

OFFICE OF THE  
NEW MEXICO PUBLIC REGULATION  
COMMISSION  
INSURANCE DIVISION



CERTIFICATE

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NEW MEXICO  
PUBLIC REGULATION  
COMMISSION  
FILED

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 July 30, 2004 on:

State Farm Insurance Group  
Bloomington, Illinois

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 4th day of May, 2005 A.D.

Superintendent of Insurance

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**REPORT OF THE MARKET CONDUCT EXAMINATION  
OF  
STATE FARM INSURANCE GROUP**

**State Farm Automobile Insurance Company  
NAIC # 25178**

**State Farm Fire and Casualty Company  
NAIC # 25143**

**As of July 30, 2004**

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Nov. 5, 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:

State Farm Mutual Automobile Insurance Company (SFMAIC),  
State Farm Fire & Casualty Company (SFFCC),

(Hereinafter referred to as SFMAIC or *Preferred* or SFFCC or *Standard* or the companies collectively as State Farm or the Company) as of July 30, 2004 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 business, focusing on underwriting and rating practices, as well as the handling of cancellations. Special attention was paid to the use and handling of information obtained by a claims history information exchange developed by ChoicePoint – the Comprehensive Underwriting Exchange (C.L.U.E.) – and consumer credit information obtained from Equifax and used for the purpose of determining an applicant's acceptability, rating tier and premium. The Examiners did not find significant non-compliance during the course of this Examination.

## **FOREWORD**

The Examiners conducted the Examination of the State Farm Mutual Automobile Insurance Company (hereafter "SFMAIC" or "Preferred".) and State Farm Fire and Casualty Company (hereafter "SFFCC" or "Standard"). This Report will refer to the companies collectively as "State Farm" 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.

## **SCOPE OF EXAMINATION**

The scope of this Examination was limited to the Company's private passenger automobile line of business. 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 C.L.U.E., information obtained and Credit Report Scoring. C.L.U.E. (Comprehensive Loss and Underwriting Exchange) is a trademark of

ChoicePoint and develops accident and loss history information. Both loss reports and credit 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 to early 2004 in order to review information that was only retained by the Company for 22 days beyond policy issue date.

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 procedures and guidelines established by the National Association of Insurance Commissioners ("NAIC").

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

The Examiners completed Personal Lines File Review Sheets ("Review Sheets") on those files, forms, and/or practices in apparent violation of New Mexico laws. The Review Sheets were submitted to the Company representatives designated by Company management as being knowledgeable about the issues raised in the findings for their review and comment.

## METHODOLOGY

The Examiners requested hard copy and/or electronic listings of data and information related to complaints, new business issued, and cancellations. The Examiners used Microsoft Access to perform a preliminary review and sort of the data to ensure that the populations from which samples were selected were limited to those records falling within the scope of the Examination. Having identified the appropriate populations of New Business Issued and/or Cancelled policies, the Examiners converted the data to Microsoft Excel, which they used to select random samples of files for review. In some instances the electronic data was used to analyze the Company's processing times and actions by internal code.

Submittal of requested data throughout the Examination was not satisfactory. State Farm concedes that there were some difficulties, mainly related to limitations in data systems that prevented it from retrieving and presenting the information in the exact format requested.

Samples were selected for review using the NAIC criteria.

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

- Personal Auto Rate Manuals and underwriting guides, underwriting bulletins, agent or producer bulletins, Intranet and other inter-office bulletins to staff or agent/producers,
- Specimen applications, policy forms, and billing notices;
- Cancellation codes, automobile symbols, and rating territories;

The Examiners requested and did not receive access to the Company's Intranet web site(s) available to the Company's agents and employees. The



Examiners were provided an overview of the Company's Intranet site by a State Farm employee knowledgeable in the operation of the Company site. State Farm's Internet site is accessible by the general public and available at [www.statefarm.com](http://www.statefarm.com).

**Complaint Data**

The Company provided a list and original files of 156 complaints received during the Examination period for the private passenger automobile line of business. The Examiners reviewed 100% of the complaint files.

**Automobile Policy Data**

The Company produced electronic listings of automobile 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 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 Preferred/Standard**

<b><u>File Type</u></b>	<b><u>Population</u></b>	<b><u>Sample</u></b>
Preferred Auto NB/Renewal	105,175	50
Preferred/Standard Orig. RNB <sup>1</sup>	37,122	200
Preferred/Standard RNB with	200	163

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<sup>1</sup> Raw New Business: original and last 22 days explained later in the Report.

C.L.U.E (last 22 days)		
Preferred Auto NB/Renewal	40,920	<u>100</u>
	<b>Total</b>	<b>513</b>

**Table II – Cancelled Policy Samples Selected**

<u>File Type</u>	<u>Population</u>	<u>Sample</u>
Preferred/Standard Cancelled	104,372	158

### **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; written underwriting rules and guidelines and to identify any trends that indicate underwriting rules that are not written;
- Calculate compliance with New Mexico insurance laws regulating timeliness;
- Perform time-study analyses.

### **HISTORY OF THE COMPANY**

SMAIC and SFFCC are foreign property and casualty insurers authorized to transact insurance business in the State of New Mexico, and are subject to the jurisdiction and regulation of the Insurance Division, pursuant to the New Mexico Insurance Code.

SFMAIC (Preferred) was incorporated on March 29, 1922 under the Uniform Mutual Law Illinois. The Company commenced business on June 7, 1922. SFMAIC is the lead company in the State Farm Group (“the Group”) and is the nation’s largest automobile insurer. The Group offers multiple lines of property, casualty and life and health insurance throughout the United States and

Canada through an exclusive agency force. Corporate offices are located in Bloomington, Illinois.

SFFCC (Standard) was organized as a stock company on June 12, 1935 under the laws of the State of Illinois. The Company, incorporated as State Farm Fire Insurance Company, was licensed and commenced business on June 29, 1935. The present title was adopted on July 1, 1950, when the Company absorbed by merger the State Farm Casualty Company.

SFFCC (Standard) is the predominant writer of the Group's non-automobile property and casualty insurance in all states and Canada, except California, Florida, and Texas. SFFCC also writes automobile insurance. SFFCC's corporate offices are located in Bloomington, Illinois.

The following table provides the New Mexico premium and production by subsidiary, as provided by the Company:

**Table III - Production Volume by Company**

	<u>Preferred</u>			
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>1/2003-6/2003</u>
<b>Written Premium</b>	\$144,700,492	\$158,221,533	\$170,412,829	\$88,460,578
<b>Earned Premium</b>	\$154,291,771	\$156,189,914	\$166,661,390	\$88,460,578
	<u>Standard</u>			
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>1/2003-6/2003</u>
<b>Written Premium</b>	\$12,621,898	\$19,738,358	\$22,376,455	\$10,171,806
<b>Earned Premium</b>	\$13,145,524	\$17,803,037	\$22,371,216	\$10,864,035

## **OPERATIONS AND MANAGEMENT**

### **Internal Audits**

The Examiners requested copies of the Company's internal audit procedures and audits conducted during the Examination period, with special emphasis on the handling of Credit Reporting and use of C.L.U.E. in the appropriate company and tiering selection of business. In the interest of time this request was rescinded during the on site Examination.

### **Computer Systems**

The Company uses a system of computers and proprietary computer software to order motor vehicle reports, and consumer reports and to rate and issue their books of personal automobile business. Agent Underwriting Inquiry (AUI) is a web-based intranet application that enables an agent to order auto underwriting reports from a vendor.

## **SALES & MARKETING**

The State Farm Group offers multiple lines of property/casualty coverages, personal automobile and homeowners insurance, and life/health insurance throughout the United States and Canada through its exclusive agency force. The Company uses exclusive independent agents to market its products in New Mexico. Agents/Producers in their local offices prepare personal automobile quotations for their clients. Quotations are prepared from information provided by applicants, and producers use the Company's AUI, Enterprise Underwriting Information (EUI) systems to assist them, as well as C.L.U.E. reports of accident and loss history information. MVR and C.L.U.E accident

information are uploaded into the Company's EUI system. The Company does not have any contractual agreements with any Managing General Agents.

## **FORMS**

### **Policy Forms and Endorsements**

The Examiners reviewed the Company's printed automobile application forms and endorsements in use during the Examination period. The Company uses paper application forms, as well as, electronic applications for its automobile insurance. The Examiners reviewed the paper forms for compliance with the State's mandates concerning fraud warnings, application alterations, and privacy policy disclosures.

No exceptions were noted.

## **UNDERWRITING AND RATING**

The Examiners investigated the Company's consistencies in interpreting information obtained from C.L.U.E. and the Company's use of its credit/claims scoring model in relationship to the Company filings, guidelines and New Mexico Statutes NMSA (1978) §§ 59A-17-9, 59A-17-4(C), and 59A-17-7.1.

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 thirty 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) states:

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

NMSA (1978) § 59A-17-7.1 states:

A. 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.

B. A motor vehicle liability insurer shall not cancel or use as a basis for nonrenewal an insurance policy if such cancellation or nonrenewal is 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.

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.

### **C.L.U.E Reports & Scoring Model**

The Examiners' analysis of the Company's use of C.L.U.E. information revealed the following findings:

- a. State Farm's uses C.L.U.E. Reports in the underwriting and rating of its Personal Automobile Policies. These Reports are obtained for all new household applications—(a.k.a. - raw new business).

- b. The Examiners were unable to view actual C.L.U.E. information beyond 22 days.
- c. C.L.U.E. information is an integral part of the Company's scoring model, which the Examiners refer to as a credit/claims score model.
- d. The heaviest weighted elements of State Farm's credit model (insurance score) are claims related.
- e. The Company's model considers several criteria, which are weighted and mathematically factored into the ultimate developed score which governs State Farm's company selection (Preferred or Standard) of any new business; since August 2003, it has also been a factor in determining eligibility for the New Business Discount (NBD) in State Farm Mutual, and for tier placement in State Farm Fire's Standard Tier Automobile Rating (STAR) program.
- f. The model uses certain criteria obtained from the customer's loss history report as indicated on C.L.U.E. The model uses accidents (both at-fault and not-at-fault) occurrences over the last 36 months, as well as, the total number of claims in the last 5 years.

Through this review, the Examiners found no exceptions related to the Company's credit/claims supplemental rating information governed by NMSA (1978) § 59A-17-9.

#### **Credit/Claims Scoring Model**

The Examiners reviewed the Company's credit/claims scoring model used for underwriting and rating. There were no exceptions noted from this review.

## **Business Practices**

During the course of the Examination the Examiners reviewed two specific practices of the Company that have a direct bearing on the amount of premium New Business insureds are charged. The review was to determine if these practices violated NMSA (1978) §§ 59A-17-7.1 and 59A-16-17(D). These practices were frequent changes to the credit/claim score band ranges and application of written underwriting requirements. The Examiners paid particular attention to “No Hits” and “Thin Files.” “No Hits” are risks for which a match between an applicant’s name and social security number and a record on the credit vendor’s database cannot be made. An example of a “no hit” would be a consumer who has never applied for or used a credit card for consumer purchases, which may be the result of the consumer’s personal preference to make purchases with cash rather than incur credit card debt.

“Thin Files” are risks for which a match is made but there is inadequate information in the applicant’s credit history to calculate an insurance credit score. An example of a “thin file” would be a consumer who holds one credit card but never makes a credit card purchase, which may be the result of the consumer’s personal preference to maintain a credit card for emergency purposes. No exceptions were noted.



### **Inconsistency in Applying Underwriting Requirements**

As policy underwriting samples were reviewed, the Examiners also conducted a review of the Company and tier selection of both Preferred and Standard to assess the Company's compliance with its written underwriting requirements and compliance with NMSA (1978) §§ 59A-17-9 and 59A-16-17(D). Through this review, the Examiners found no substantial non-compliance.

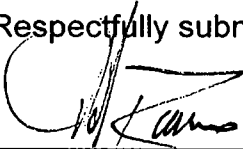
### **CANCELLATIONS OR NONRENEWALS**

The purpose of the Examiners' review of Preferred and Standard's cancelled or nonrenewed policy files was to determine if the Company's procedures were consistent with New Mexico law. The review included policies cancelled due to underwriting actions of the Company; nonpayment of premiums, insured's request or nonrenewals during the Examination period. Through this review, the Examiners found no substantial non-compliance.

## 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,

A handwritten signature in black ink, appearing to read "N. Romero", is written over a horizontal line.

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