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OFFICE OF THE
NEW MEXICO PUBLIC REGULATION
COMMISSION
INSURANCE DIVISION

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CERTIFICATE

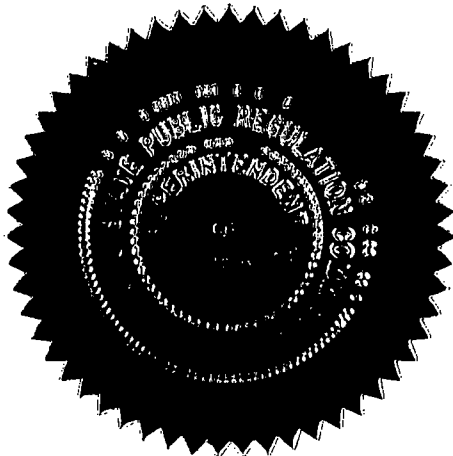
I, Eric P. Serna, Superintendent of Insurance of the State of New Mexico, do hereby certify that the attached Report of Examination for the period ending December 31, 2003 on:

USAA INSURANCE GROUP
San Antonio, Texas

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 28th
day of January, 2005 A.D.

Superintendent of Insurance

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REPORT OF THE MARKET CONDUCT EXAMINATION

of

USAA INSURANCE GROUP

United Services Automobile Association

NAIC # 25941

and

USAA Casualty Insurance Company

NAIC # 25968

and

USAA General Indemnity Company

NAIC # 18600

(As of December 31, 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 the USAA INSURANCE GROUP, including:

United Services Automobile Association
NAIC # 25941

USAA Casualty Insurance Company
NAIC # 25968

USAA General Indemnity Company
NAIC # 18600

USAA Insurance Group maintains its home office at 9800 Fredericksburg Road, San Antonio, Texas 78288. This examination was conducted at the Company's administrative offices at the home office location.

EXECUTIVE SUMMARY

The Examiners conducted the examination of three companies in the USAA Insurance Group. After extensive review, the Examiners were unable to find a material exception.

FOREWORD

The Examiners conducted the examination of three companies in the USAA Insurance Group ("USAA-IG" or "the Company"). Initially, the examination was called to review only United Services Automobile Association ("USAA") and USAA Casualty Insurance Company ("CIC"). Two weeks into the onsite examination, the Examiners determined that the Company's mechanism for tier assignment necessitated the inclusion of a review of USAA General Indemnity Company ("GIC"). An amended call letter was provided to the Company during the onsite examination. The review of this third company was limited to new business underwriting and rating practices, and did not include either cancelled file, nonrenewed file, or complaint reviews.

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 of Examination.

SCOPE OF EXAMINATION

The scope of this examination was limited to the Company's private passenger automobile coverage. 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 also obtained from ChoicePoint and used for the purposes of determining an applicant's acceptability and premium. The Company's current system-based tiering program was implemented in New Mexico beginning December 2001. For this reason the examination period was modified to cover the period from January 1, 2002 through December 31, 2003.

Independent Examiners conducted this examination pursuant to the insurance laws of the State of New Mexico, as authorized 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”).

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 New Mexico Division of Insurance. Examination findings may result in administrative action by the Division of Insurance.

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 laws. The Review Sheets were submitted to the Company representatives designated by the Company management as being knowledgeable about the issues raised in the Examiners' findings for their review and comment.

STATUTES AND RULES CITED

The Examiners have alleged that the Company is in apparent violation of the following New Mexico Statutes: NMSA § 59A-16C-10(A).

HISTORY OF THE COMPANY

USAA was incorporated and began business under the name United States Army Automobile Insurance Association on June 1, 1922. The company is organized as a reciprocal inter-insurance exchange under the laws of the State of Texas and specializes in personal lines property and casualty insurance. Subscribers to the exchange are limited to active and former commissioned, noncommissioned, and warrant officers of the regular forces and reserve components of the United States Armed Services and a group, including employees, established by the company's by-laws.

CIC was originally incorporated and licensed in Texas under the name United Services Casualty insurance Company in September 1968. The current name was adopted in 1970. In July 1990, CIC redomesticated to Florida, and in January 2000, the company redomesticated back to Texas. CIC is a stock property and casualty insurer specializing in writing personal lines coverage for

active duty enlisted personnel, other than noncommissioned officers ("NCOs"), and the ex-dependents of USAA members.

USAA-IG has no agency force except as may be required by state law. Direct sales and claims handling are performed via mail and telephone at the Company's home office in San Antonio, Texas, as well as its regional offices in Phoenix, Arizona; Colorado Springs, Colorado; Norfolk, Virginia; Sacramento, California; and Tampa, Florida.

The following table summarizes the Company's premium income, loss ratios, and policies in force from January 1, 2001 through June 30, 2003:

Table I – USAA Production and Loss Ratios/Policy Counts

	<u>2001</u>	<u>2002</u>	<u>As of June 2003</u>
Written Premium	\$ 26,885,890	\$ 28,241,056	\$ 15,362,260
Earned Premium	\$ 26,594,404	\$ 27,878,828	\$ 14,835,976
Loss Ratio	62%	62%	58%
Policies in Force	20,217	20,542	20,685

Table II – CIC Production and Loss Ratios/Policy Counts

	<u>2001</u>	<u>2002</u>	<u>As of June 2003</u>
Written Premium	\$ 16,879,256	\$ 18,297,312	\$ 10,216,767
Earned Premium	\$ 16,676,131	\$ 17,949,171	\$ 9,797,969
Loss Ratio	53%	69%	53%
Policies in Force	13,606	14,154	14,552

UNDERWRITING AND RATING

The primary focus of this targeted examination was the Company's underwriting and rating practices. The Examiners reviewed the Company's underwriting manuals and guides to ensure the fair treatment of policyholders.

As explained in the Methodology section, the Examiners extensively reviewed underwriting guidelines, filed rating rules, and rates in effect during the examination period. There were no apparent violations found.

Use of Loss History (C.L.U.E. Reports) in Rating

The Company uses C.L.U.E. reports to obtain loss history information for all new business. The Examiners compared the information contained on the C.L.U.E. reports to the tier assignments for each policy to determine whether the Company uses not-at-fault accidents or comprehensive losses to assign insureds to a less advantageous tier.

Based on their review of the Company's use of C.L.U.E. reports, the Examiners found no evidence that USAA-IG currently uses either not-at-fault accidents or comprehensive losses in its underwriting and rating.

Credit Scoring

The Company obtains a credit score from ChoicePoint for all new business applications, unless the applicant is classified as a returning member.

No Hits and Thin Files. "No Hits" are defined as risks in which a match between applicant's name and a record on the credit vendor's database cannot be made. "Thin Files" are defined as risks for which a match is made, but there is inadequate information in the credit file to calculate a score. The Examiners found no deficiencies regarding the Company's treatment of No Hits and Thin Files.

OPERATIONS AND MANAGEMENT

Fraud Plan

The Examiners reviewed the Company's fraud plan and requested proof that the plan had been filed with the Division as required by NMSA (1978) § 59A-16C-10(A):

Within six months of the effective date of the Insurance Fraud Act [59A-16C-1 to 59A-16C-16 NMSA 1978] and by July 1 of each succeeding year every insurer who in the previous calendar year reported ten million dollars (\$10,000,000) or more in direct written premiums in New Mexico shall establish, prepare, implement and submit to the superintendent an anti-fraud plan that is reasonably calculated to detect, prosecute and prevent insurance fraud. Any subsequent amendments to the plan shall be submitted to the superintendent at the time they are adopted.

The Examiners found that the Company had failed to file its fraud plan with the Division during the examination period, in apparent violation of NMSA (1978) § 59A-16C-10(A).

The Company agreed with this finding. The Company also provided documentation to the Examiners that it filed its fraud plan with the Division on June 7, 2004, and is currently in compliance with this statutory requirement.

METHODOLOGY

The Examiners requested and received hard copy and/or electronic listings of data and information related to complaints, new business issued, cancellations, and nonrenewed policies. The Company provided complaint data in hard copy and provided the policy data by CD-ROM in delimited text format. 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 selected random samples of files for review. New business issued samples were randomly selected using the Company's own system. In some instances the electronic data was used to analyze the Company's processing times and actions by internal code.

The Examiners selected samples 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 be selected.

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.

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 Examiners received a list of 171 USAA and CIC complaints received by the Company during the examination period for all lines of business. Of

these, 99 complaints related to private passenger automobile. The Examiners reviewed all 99 (100%) of the USAA and CIC automobile complaint files.

Automobile Policy Data

The Examiners received electronic listings of automobile new business and cancellations processed during the examination period. The Company's own system was used to generate random samples of new business files for review, indicated on Table I below as "Random Sample Size." The list of files provided included numerous duplications. Elimination of these duplicates resulted in sample sizes sufficient to satisfy the NAIC guidelines for random sample selection, indicated on Table I below as "Actual Sample Size."

Table I – New Business Samples Selected

<u>Company</u>	<u>Population</u>	<u>Random Sample Size</u>	<u>Actual Sample Size</u>
USAA	1,488	92	50
CIC	1,739	85	54
GIC	<u>708</u>	<u>56</u>	<u>46</u>
Totals	3,935	233	150

The Examiners received electronic data listings of USAA and CIC policies cancelled during the examination period. The Examiners used Microsoft Access to confirm the dates the policies were cancelled. The Examiners determined the percentage of policies cancelled in each year of the examination period and selected a stratified random sample of files for review as follows:

Table II – Cancelled Policy Samples Selected

<u>File Type</u>	<u>Population</u>	<u>2002 %</u>	<u>2003 %</u>	<u>Sample Size</u>
USAA	4,598	40%	60%	50
CIC	1,222	48%	52%	50
			Total	100

Due to the small population of policies nonrenewed during the examination period, the Examiners selected a systematic sample of USAA policies and selected a random sample of CIC nonrenewals for review as follows:

Table III – Nonrenewed Policy Samples Selected

<u>File Type</u>	<u>Population</u>	<u>Sample Size</u>
USAA	100	50
CIC	116	50
	Total	100

File Review Methodology

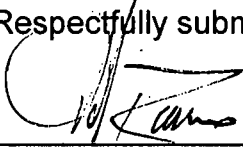
During the file review the Examiners used a proprietary Access database and Excel spreadsheets and formulas to:

- Log and track the files reviewed, as well as examination requests and Examiners' 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,



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