

OFFICE OF THE
NEW MEXICO PUBLIC REGULATION
COMMISSION
INSURANCE DIVISION



CERTIFICATE

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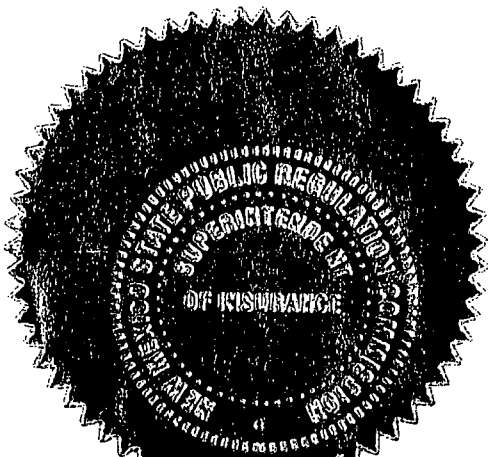
I, Eric P. Serna, Superintendent of Insurance of the State of New Mexico, do hereby certify that the attached Report of Examination for the period ending June 30, 2003 on:

GEICO Insurance Group
Washinton, DC

Was recently completed by *Nestor 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 26th
day of May, 2005 A.D.

Handwritten signature of Eric P. Serna.

Superintendent of Insurance

02-04015-IN

NEW MEXICO
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REPORT OF THE MARKET CONDUCT EXAMINATION

of

GEICO INSURANCE GROUP

**GEICO General Insurance Company
NAIC #35882**

**Government Employees Insurance Company
NAIC #22063**

**GEICO Indemnity Company
NAIC #22055**

**GEICO Casualty Company
NAIC #41491**

(As of June 30, 2003)

TABLE OF CONTENTS

EXECUTIVE SUMMARY.....	iii
FOREWORD.....	1
SCOPE OF EXAMINATION.....	1
STATUTES AND RULES CITED.....	3
COMPANY HISTORY.....	3
GEICO General Insurance Company.....	4
Government Employees Insurance Company.....	4
GEICO Indemnity Company.....	5
GEICO Casualty Company.....	6
Table III - Production and Loss Ratios/Policy Counts.....	7
UNDERWRITING AND RATING.....	8
Overview of Company Systems.....	10
CANCELLATIONS.....	12
GG Cancelled Policies.....	13
GE Cancelled Policies.....	13
GI Cancelled Policies.....	14
GC Cancelled Policies.....	14
METHODOLOGY.....	15
Complaint Data.....	16
Personal Automobile Policy Data.....	16
Table I – New Business Auto Samples Selected-Last 60-days.....	16
Table II – Cancelled Policy Samples Selected.....	17
File Review Methodology.....	17
ACKNOWLEDGEMENT.....	18
EXHIBITS.....	19

December 8, 2004

Honorable Eric P. Serna
Superintendent of Insurance
State of New Mexico
P.O. Drawer 1269
Santa Fe, New Mexico 87504-1269

Superintendent Serna:

Pursuant to your instructions and in accordance with NMSA (1978) § 59A-4-5, an examination has been made of the business affairs and market conduct operations of the GEICO INSURANCE GROUP, including:

GEICO General Insurance Company
NAIC #35882

Government Employees Insurance Company
NAIC #22063

GEICO Indemnity Company
NAIC #22055

GEICO Casualty Company
NAIC #41491

This examination was conducted at the Company's administrative offices located at 4201 Spring Valley Road, Dallas, Texas 75244-3694.

EXECUTIVE SUMMARY

The following are the material findings made by the Examiners during the onsite examination of GEICO Insurance Group:

1. Cancellations:

- GEICO failed, in the case of “without cause” cancellations, to send a 10-day cancellation notice to the insured within the first 60 days of coverage, in apparent violation of NMSA (1978) § 59A-18-29(B).
- For policies in effect more than 60 days, GEICO failed to provide at least 15 days notice of cancellation in apparent violation of NMSA (1978) §59A-18-29(C) and NMAC 13.8.4.8(C).

FOREWORD

The Examiners conducted the examination of four companies in the GEICO Insurance Group: GEICO General Insurance Company ("GG"), Government Employees Insurance Company ("GE"), GEICO Indemnity Company ("GI"), and GEICO Casualty Company ("GC").

This Report will refer to the Companies collectively as "GEICO" or "the Company." This examination was conducted in accordance with New Mexico Statutes Annotated (1978), Chapter 59A, and New Mexico Administrative Code, Title 13 ("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.

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 personal automobile business. 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 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 Comprehensive Loss and Underwriting Exchange (CLUE), a trademark of ChoicePoint, which collects accident and loss history information, and to consumer information developed through consumer credit reports obtained from Trans Union. Both reports singularly and collectively were used for the purposes of determining an applicant's Company acceptability and premium rate tiers, which in turn determines the insured's premium level. This examination was called for the period from January 1, 2001, through June 30, 2003. The end date was later expanded, however, to April 23, 2004 in order for the Examiners to review certain policy information, specifically CLUE reports, which were only retained by the Company on new business for 90 days beyond issue date.

Under contract with the New Mexico Division of Insurance ("the Division") 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 or issue findings regarding specific Company practices does not constitute acceptance by the Division.

In accordance with the Division procedures, the Examiners completed Preliminary Findings on those files, forms, and/or practices found to be in apparent violation of New Mexico laws. The Preliminary Findings were submitted to Company management for their review and comments.

References to Preliminary Findings in this Report are identified as an **EXHIBIT** or included in the text.

STATUTES AND RULES CITED

The Examiners have alleged that the Company is in apparent violation of the following statutes and administrative rule.

New Mexico Statutes:

NMSA (1978) §§ 59A-18-29(B), and 59A-18-29(C).

New Mexico Administrative Rules:

NMAC 13.8.4.8(B).

In addition to the insurance codes and rules cited for potential violations of New Mexico insurance laws, the Examiners made reference to the following statutes: NMSA (1978): §§ 59A-4-1, *et seq.*

COMPANY HISTORY

The following four GEICO companies are stock property and casualty companies domiciled in Maryland and authorized to transact business in the state of New Mexico. The home office of the GEICO provided history of each of the companies listed below.

GEICO General Insurance Company

GG was incorporated on March 27, 1978 under the temporary title "Equi-Gen Insurance Company", under the laws of the state of Iowa, to act as the vehicle for the transfer of the corporate domicile of the Equitable General Insurance Company from Forth Worth, Texas to Des Moines, Iowa, effective December 31, 1978.

The name of the Company was changed to "Houston Casualty Company" on April 9, 1935, to "Houston Fire and Casualty Insurance Company" in 1936, and then to "Houston General Insurance Company" on December 31, 1971. The Company again changed its corporate title on June 1, 1975 to "Equitable General Insurance Company."

Complete financial control of the Company was acquired on March 31, 1982, by Government Employees Insurance Company, a Maryland corporation, which in turn, is a wholly owned subsidiary of GEICO Corporation, a Delaware corporation. The present title, "GEICO General Insurance Company" was adopted on September 29, 1982.

Since 1987, GG has provided personal automobile insurance for preferred risk individuals who are not government employees or military personnel.

Government Employees Insurance Company

GE was incorporated in the District of Columbia under the District of Columbia Business Corporation Act of 1901 on November 30, 1937 and issued capital stock. The Company commenced business on December 1, 1937 and was privately owned until 1948.

On January 31, 1979 the Company reincorporated under the District of Columbia Business Corporation Act of 1954. Subsequent to the reincorporation, the Company reorganized its corporate structure by the creation of a parent Company, GEICO Corporation, a Delaware corporation on January 31, 1979. On January 3, 1986, the Company transferred its domicile from the District of Columbia to the State of Maryland. Its present management and employees conduct the insurance operations of the Company as a subsidiary of GEICO Corporation.

GE has traditionally focused on writing preferred risk automobile insurance to active or retired government employees or military personnel primarily through direct response marketing.

GEICO Indemnity Company

GI was incorporated on March 22, 1961, and reincorporated in 1980 in the District of Columbia under the name of Criterion Insurance Company. On January 3, 1986, the Company was reincorporated and redomesticated from the District of Columbia to the state of Maryland and the name of the Company was changed to GEICO Indemnity Company on June 25, 1986. The Company commenced underwriting activities on September 1, 1961. Effective September 30, 1992, GEICO Indemnity Company became the wholly owned subsidiary of GEICO Corporation.

Historically, the Company has provided automobile and motorcycle insurance to young adults, military personnel and other drivers who do not qualify as a preferred risk with GG or GE, which was marketed through general field

representatives. However, for the past few years, GI's insurance policies have been sold to the general standard risk market through direct response marketing techniques.

GEICO Casualty Company

GC was incorporated on August 31, 1982, in the State of Maryland under the name of Guardian Casualty Company as a wholly owned subsidiary of Criterion Insurance Company (later renamed GEICO Indemnity Company). The Company's name was changed to Criterion Casualty Company on January 31, 1983, and it began operations in May 1983. On January 6, 1994, the Company's name was changed to GEICO Casualty Company. The Company's parent, GEICO Indemnity Company (a Maryland corporation), is a wholly owned subsidiary of GEICO Corporation.

Charter powers permit the handling of all forms of property and casualty insurance coverage. The Company was formed in 1982 to offer non-standard risk automobile insurance to the military market principally through general field representatives. Currently, the Company sells policies to the general non-standard risk market through direct response sources.

The GEICO Corporation, previously a publicly held company, became an indirect wholly owned subsidiary of Berkshire Hathaway, Inc., a Delaware corporation on January 2, 1996.

In July 2003, Fitch Ratings, insurance industry analyst, affirmed GEICO's AAA rating and cited GEICO's position as a core member of the Berkshire Hathaway group of companies.

GC's personal automobile premium incomes, losses, loss ratios and policy counts during the past two calendar years through June 2003 for New Mexico were reported to the Examiners and are displayed below:

Table III - Production and Loss Ratios/Policy Counts

GEICO General Insurance Company

Year	<u>2001</u>	<u>2002</u>	<u>June 2003</u>
Written Premium	\$20,841,279	\$23,393,052	\$13,411,499
Earned Premium	\$20,501,685	\$22,626,299	\$12,849,431
Incurred Losses	\$13,583,682	\$15,088,861	\$ 7,802,288
Loss Ratio	66%	67%	61%
Policies In Force	19,592	21,230	22,599

Government Employees Insurance Company

Year	<u>2001</u>	<u>2002</u>	<u>June 2003</u>
Written Premium	\$17,019,941	\$17,972,345	\$10,070,694
Earned Premium	\$17,048,416	\$17,604,543	\$ 9,697,165
Incurred Losses	\$11,630,420	\$11,331,400	\$ 4,799,335
Loss Ratio	68%	64%	50%
Policies In Force	13,956	14,356	15,056

GEICO Indemnity Company

Year	<u>2001</u>	<u>2002</u>	<u>June 2003</u>
Written Premium	\$ 6,087,839	\$ 7,891,986	\$ 5,418,279
Earned Premium	\$ 5,936,270	\$ 7,285,738	\$ 4,785,572
Incurred Losses	\$ 3,524,706	\$ 4,375,688	\$ 2,682,840
Loss Ratio	59%	60%	56%
Policies In Force	4,318	5,780	7,203

GEICO Casualty Company

Year	<u>2001</u>	<u>2002</u>	<u>June 2003</u>
Written Premium	\$ 3,135,101	\$ 3,361,144	\$ 2,201,316
Earned Premium	\$ 3,264,217	\$ 3,155,895	\$ 2,013,694
Incurred Losses	\$ 1,456,933	\$ 1,218,707	\$ 1,211,952
Loss Ratio	45%	39%	60%
Policies In Force	2,108	2,288	2,748

UNDERWRITING AND RATING

The underwriting and rating portion of this Examination was to determine the Company's compliance with New Mexico insurance statutes and rules. Attention was also given to the Company's use of credit-based insurance scoring and the models used in the overall underwriting and rating process.

GEICO has a system called the four-company approach for the underwriting and rating of its personal automobile business. Those Companies are:

- GG - Preferred Risk, non-government employees.
- GE - Preferred Risk, government employees.
- GI - Standard Risk, Government or non-government.
- GC- Non-standard Risk, Government or non-government.

This system allows for customers to be moved upward into a more preferred Company as they gain more driving experience or have loss activity fall off their records. It also may allow customers to be moved downward into a less preferred Company as opposed to being cancelled if they no longer meet the preferred underwriting criteria.

The Examiners requested copies of the Companies' underwriting guidelines, filed rating methodologies, and rates in effect during the Examination period for all four companies. In particular, the Examiners requested a description of the Company's use and application of CLUE and credit scoring in its underwriting, rating and Company selection process.

The Examiners investigated the Company for consistencies in interpreting loss history information obtained from CLUE reports to determine compliance with its rate and rule filings, underwriting guidelines and New Mexico Statutes NMSA (1978) §§ 59A-17-9, 59A-17-4(C), 59A-17-7.1, and 59A-17-6(A).

State law requires automobile insurers to file their rates for approval by the Division prior to use. NMSA (1978) § 59A-17-9 states:

As to insurance subject to Chapter 59A, Article 17 NMSA 1978, other than workmen's compensation insurance, every insurer or the rate service organization designated by the insurer for filing of rates as provided in Chapter 59A, Article 17 NMSA 1978, 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 they become effective. No filing made pursuant to this section shall become effective until approved or deemed approved by the superintendent in accordance with Section 59A-17-13 NMSA 1978.

NMSA (1978) § 59A-17-4(C) defines "supplementary rate information as follows:

"supplementary rate information" includes any manual or plan of rates, statistical plan, classification, rating schedule, minimum premium, policy fee, rating rule, rate-rated underwriting rule and any other information prescribed by rule of the superintendent.

NMSA (1978) § 59A-16-17(D) states:

No such insurer or organization shall make or permit any unfair discrimination between insureds...having like insuring or risk characteristics, in the premium or rates charged for insurance or coverage, or in the dividends or other benefits payable thereon, or in any other of the terms and conditions of the insurance or coverage.

Upon completion of this review of underwriting and rating, no material exceptions were noted.

Overview of Company Systems

In order to understand the Company's underwriting and rating mechanism, it is first necessary to understand the interrelationship of the electronic systems established by GEICO for these purposes. These systems are:

- SalesTalk System – the Company's front-line, point-of sale database;
- CAU – "Computer-Assisted Underwriting" system; and
- OASIS – the Company's rating and policy issuance system.

The Examiner's analyzed the Company's use of CLUE information and individual Credit Reports by examining the internal operations of SalesTalk and the CAU system. The CAU system determines Company placement and rating tier levels based on information taken from the customer and OASIS. The Examiners' review revealed the following facts:

1. Loss history information from CLUE Reports is used in the underwriting and rating of all new business accounts.
2. The CLUE information is initially uploaded to the Company's SalesTalk system during the application process. The information is then filtered through the CAU system, and this system determines the Company placement and rating tier level to which the risk is assigned.
3. The original CLUE information is not retained in SalesTalk beyond 90 days; however, this information is interpolated into the Company's CAU system and is ultimately reflected in the pricing and policy issuance via the Company's OASIS system.

4. The financial credit score is ordered at the point of sale on new business accounts through Trans Union and is calculated by Fair Isaac's "Assist 2.0" Model. This score is strictly a financial score and includes only those characteristics used by Fair Isaac. This score is then uploaded to the Company's CAU system and becomes one of several underwriting characteristics that make up the Company's market selection and rating tier process.
5. The Company's CAU system takes over in the assessing of the CLUE information along with all the other application information and the insurance score retrieved from Fair Isaac. The result from the CAU is an "underwriting score" that is then used to determine whether a risk is placed in the Company's preferred, standard, or non-standard market/company and selects the actual rating tier level to be used.
6. The underwriting score is developed in direct proportion to the manner in which GEICO's CAU model reads and acts upon information within the insured's loss history (CLUE report), consumer credit report, and other application information.
7. The CAU model will be discussed separately in this Report; however, it is important to note in this section that loss history information is weighted and mathematically factored into the developed underwriting score, which in turn governs the Company's placement and subsequent policy rating tier assignments.
8. The Company uses numerous characteristics in its present model.

CANCELLATIONS

The purpose of the Examiners' review of the Company's cancelled or nonrenewed policy files was to determine that GEICO's procedures were consistent with New Mexico law. The review included policies cancelled due to underwriting actions of the Company, nonpayment of premiums, or nonrenewals during the Examination period. In addition to reviewing the cancellation notices for proper number of days and reasons, the Examiners confirmed that a proof of mailing was produced for each notice.

The Company provided the population runs of policies cancelled during the Examination period (from January 1, 2002 through December 31, 2003) because of underwriting decisions or nonpayment of premiums. The Examiners selected 100 files for each Company. NMSA (1978) § 59A-18-29 provides in pertinent part:

- B. An insurer may cancel its policy without cause at any time within sixty (60) days next following original issuance and effective date of the policy. The insurer shall give the named insured written notice of such cancellation not less than ten (10) days prior to the effective date of the cancellation, which effective date shall fall within such sixty (60) day period.
- C. Subject to Subsection A above, after expiration of the sixty (60) day period referred to in Subsection B an insurer or agent shall not cancel except for reasonable cause such policies and for such causes, and with advance notice of cancellation for such period of time, as may from time to time be provided by rules and regulations of the superintendent. Such rules and regulations may also require that statement of the reasons for such cancellation be contained in the notice of cancellation given to specified persons.

Pursuant to NMSA (1978) § 59A-18-29(C), the Division adopted NMAC 13.8.4.8, which states in pertinent part:

- A. 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.
- B. 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.

GG Cancelled Policies

Company records indicated a population of 11,821 GG personal automobile policies cancelled during the Examination period. From this population, the Examiners selected a sample of 100 files for review.

The Examiners identified 7 of the 100 GG "without cause" cancellations, in which the notice was not sent within 60-days of the effective date of coverage. This action is an apparent violation of NMSA (1978) § 59A-18-29(B) (**Exhibit 1**).

GE Cancelled Policies

Company records indicated a population of 7,320 GE personal automobile policies cancelled during the Examination period. From this population, the Examiners selected a sample of 100 files.

The Examiners identified 2 out of 100 GE cancelled files were "without cause", in which cancellation notice was not sent anytime within 60-days of the

effective date of coverage, in apparent violation of NMSA (1978) § 59A-18-29(B) **(Exhibit 1)**.

GI Cancelled Policies

Company records indicated a population of 9,671 GI personal automobile policies cancelled during the Examination period. From this population, the Examiners selected a sample of 100 files.

The Examiners identified 2 out of 100 GI cancelled files, in which coverage was cancelled within the first 60 days of the effective date of coverage; however, the Company failed to send the notice in the prescribed time period, specifically not less than 10 days prior to the effective date of cancellation, which is an apparent violation of NMSA (1978) § 59A-18-29(B) **(Exhibit 1)**.

GC Cancelled Policies

Company records indicated a population of 6,556 GC personal automobile policies cancelled during the Examination period. From this population, the Examiners selected a sample of 100 files.

The Examiners identified 8 of the 100 GC cancelled files where “without cause” cancellation notice was not sent within 60-days of the effective date of coverage, in apparent violation of NMSA (1978) § 59A-18-29(B) **(Exhibit 1)**.

The Examiners identified 1 of the 100 GC cancelled files (Examination File Number MS 170) where the cancellation was effective more than 60 days after the effective date of coverage **(Exhibit 1)**. The Company cancelled this policy for a reason (named driver exclusion) not permitted by NMAC 13.8.4.8(B). This

cancellation is an apparent violation of NMSA (1978) § 59A-18-29(C) and NMAC 13.8.4.8(B).

The Company agreed with all the findings listed above for all four companies.

METHODOLOGY

The Examiners requested, and the Company supplied, hard copy and/or electronic listings of data and information related to complaints, cancellations, and new business. The Examiners used Microsoft Excel to sort the data to ensure that the populations from which samples were selected were limited to those records falling within the scope of the examination. The Examiners also used this data to select random samples of underwriting and cancellation files for review.

Samples were selected for review using the NAIC criteria, which suggest that:

- For a population greater than 5,000, a sample of 100 files be selected;
- For a population of 50 to 5,000, a sample of 50 files be selected; and
- For a population of less than 50, all files are selected.

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

- Underwriting and rating manuals including automobile symbols, territories, guidelines and bulletins;
- Specimen applications and policy forms (endorsements and billing notices);
- Cancellation reason codes, cancellation letters and proof of mailing;
- Advertising materials.

During the course of this examination, apparent deficiencies and issues relating to the operations and business practices of the Company were identified. These are deemed to be apparent until the adoption of this Report by the Superintendent at which time the Report shall be admissible as evidence of the facts pursuant to NMSA (1978), § 59A-4-13(A).

Complaint Data

The Company provided a copy of its complaint logs and 197 paper files for complaints received during the examination. The Examiners reviewed 100% of the complaint files.

Personal Automobile Policy Data

The Company produced electronic listings of personal automobile new business and cancellations processed during the examination period.

Since CLUE report information is not retained indefinitely on GEICO's system; the Examiners requested a listing of new business policies issued within the past 60-days (February 23, 2004 through April 23, 2004) to verify the CLUE reports. The Examiners sorted this data by Company and credit score ranges. This sort was given to the Company to randomly select 50 new business files with 3 digit insurance scores, and 50 files classified as "No Hits", "No Score" or "Not Run/Refused" for a total of 100 files for each of the four companies. The following samples were selected:

Table I – New Business Auto Samples Selected-Last 60-days¹

<u>File Type</u>	<u>Population</u>	<u>Sample Size</u>
GG Auto – Preferred-All Others	10,874	100

¹ New Business policies issued in the last 60 days, as explained later in the Report.

GE Auto – Pref.-Military/Government.	4,975	100
GI Auto – Standard	10,145	100
GC Auto – Non-Standard	5,556	<u>100</u>
	Total	400

Additionally, the Examiners selected their random samples of cancellations processed within each calendar year of the examination period.

The following samples were selected from each of the populations:

Table II – Cancelled Policy Samples Selected

<u>File Type</u>	<u>Population</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Sample Size</u>
GG Cancelled	11,821	42%	39%	19%	100
GE Cancelled	7,320	44%	39%	17%	100
GI Cancelled	9,671	37%	40%	23%	100
GC Cancelled	6,556	41%	37%	22%	<u>100</u>
				Total	400

File Review Methodology

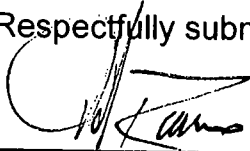
During the file review, the Examiners used a proprietary Access database and Excel spreadsheets and formulas to:

- Log and track the files reviewed, as well as Examination requests and Preliminary Findings;
- Confirm compliance with filed rating procedures, written underwriting rules and guidelines, and to identify any trends that indicate that underwriting rules were not followed;
- Calculate compliance with New Mexico insurance laws regulating timeliness;
- Perform time-study analysis.

ACKNOWLEDGEMENT

Lyn Sloan, CIE, CIC, Rosemary Cutter, Sandra Lewis, JD, and Laura Cohen participated in this examination and join the Examiner-in-Charge in gratefully acknowledging the assistance extended by the examination coordinator.

Respectfully submitted,



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