

OFFICE OF THE  
NEW MEXICO PUBLIC REGULATION  
COMMISSION  
INSURANCE DIVISION



CERTIFICATE

NEW MEXICO  
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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:

Sentry Insurance Group  
Stevens Point, WI

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 2003 A.D.

Handwritten signature of Eric P. Serna.

Superintendent of Insurance

02-04012-IN

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**REPORT OF THE MARKET CONDUCT EXAMINATION**

of

**SENTRY INSURANCE GROUP**

**DAIRYLAND INSURANCE COMPANY  
NAIC # 21164**

(As of June 30, 2003)

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December 10, 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 SENTRY INSURANCE GROUP, including:

DAIRYLAND INSURANCE COMPANY  
NAIC # 21164

This examination was conducted at the Examiners' offices located at the claims office of its affiliate Sentry Insurance Company located at 9060 East Via Linda, Scottsdale, Arizona 85258.

## EXECUTIVE SUMMARY

The following are the findings made by the Examiners during the onsite examination of Sentry Insurance Group (Dairyland Insurance Company):

**1. Underwriting and Rating Practices (General):**

- The Company does not use loss history information from C.L.U.E. reports in the underwriting or rating of its personal lines automobile coverage in New Mexico.
- The Company does not use credit scoring or credit information in the underwriting or rating of its personal lines automobile coverage in New Mexico.
- The Company does not use not-at-fault accidents to increase premiums or to cancel or nonrenew coverage for its personal lines automobile coverage in New Mexico, as required by NMSA (1978) § 59A-17-7.1.

**2. Motorcycle**

- a. **Deviation from Filed Rates:** The Company's filed rates for motorcycle coverage include three classifications: Preferred, Elite, and Standard Programs. On and after May 21, 2001, however, all new business was placed in the Standard Program, contrary to the rates on file with the Division. The Examiners identified 20 New Business files and one Cancelled file that qualified for the Elite or Preferred rate programs. The failure to classify policies according to the criteria contained in its rate filings constitutes a deviation from filed rates in apparent violation of NMSA (1978) § 59A-17-9. The failure to apply rates as filed resulted in overcharges to these 21 policyholders of \$1,929.85.
- b. **Unfair Discrimination:** The Examiners identified several motorcycle policies that renewed during the examination period where the policies maintained their classification of Elite or Preferred after May 21, 2001. One policy was upgraded from Elite to Preferred after May 21, 2001. The failure to classify all qualifying New Business and renewal policies within the Preferred and/or Elite programs constitutes unfair discrimination in the rates applied, in apparent violation of NMSA (1978) § 59A-16-17(D).

## FOREWORD

The Examiners conducted the examination of Dairyland Insurance Company ("Dairyland" or "the Company"). The Examiners conducted this examination 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 of Examination.

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

## SCOPE OF EXAMINATION

The scope of this examination was limited to Dairyland'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 and motorcycle coverage and to determine whether Dairyland's operations and practices are consistent with the public interest. 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 or issue findings regarding specific 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 found to be in apparent violation of New Mexico laws. The Review Sheets were submitted to the Company representatives designated by the Company management as being knowledgeable about the issues raised for their review and comment.

#### **STATUTES AND RULES CITED**

The Examiners found that Dairyland is in apparent violation of the following New Mexico Statutes: NMSA (1978) §§ 59A-16-17(D), and 59A-17-9.

In addition to the statutes cited for potential violations of New Mexico insurance laws, the Examiners made reference to the following statutes: NMSA (1978) §§ 59A-4-1, *et seq.*, 59A-17-7.1, and 59A-17-6(E).

## HISTORY OF THE COMPANY

Dairyland is a stock property and casualty company domiciled in Wisconsin and authorized to transact business in the State of New Mexico. Dairyland is a wholly owned subsidiary of its parent company, Sentry Insurance and Mutual Company (SIAMCO). Dairyland specializes in nonstandard private passenger automobile and preferred/standard motorcycle insurance.

Dairyland is licensed to transact insurance in 45 states, and markets its products through independent agents. SIAMCO provides administrative support services to Dairyland throughout its nationwide regional, marketing and administrative offices.

Originally named Dairyland Mutual Insurance Company, the Company was incorporated on January 8, 1953 and commenced business the following month. In 1965 the Company reorganized from a mutual to a stock corporation and changed its name to Dairyland Insurance Company. The Sentry Corporation acquired majority control of Dairyland in 1966 and by March of 1978 became its sole shareholder. The Sentry Corporation then transferred ownership of Dairyland to SIAMCO in 1986 for the purpose of separating insurance operations from non-insurance operations.

**Table I - Production and Loss Ratios/Policy Counts**

	<u>2001</u>	<u>2002</u>	<u>June 2003</u>
<b>Written Premium</b>	\$32,385,722	\$28,537,451	\$16,193,583
<b>Earned Premium</b>	\$32,602,151	\$28,107,575	\$16,049,818
<b>Loss Ratio</b>	64%	57%	43%
<b>Expense Ratio</b>	38%	41%	not available
<b>Policies In Force</b>	21,409	22,454	24,199



## UNDERWRITING AND RATING

### Underwriting

The Examiners reviewed the underwriting guidelines in use by Dairyland during the examination period. The guidelines in effect at the beginning of the examination period had been in effect from and after March 30, 2000 for new business and April 30, 2000 for renewal business. The guidelines were revised three times during the examination period:

**Table II – Underwriting Guideline Revisions**

<u>Revision</u>	<u>Effective (New Business)</u>	<u>Effective (Renewals)</u>
1	10/01/01	11/01/01
2	12/10/02	01/10/03
3	06/06/03	07/05/03

One of the primary issues of this targeted examination was to review and assess the Company's use of loss information from C.L.U.E. reports and the Company's use of credit scoring in the underwriting and rating of its products. The Examiners noted that Dairyland uses neither C.L.U.E. nor credit scoring in the underwriting or rating of its personal lines automobile coverage in New Mexico.

The Examiners reviewed the guidelines to determine whether Dairyland implemented any underwriting guidelines that violate the laws of the State of New Mexico or which unfairly discriminate against individuals or groups of New Mexico residents. One of the specific issues addressed in this review was whether Dairyland uses not-at-fault accidents to raise rates or to cancel or nonrenew coverage, practices that are prohibited by NMSA (1978) § 59A-17-7.1. No exceptions were noted.

## **Rating**

Dairyland provided copies of its filed rates in use during the exam period as well as copies of the rating rules and guidelines available to its agents via CD-ROM or over the Internet. The Examiners compared the guidelines distributed to the agents with the filed rates and found that the automobile guidelines contained an error. For new business written on and after July 1, 2002, and for renewal business written on and after July 27, 2002, the published rate guides omitted the rates for single males ages 16 to 19. The Examiners found in their review that the correct rates had been filed with and approved by the Division.

Dairyland's rating structure for both automobile and motorcycle coverage is very straightforward. Base rates established by age, gender and marital status are modified according to prescribed discounts and surcharges. Premiums are also modified according to the vehicle age and coverage purchased. The Examiners rated 100 percent of the policy files reviewed.

## **Automobile New Business**

From a population of 48,941 automobile policies issued from January 1, 2001 through June 30, 2003, the Examiners selected a stratified random sample of 100 policies to review. The Examiners selected this sample on a pro rata basis according to the number of policies issued in each calendar year of the examination period. In addition to reviewing the underwriting of each application, the Examiners confirmed the premiums charged based on the rating guidelines provided by the Company.

## **Motorcycle New Business**

From a population of 4,920 motorcycle policies issued from January 1, 2001 through June 30, 2003, the Examiners selected a stratified random sample of 50 policies to review. The Examiners selected this sample on a pro rata basis according to the number of policies issued in each calendar year of the examination period. In addition to reviewing the underwriting of each application, the Examiners confirmed the premiums charged based on the rating guidelines provided by the Company. The Examiners found the following apparent violations of New Mexico statutes and rules.

### **Deviating From Filed Rates**

Dairyland's filed rating structure for motorcycle coverage consists of three classifications based on both driver and cycle characteristics. These are called the Standard Program, Preferred Program, and Elite Program. All rates filed with the Division, before and after May 21, 2001, consist of these three classifications and include actuarial support for the classifications.

On May 21, 2001, however, Dairyland eliminated the Preferred and Elite Programs without refiling its rates. Certain individuals, who were put into these programs prior to May 21, 2001, were permitted to continue with the more advantageous rate structure, and in the case of one file under review, the insured was reclassified at renewal from the Elite program to the Preferred Program after May 21, 2001.

Of the 50 files in the motorcycle New Business Issued sample, 20 files qualified for the Elite or Preferred Programs but were placed in the Standard

Program, contrary to the rates on file with the Division. The failure to classify policies according to the criteria contained in its filings constitutes a deviation from filed rates in apparent violation of NMSA (1978) § 59A-17-9<sup>1</sup> (**Exhibit 1**). The failure to apply filed rates resulted in overcharges to these 20 policyholders of \$1,844.85.

Dairyland disagreed with this finding and asserts that since the Standard Program rates were filed with and approved by the NMDOI, it did not deviate from its filed rates. The rate filings, however, specifically establish classes of coverage based on risk factors related to the rider and the motorcycle. Failure to apply these classifications where appropriate deviates from the Company's filed rates. The actuarial support for the Standard Program rates is based on the assumption that certain riders and cycles would be placed in the Elite Program or Preferred Programs and will receive lower premiums based on more favorable risk factors. Since the rates established for the Standard Program were based on an assumption that better risks would be placed in the Elite or Preferred Programs, the practice of placing all policies in the Standard Program results in a potentially excessive premiums to all policyholders.

### **Unfair Discrimination**

NMSA (1978) § 59A-16-17(D) states:

No such insurer or organization shall make or permit any unfair discrimination between insureds or property 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.

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<sup>1</sup> See page 11 for the text of this statute.

The Examiners identified several policies that renewed during the examination period where the policies maintained their classification of Elite or Preferred, as well as one policy that was upgraded from Elite to Preferred. The failure to classify all qualifying New Business and renewal policies within these programs constitutes unfair discrimination in the rates applied, in apparent violation of NMSA (1978) § 59A-16-17(D) (**Exhibit 1**).

The Company disagreed with the Examiners and maintained that applying the Elite and Preferred Programs to certain renewal policies is not unfairly discriminatory. Dairyland relies on NMSA (1978) 59A-17-6(E), which states in part that rates are not unfairly discriminatory because different rates result for policyholders with like loss exposures but different expense factors:

There is unfair discrimination if one rate is unfairly discriminatory in relation to another in the same class if it clearly fails to reflect equitably the differences in expected losses and expenses. Rates are not unfairly discriminatory because different premiums result for policyholders with like loss exposures but different expense factors, or like expense factors but different loss exposures, so long as the rates reflect the differences with reasonable accuracy. Rates are not unfairly discriminatory if they are averaged broadly among persons insured under a group, franchise or blanket policy.

The Company states that because its renewal commissions are less than its new business commissions, the policies renewing in the Elite or Preferred programs have different expense factors. By this logic, however, all qualifying policies should be assigned to the Elite or Preferred programs at renewal because of the lower commission expense factor.

Clearly, the establishment of these rate programs was based entirely on risk factors, not commissions or other expense factors. The very statute cited by the Company in its response defines unfair discrimination in rates as "[failing] to

reflect equitably the differences in expected losses and expenses." All individuals meeting the eligibility criteria for the Elite or Preferred Programs share the same driver and cycle risk factors. Providing the enhanced program rates to select insureds whose policies initiated before May 21, 2001, therefore, is unfair discrimination within the meaning of NMSA (1978) §§ 59A-16-17(D) and 59A-17-6(E).

The Company's final position is that risk placement is based on underwriting criteria, not the filed rates. When the Company has filed and approved rates establishing different premium structures based on differing risk/underwriting characteristics, it is bound by those approved rates until and unless it files and receives approval for a different rating structure. Dairyland has not only failed to file rate structures eliminating the favorable Elite and Preferred premium structures, but it has in fact continued after May 21, 2001, to file rates establishing and providing actuarial support for its three rate "programs."

## **CANCELLATIONS**

### **Automobile Cancelled Policies**

The Examiners reviewed a sample of 100 automobile policies from a population of 18,453 policies cancelled during the examination period. The reasons for policy cancellation were as follows:

**Table III - Reasons for Automobile Policy Cancellation**

<u>Reason</u>	<u>Number</u>
Non-payment (mid-term)	54
Insured election	26
Company election within 60-day underwriting period	10
Non-payment (renewal)	5
Non-payment (new business)	5
<b>Total</b>	<b>100</b>

No exceptions were noted during the review of the automobile cancelled policies.

**Motorcycle Cancelled Policies**

The Examiners reviewed a sample of 50 motorcycle policies from a population of 2,849 policies cancelled during the examination period. The Examiners identified one file where the insured qualified for the Elite Program but coverage was issued in the Standard Program (**Exhibit 3**). This is an apparent violation of NMSA (1978) § 59A-17-9. The failure to apply filed rates resulted in an overcharge to this insured of \$85.00.

Failure to afford this insured the Elite program rates provided to other insureds renewing during the same time period constitutes an additional case of unfair discrimination in apparent violation of NMSA (1978) § 59A-16-17(D).

The reasons for policy cancellation were as follows:

**Table IV - Reasons for Motorcycle Policy Cancellation**

<u>Reason</u>	<u>Number</u>
Insured election	20
Non-payment (mid-term)	18
Company election within 60-day underwriting period	11
Non-payment (new business)	1
Non-payment (renewal)	0
<b>Total</b>	<b>50</b>

No other exceptions were noted during the review of motorcycle cancelled policies.

### METHODOLOGY

The Examiners requested and received 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. The Examiners used these listings to select samples of files to be reviewed and in some instances used the electronic data to analyze Dairyland's processing of the business. In addition, the Examiners 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;
- Internet access to the web site(s) accessible by Dairyland's agents.

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 less than 50 all files be selected.

During the course of this examination, the Examiners identified certain apparent deficiencies and issues relating to the operations and business practices of the Company. 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 Examiners received from the Company a list of 38 complaints received during the examination period. The Company received 36 of these complaints through the Division. Two complaints were sent directly to the Company by the insureds. The Examiners selected all 38 complaint files for review.

### **Automobile and Motorcycle Policy Data**

Dairyland produced electronic listings of automobile and motorcycle New Business and Cancellations processed during the examination period. The Examiners sorted the data 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 effected during the examination period. Based on the percentages of records within each calendar year, the Examiners selected their stratified random samples with a pro rata distribution by year. The following random samples were selected from each of the populations:

**Table V – New Business Samples Selected**

<u>Type</u>	<u>Population</u>	<u>Sample</u>
Automobile New Business Issued	48,941	100
Motorcycle New Business Issued	4,920	50
Automobile Cancelled	18,453	100
Motorcycle Cancelled	2,849	50
All Cancelled With Closed Claims	76	76

**File Review Methodology**

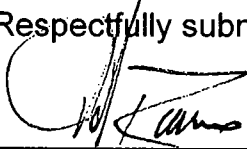
During the file review the Examiners used a proprietary Access database and Excel spreadsheets to:

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

## 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,



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