such cancellation from any notice mailed to an additional insured or lienholder under the policy.

**FICOA Cancelled Policies**

Company records indicated a population of 161,143 FICOA automobile and motorcycle policies cancelled during the examination period. Before selecting the sample, the Examiners eliminated those records that could be identified by reason code as having been cancelled at the insured's request. From the remaining files, the Examiners selected a sample of 100 files for review.

The Examiners issued findings on two of the FICOA Cancelled files, (Examination files F-CN012 and F-CN025) where the cancellation was effective more than 60 days after the effective date of coverage, for failing to provide the reason for the cancellation, in apparent violation of NMAC 13.8.4.8(C) (**Exhibit 4**).

With regard to File F-CN012, Farmers indicated that the policy was cancelled mid-term after the Company learned of an alcohol-related violation. The notice stated that the policy no longer conformed to the Company's underwriting guidelines. The Company's position is that it cancelled the policy for a valid reason as defined by the rule and it had provided a reason for the cancellation.

The intent of the law is to provide a meaningful notice as to the reason for the cancellation. The Farmers' underwriting guidelines contain dozens of criteria for eligibility. Merely stating that the policy no longer conforms to underwriting
guidelines provides no real notice as to the reason for the cancellation, and the finding is therefore justified.

With regard to File F-CN025, the Company indicates that the cancellation was voided before it became effective. As in the case of F-CN012, this notice stated merely that the policy no longer conformed to underwriting guidelines. The notice is insufficient for failing to provide the reason for the cancellation, and the finding is justified.

Although the Company disagreed with these findings, they have agreed to revisit the issue with their underwriting and training teams.

MCIC Cancelled Policies

Company records indicated a population of 91,956 MCIC automobile and motorcycle policies cancelled during the examination period. Before selecting the sample, the Examiners eliminated those records that could be identified by reason code as having been cancelled at the insured's request. From the remaining files, the Examiners selected a sample of 100 files for review. No exceptions were noted.

Cancelled Policies with Claims Closed Without Payment

The Company was unable to retrieve from its system a list of policies closed without payment within 30 days prior to the date of a claim closed without payment.

File Review

The Examiners reviewed the complaint files supplied by the Company. With regard to those complaints that were directed to the Company by the Division, the Examiners paid particular attention to the timeliness of the
Company's response to the Division. NMSA (1978) § 59A-4-3 states in pertinent part:

The superintendent may direct an inquiry to any person subject to supervision under the Insurance Code with respect to any transaction or matter within the scope of such supervision. Upon receipt of the request, the person shall promptly furnish to the superintendent requested information in possession or control of such person. * * *

The Company provided a list and original files of 185 complaints received during the examination period for the private passenger automobile line of business. The reasons for the complaints are provided below:

Table V - Reasons for Complaints

<table>
<thead>
<tr>
<th>Reason</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims Handling</td>
<td>124</td>
<td>67.0%</td>
</tr>
<tr>
<td>Premium/Rating</td>
<td>12</td>
<td>6.5%</td>
</tr>
<tr>
<td>Agent Handling/Service</td>
<td>10</td>
<td>5.4%</td>
</tr>
<tr>
<td>Coverage Issues</td>
<td>10</td>
<td>5.4%</td>
</tr>
<tr>
<td>CR Attitude/Communication</td>
<td>10</td>
<td>5.4%</td>
</tr>
<tr>
<td>Billing</td>
<td>8</td>
<td>4.3%</td>
</tr>
<tr>
<td>Cancellation/Nonrenewal</td>
<td>5</td>
<td>2.8%</td>
</tr>
<tr>
<td>Credit Scoring</td>
<td>4</td>
<td>2.2%</td>
</tr>
<tr>
<td>C.L.U.E. Reporting</td>
<td>1</td>
<td>0.5%</td>
</tr>
<tr>
<td>Refunds</td>
<td>1</td>
<td>0.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>185</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

The Examiners completed their review of all 185 complaints. The Examiners found that in three (2%) of the 185 files the Company failed to respond to the Division in the time prescribed by the Division (Exhibit 5). This constitutes three apparent violations of NMSA (1978) § 59A-4-3. The Company noted that these three late responses were isolated incidents, and not a company practice.
ACKNOWLEDGEMENT

Lyn Sloan, CIE, Rosemary Cutter, Sondra Davis, Sandra Lewis, JD, and Laura Cohen participated in this examination and join the Examiner-in-Charge in gratefully acknowledging the courteous cooperation and professionalism extended by the examination coordinators.

Respectfully submitted,

Nestor J. Romero, CPA, CFE, CIE
Examiner in Charge