

**REPORT OF  
MARKET CONDUCT EXAMINATION  
OF**

**LITITZ MUTUAL INSURANCE COMPANY**

**Lititz, Pennsylvania**

**AS OF  
August 2, 2004**

**COMMONWEALTH OF PENNSYLVANIA**



**INSURANCE DEPARTMENT  
MARKET CONDUCT DIVISION**

**Issued: September 7, 2004**

# LITITZ MUTUAL INSURANCE COMPANY

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BEFORE THE INSURANCE COMMISSIONER  
OF THE  
COMMONWEALTH OF PENNSYLVANIA

ORDER

AND NOW, this 29 day of April, 2002, in accordance with Section 905(c) of the Pennsylvania Insurance Department Act, Act of May 17, 1921, P.L. 789, as amended, P.S. § 323.5, I hereby designate Randolph L. Rohrbaugh, Deputy Insurance Commissioner, to consider and review all documents relating to the market conduct examination of any company and person who is the subject of a market conduct examination and to have all powers set forth in said statute including the power to enter an Order based on the review of said documents. This designation of authority shall continue in effect until otherwise terminated by a later Order of the Insurance Commissioner.



  
\_\_\_\_\_  
M. Diane Koken  
Insurance Commissioner

Lititz Mutual Insurance Company

Docket No.  
MC04-08-012

Market Conduct Examination as of the  
close of business on August 2, 2004

**ORDER**

A market conduct examination of Lititz Mutual Insurance Company was conducted in accordance with Article IX of the Insurance Department Act, 40 P.S. § 323.1, *et seq.*, for the period July 1, 2002 through June 30, 2003. The Market Conduct Examination Report disclosed exceptions to acceptable company operations and practices. Based on the documentation and information submitted by Respondent, the Department is satisfied that Respondent has taken corrective measures pursuant to the recommendations of the Examination Report.

It is hereby ordered as follows:

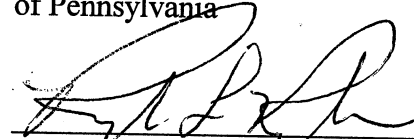
1. The attached Examination Report will be adopted and filed as an official record of this Department. All findings and conclusions resulting from the review of the Examination Report and related documents are contained in the attached Examination Report.
2. Respondent shall comply with Pennsylvania statutes and regulations.

3. Respondent shall comply with all recommendations contained in the attached Report.

4. Respondent shall file an affidavit stating under oath that it will provide each of its directors, at the next scheduled directors meeting, a copy of the adopted Report and related Orders. Such affidavit shall be submitted within thirty (30) days of the date of this Order.

The Department, pursuant to Section 905(e)(1) of the Insurance Department Act (40 P.S. § 323.5), will continue to hold the content of the Examination Report as private and confidential information for a period of thirty (30) days from the date of this Order.

BY: Insurance Department of the Commonwealth  
of Pennsylvania



\_\_\_\_\_  
Randolph L. Rohrbaugh  
Deputy Insurance Commissioner

(September 7, 2004)

## I. INTRODUCTION

The market conduct examination was conducted at Lititz Mutual Insurance Company's offices located in Lititz, Pennsylvania, from April 5, 2004, through April 22, 2004. Subsequent review and follow-up was conducted in the office of the Pennsylvania Insurance Department.

Pennsylvania Market Conduct Examination Reports generally note only those items to which the Department, after review, takes exception. However, the Examination Report may include management recommendations addressing areas of concern noted by the Department, but for which no statutory violation was identified. This enables Company management to review those areas of concern in order to determine the potential impact upon Company operations or future compliance. A violation is any instance of Company activity that does not comply with an insurance statute or regulation. Violations contained in the Report may result in imposition of penalties.

In certain areas of review listed in this Report, the examiners will refer to "error ratio." This error ratio is calculated by dividing the number of policies with violations by the total number of policies reviewed. For example, if 100 policies are reviewed and it is determined that there are 20 violations on 10 policies, the error ratio would be 10%.

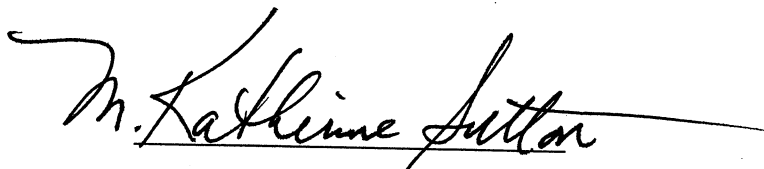
Throughout the course of the examination, Company officials were provided with status memoranda, which referenced specific policy numbers with citation to each section of law violated. Additional information was requested to clarify apparent violations. An exit conference was conducted with Company personnel to discuss the various types of violations identified during the examination and review written summaries provided on the violations found.

The courtesy and cooperation extended by the officers and employees of the Company during the course of the examination is hereby acknowledged.

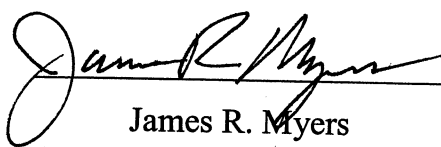
The undersigned participated in this examination and in preparation of this Report.



Chester A. Derk, Jr., AIE, HIA  
Market Conduct Division Chief



M. Katherine Sutton  
Market Conduct Examiner



James R. Myers  
Market Conduct Examiner



## **II. SCOPE OF EXAMINATION**

The Market Conduct Examination was conducted on Lititz Mutual Insurance Company, hereinafter referred to as "Company," at their office located in Lititz, Pennsylvania.

The examination was conducted pursuant to Sections 903 and 904 (40 P.S. § 323.3 and 323.4) of the Insurance Department Act and covered the experience period of July 1, 2002, through June 30, 2003, unless otherwise noted. The purpose of the examination was to determine the Company's compliance with Pennsylvania insurance laws and regulations.

The examination focused on Company operations in the following areas:

1. Personal Lines Property
  - Underwriting - Appropriate and timely notices of nonrenewal, mid-term cancellations, 60-day cancellations and declinations.
  - Rating - Proper use of all classification and rating plans and procedures.
2. Commercial Property
3. Claims
  - Standards for prompt, fair and equitable settlements.
  - Use of proper Peer Review procedures.
4. Consumer Complaints
5. Forms
6. Advertising
7. Licensing

### **III. COMPANY HISTORY AND LICENSING**

Lititz Mutual Insurance Company, the lead member of Lititz Mutual Group, was incorporated on September 17, 1888 as the Agricultural Mutual Fire Insurance Company of Lancaster County, under the laws of Pennsylvania and began business the same year. The title was changed to the Lititz Agricultural Mutual Fire Insurance Company on January 5, 1901, and to its present form in January 1941. The Southern Mutual Insurance Company, Quarryville, Pennsylvania, was merged with and into the Company on December 31, 1963.

#### **LICENSING**

Lititz Mutual Insurance Company is licensed in DE, FL, KS, MD, MO, NC, OH, PA, SC, VA and WV. The Company's 2003 annual statement reflects Direct Written Premium for all lines of business in the Commonwealth of Pennsylvania as \$20,684,245. Premium volume related to the areas of this review were: Homeowners' Multiperil \$12,314,146; Farmowners' Multiperil \$1,452,142; Earthquake \$18,412; Fire and Allied Lines \$2,501,818; Commercial Multiperil \$2,641,188; Inland Marine \$305,510; Other Liability \$1,405,425 and Burglary \$604.

#### **IV. UNDERWRITING PRACTICES AND PROCEDURES**

As part of the examination, the Company was requested to supply underwriting guides, bulletins, directives or other forms of underwriting procedure communications for each line of business being reviewed. Underwriting guides were furnished for personal and commercial lines property coverages. The purpose of this review was to identify any inconsistencies which could be considered discriminatory, specifically prohibited by statute or regulation, or unusual in nature.

The following violation was noted.

*1 Violation. Act 205, Section 5(a)(4) (40 P.S. §1171.5(a)(4)) - Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined.*  
Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance. The violation noted was for the requirement of supporting business as noted in the underwriting guide.

Fire & Allied Lines – 1 & 2 family dwellings require supporting Lititz Mutual Commercial coverage.

## **V. UNDERWRITING**

### **A. Homeowners**

#### **1. 60 Day Cancellations**

A 60 day cancellation is considered to be any policy which was cancelled within the first 60 days of the inception date of the policy.

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) (40P.S. §1171.5(a)(9)), which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the cancellation notice.

From the universe of 269 personal line property policies, which were cancelled within the first 60 days of the inception date during the experience period, 159 files were selected for review. The property files consisted of 100 homeowner and 59 tenant homeowner policies. All 159 files requested were received and reviewed.

No violations were noted.

#### **2. Mid-term Cancellations**

A Mid-term cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date.

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) (40P.S. §1171.5(a)(9)), which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the cancellation notice.

From the universe of 1,931 personal line property policies, which were cancelled mid-term during the experience period, 150 files were selected for review. These files consisted of homeowner policies. All 150 files requested were received and reviewed. There were 137 mid-term cancellations and 13 files identified as 60 day cancellations. The 4 violations noted were based on 4 files, resulting in an error ratio of 3%.

The following violations were noted.

*4 Violations Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)]*

Prohibits canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless 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 company; or there has been a substantial change or increase in hazard in the risk assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in the hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium when due or for any other reasons approved by the Commissioner. The violations noted were due to improper reasons for mid-term cancellation.

**Tenant Homeowner**

From the universe of 317 personal line property policies, which were cancelled mid-term during the experience period, 100 files were selected for review. The property files consisted of tenant homeowner policies. All 100 files requested were received and reviewed. There were 94 mid-term cancellations and 6 files identified as 60 day

cancellations. The 4 violations noted were based on 4 files, resulting in an error ratio of 4%.

The following violations were noted.

*3 Violations Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)]*

Prohibits canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless 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 company; or there has been a substantial change or increase in hazard in the risk assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium when due or for any other reasons approved by the Commissioner. The violations noted were due to improper reasons for mid-term cancellation.

*1 Violation Act 205, Section 5(a)(7)(iii) [40 P.S. §1171.5(a)(7)(iii)]* - “Unfair Methods of Competition” and “Unfair or Deceptive Acts or Practices” in the business of insurance means. (7) Unfairly discriminating by means of: (iii) making or permitting any unfair discrimination between individuals of the same class and essentially the same hazard with regard to underwriting standards and practices or eligibility requirements by reason of race, religion, nationality or ethnic group, age, sex, family size, occupation, place of residence, or marital status. The terms “underwriting standards and practices” or “eligibility rules”

do not include the promulgation of rates if made or promulgated in accordance with the appropriate rate regulatory act of this Commonwealth and regulations promulgated by the Commissioner pursuant to such act. The violation was for not providing a specific reason for a 60 day cancellation.

### 3. Nonrenewals

A nonrenewal is considered to be any policy that was not renewed, for a specific reason, at the normal twelve-month policy anniversary date.

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) [40 P.S. §1171.5(a)(9)], which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the nonrenewal notice.

From the universe of 240 Homeowner policies, which were nonrenewed during the experience period, 50 files were selected for review. All 50 files requested were received and reviewed. The 10 violations noted were based on 10 files, resulting in an error ratio of 20%.

The following violations were noted.

#### *9 Violations Act 205, Section 5(a)(9) [40 P.S. §1171.5(a)(9)]*

Prohibits canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless 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 company; or there has been a substantial change or increase in

hazard in the risk assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium when due or for any other reasons approved by the Commissioner.

AND

*Adjudication. Mohnal/Lebanon Mutual, P95-08-048 (1998)*

When the insurer notifies its agent of an allegedly hazardous condition on the insureds' property together with recommendations to correct the condition but does not notify the insureds, a cancellation based upon a failure to comply with the recommendations violates Act 205. The violations were due to improper reasons for nonrenewal and failure to notify insureds of recommendations to correct conditions prior to nonrenewal.

*1 Violation Act 205, Section 5(a)(9)(ii) [40 P.S. §1171.5(a)(9)(ii)] - State the date, not less than thirty days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective. The violation was for failure to provide 30 days notice of cancellation.*

## **B. Farmowners**

### **1. 60 Day cancellation**

A 60 day cancellation is considered to be any policy, which was cancelled within the first 60 days of the inception date of the policy.

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) [40 P.S. §1171.5(a)(9)], which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the nonrenewal notice.



From the universe of 2 Farmowner policies, which were cancelled with the first 60 days of the inception date during the experience period, both files were selected for review.

No violations were noted.

## 2. Mid-term Cancellations

A Mid-term cancellation is any policy termination that occurs at any time other than the twelve-month policy anniversary date.

The purpose of the review was to determine compliance with Act 86, Section 2 (40 P.S. §3402), which prohibits cancellation except for specified reasons, Section 3 (40 P.S. §3403), which establishes the requirements which must be met regarding the form and conditions of the cancellation notice and Section 4 (a) and (b) (40 P.S. § 3404), which establishes the requirements which must be met regarding return of premium to the insured.

The universe of 39 Farmowner policies reported by the Company as cancelled mid-term, was selected for review. All 39 files were received and reviewed. The 5 violations noted were based on 5 files, resulting in an error ratio of 13%.

The following findings were made.

### *2 Violations Act 86, Section 3(a)(3)(ii) [40 P.S. §3403(a)(3)(ii)]*

Requires that a mid-term cancellation notice shall be forwarded directly to the named insured or insureds at least 60 days in advance of the effective date of termination unless one or more of the following exist. The insured has failed to pay a premium when due, whether the premium is payable directly to the company or its agents or indirectly

under a premium finance plan or extension of credit, in which case, the prescribed written notice of cancellation shall be forwarded directly to the named insured at least 15 days in advance of the effective date of termination. The violations noted were the result of the cancellation notices providing less than the required 15 days notice for nonpayment of premium.

*3 Violations Act 86, Section 2 (40P.S. § 3402) Grounds for cancellation.*

Cancelling in mid-term a policy of insurance covering commercial property and casualty risks is prohibited for any reason other than those enumerated under this section. The files noted were cancelled for reasons not supported in the policy file.

**3. Nonrenewals**

A nonrenewal is considered to be any policy that was not renewed, for a specific reason, at the normal twelve-month policy anniversary date.

The review was conducted to determine compliance with Act 86, Section 3 [40 P.S. §3403], which establishes the requirements that must be met regarding the form and condition of the nonrenewal notice.

From a universe of 4 Farmowner policies reported as being nonrenewed during the experience period, all 4 policies were selected for review. The 1 violation noted resulted in an error ratio of 25%.

The following violation was noted.

*1 Violation Act 86, Section 3(a)(2) [40 P.S. §3403(a)(3)(ii)] Requires that a nonrenewal notice shall be forwarded directly to the named insured or*

insureds at least 60 days in advance of the effective date of termination. The cancellation notice gave less than 60 days notice.

### **C. Earthquake**

#### **Mid-term Cancellations**

A mid-term cancellation is any policy that terminates after the first 60 days of initial issue, and other than the normal twelve-month policy anniversary date.

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) [40 P.S. §1171.5(a)(9)], which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the mid-term cancellation notice.

The universe of 10 personal line property policies with earthquake coverage, which were cancelled mid-term during the experience period, was selected for review. The property files consisted of homeowner policies. All 10 files requested were received and reviewed.

No violations were noted.

### **D. Dwelling Fire**

#### **1. 60-Day Cancellations – Tenant and Owner Occupied**

A 60 Day cancellation is considered to be any policy, which was cancelled within the first 60 days of the inception date of the policy

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) [40 P.S. §1171.5(a)(9)],

which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the nonrenewal notice.

The universe of 18 Dwelling Fire policies reported as being cancelled within the first 60 days, during the experience period, was selected, received and reviewed. The 2 violations noted were based on 2 files, resulting in an error ratio of 11%.

The following findings were made.

*2 Violations Act 205, Section 5(a)(4) [P.S. § 1171.5(a)(4)] Unfair Methods of Competition and Unfair or Deceptive Acts or Practices defined.*

(a) "Unfair Methods of Competition" and "Unfair or Deceptive Acts or Practices" in the business of insurance means.

(4) Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance. The policies noted contained notices reflecting the policies were cancelled due to lack of supporting business.

## 2. Mid-term Cancellations

A mid-term cancellation is any policy that is cancelled after the first 60 days of initial issue and other than the normal twelve-month policy anniversary date.

The primary purpose of the review was to determine personal lines compliance with Act 205, Unfair Insurance Practices Act, Section 5(a)(9) (40P.S. §1171.5(a)(9), which establishes the conditions under which cancellation of a policy is permissible along with the form requirements of the cancellation notice.

(a) Dwelling Fire – Owner Occupied

From a universe of 39 Dwelling Fire – Owner Occupied policies cancelled mid-term during the experience period, all 39 files were selected, received and reviewed. Of these 39 cancellations, 35 were mid-term cancellations and 4 were 60 day cancellations. The 8 violations noted were based on 8 files, resulting in an error ratio of 21%.

The following violations were noted.

*3 Violations Act 205 Unfair Insurance Practices, Section 5(a)(9) (40P.S. § 1171.5) Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined. - (a) “Unfair Methods of Competition” and Unfair or Deceptive Acts or Practices” in the business of insurance means. (9) Canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless 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 company; or there has been a substantial change or increase in hazard in the risk assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium whether such premium is payable directly to the company or its agent or indirectly under any premium finance plan or extension of credit; or for any other reasons approved by the Commissioner. The policies noted were cancelled for reasons not permitted at mid-term.*

*1 Violation Act 205, Section 5(a)(9)(iv) [40 P.S. §1171.5(a)(9)(iv)] – Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined.* (9) No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall.

(iv) Advise the insured of his right to request, in writing, within ten days of receipt of the notice of cancellation or intention not to renew that the Insurance Commissioner review the action of the insurer.

AND

Title 31, Pa. Code §59.6(7)(ii) – Notice of cancellation or refusal to renew; requirements. (7)(ii) The notice shall include the addresses of the four regional offices of the Insurance Department. The file contained a cancellation notice which did not comply.

*1 Violation Act 205, Section 5(a)(9)(ii) (40 P.S. §1171.5(a)(9)(ii)) Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined.*

(9) No cancellation or refusal to renew by any person shall be effective unless a written notice of the cancellation or refusal to renew is received by the insured either at the address shown in the policy or at a forwarding address. Such notice shall:

(ii) State the date, not less than thirty days after the date of delivery or mailing on which such cancellation or refusal to renew shall become effective. The file noted contained a cancellation notice with less than the required 30 days.

*2 Violations Title 31, Pa. Code §59.9(b) Nonapplicability of the Acts.* The period of 60 days referred to in section 5(a)(9) and (c)(3) of The Unfair Insurance Practices Act (40 P.S. §1171.5(a)(9) and (c)(3) is intended

to provide to insurers a reasonable period of time, if desired, to investigate thoroughly a particular risk while extending coverage during the period of investigation. An insurer may cancel the policy provided it gives at least 30 days notice of termination and provide it gives notice no later than the 60<sup>th</sup> day. The insurer's decision to cancel during this 60-day period must not violate section 5(a)(7)(iii) of The Unfair Insurance Practices Act (40 P.S. §1171.5(a)(7)(iii)).

AND

Title 31, Pa. Code §59.6 (5)(6) – Notice of cancellation or refusal to renew; requirements. Notices of cancellation or refusal to renew shall meet the following requirements.

(5)The reasons given for cancellation or refusal to renew shall be clear and complete. If the reason is a material misrepresentation, fraudulent statement, omission or concealment of fact material to the acceptance of the risk, or to the hazard assumed by the company, made by the insured, the insurer shall specify what statements, omissions or concealments it relied on for its action.

(6)If the reason is a substantial change or increase in hazard, the insurer shall specify the changes or increased hazards it relied on for its actions. If the reason is failure to pay a premium, the insurer shall specify the amount due, and the date when it was due. The files noted contained cancellations where the reason was not specific.

*1 Violation Act 205, Section 5(a)(4) [40 P.S. §1171.5 (a) (4)] - Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined.*

“Unfair Methods of Competition” and “Unfair or Deceptive Acts or Practices” in the business of insurance means.

(4) Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or

tending to result in unreasonable restraint of, or monopoly in, the business of insurance. The policy noted was cancelled due to no supporting business, although the reason on the notice was not specific.

(b) Dwelling Fire Tenant Occupied

The purpose of the review was to determine compliance with Act 86, Section 2 (40 P.S. §3402), which prohibits cancellation except for specified reasons and Section 3 (40 P.S. §3403), which establishes the requirements, which must be met regarding the form and condition of the cancellation notice.

From a universe of 444 Tenant Occupied Dwelling Fire policies reported as being cancelled mid-term during the experience period, 100 policies were selected, received and reviewed. Seven of the policies presented were 60 day cancellations. The 8 violations noted were based on 8 files, resulting in an error ratio of 8%.

The following violations were noted.

*2 Violations Act 205, Section 5(a)(4) [P.S. § 1171.5(a)(4)] Unfair Methods of Competition and Unfair or Deceptive Acts or Practices defined.*

(a) "Unfair Methods of Competition" and "Unfair or Deceptive Acts or Practices" in the business of insurance means.

(4) Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance. The policies noted were cancelled due to lack of supporting business.



*3 Violations Act 86, Section 2 (40P.S. § 3402) Grounds for cancellation.* Cancelling in mid-term a policy of insurance covering commercial property and casualty risks is prohibited for any reason other than those enumerated under this section. The policies noted were cancelled for reasons not permitted and not supported by the policy file.

*2 Violations Act 86, Section 3(a)(3)(ii) [40 P.S. §3403(a)(3)(ii)]* Requires that a mid-term cancellation notice shall be forwarded directly to the named insured or insureds at least 60 days in advance of the effective date of termination unless the insured has failed to pay a premium when due, whether the premium is payable directly to the company or its agents or indirectly under a premium finance plan or extension of credit, in which case, the prescribed written notice of cancellation shall be forwarded directly to the named insured at least 15 days in advance of the effective date of termination. The policies reflected cancellation notices that gave less than 60 days notice.

*1 Violation Title 31, Pa. Code, Section 113.88* – The reason given for nonrenewal or cancellation shall be clear and complete. It shall be stated so that a person of average intelligence and education can understand it. Phrases such as “losses” or “underwriting reasons” are not sufficiently specific reasons for nonrenewal or cancellation. The file noted was cancelled within 60 days and the reason was not specific.

### 3. Nonrenewals

A nonrenewal is considered to be any policy that was not renewed, for a specific reason, at the normal twelve-month policy anniversary date.

The review was conducted to determine compliance with Act 86, Section 3 [40 P.S. §3403], which establishes the requirements that must be met regarding the form and condition of the nonrenewal notice.

The universe of 52 Dwelling Fire policies reported as being nonrenewed during the experience period, was selected. All 52 policies were received for review. The 28 violations noted were based on 28 files, resulting in an error ratio of 54%.

The following violations were noted.

*10 Violations Act 205, Section 5(a)(4) [P.S. § 1171.5(a)(4)] Unfair Methods of Competition and Unfair or Deceptive Acts or Practices defined.*

(a) "Unfair Methods of Competition" and "Unfair or Deceptive Acts or Practices" in the business of insurance means.

(4) Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance. The policies noted contained notices which either stated the lack of supporting business as the nonrenewal reason, contained notices with non-specific reasons, or the notice was missing.

*11 Violations Act 86, Section 3(a)(2) [40 P.S. §3403(a)(3)(ii)]* Requires that a nonrenewal notice shall be forwarded directly to the named insured or insureds at least 60 days in advance of the effective date of termination. The policies noted reflected cancellation notices that gave less than 60 days notice.

*4 Violations Act 86, Section 3(a)(5) (40 P.S. § 3403(a)(5) –* A nonrenewal shall state the specific reasons for the nonrenewal. The reasons shall identify the

condition, factor or loss experience which caused the nonrenewal. The notice shall provide sufficient information or data for the insured to correct the deficiency.

AND

*Title 31, Pa. Code, Chapter 113* – The reason given for nonrenewal or cancellation shall be clear and complete. It shall be stated so that a person of average intelligence and education can understand it.

Phrases such as “losses” or “underwriting reasons” are not sufficiently specific reasons for nonrenewal or cancellation. The files noted contained nonrenewal notices that did not state a specific reason.

*3 Violations The Insurance Department Act, Section 903(a) [40 P.S. §323.3(a)]*

(a) Every company or person subject to examination in accordance with this act must keep all books, records, accounts, papers, documents and any or all computer or other recordings relating to its property, assets, business and affairs in such manner and for such time periods as the department, in its discretion, may require in order that its authorized representatives may readily ascertain whether the company or person has complied with the laws of this Commonwealth. The files noted were missing from the exam or missing material and compliance could not be determined.

4. Rescissions

A rescission is a policy that was cancelled back to the original inception date and no coverage was afforded.

The primary purpose of the review was to determine compliance with Act 68, Section 2003 (40 P.S. §991.2003), which establishes conditions under which action by the insurer is prohibited and Section 2006 (40 P.S. §991.2006), which establishes the

requirements which must be met regarding the form and conditions of the cancellation notice.

The universe of 2 policies that were rescinded during the experience period was selected for review. Both files selected were received and reviewed.

No violations were noted.

#### 5. Personal Lines Declinations

A declination or refusal to write is considered to be an application that was refused and no policy issued by the Company.

The primary purpose of the review was to determine compliance with Act 205, Section 5 [40 P.S. §1171.5], which defines unfair methods of competition and unfair or deceptive acts or practices.

From a universe of 125 personal property lines declinations reported to have occurred within the experience period, 75 records were selected, received and reviewed. The 1 violation noted resulted in an error ratio of 1%.

The following violation was noted.

- 1 Violation Act 205, Section 5(a)(4) [40 P.S. §1171.5(a)(4)] Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined.*
- (a) "Unfair Methods of Competition" and "Unfair or Deceptive Acts or Practices" in the business of insurance means.
  - (4) Entering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the

business of insurance. The file noted contained a refusal to write based on no supporting business.

## **E. Commercial Property**

### **Mid-Term Cancellations**

A mid-term cancellation is any policy that terminates after the first 60 days of initial issue, and other than the normal twelve-month policy anniversary date.

The purpose of the review was to determine compliance with Act 86, Section 2 [40 P.S. §3402], which prohibits cancellation except for specified reasons, Section 3 [40 P.S. §3403], which establishes the requirements, which must be met regarding the form and condition of the cancellation notice and Section 4 [40 P.S. §3404], which establishes the requirements for the return of unearned premium to the named insured.

### **(a) Commercial Fire**

The universe of 37 commercial line property policies, which were cancelled mid-term during the experience period was selected for review. The property files consisted of commercial fire policies. All 37 files requested were received and reviewed. There were 2 files identified as 60 day cancellations. The 2 violations noted were based on 2 files, resulting in an error ratio of 5%.

The following violations were noted.

*2 Violations Act 86, Section 4(b) [40 P.S. §3404(b)]* Requires that unearned premium must be returned to the insured not later than 30 days after the effective date of termination where commercial property or casualty risks are cancelled in mid-term by the insured. The files

noted did not evidence the unearned premium was returned to the insured within 30 days.

**(b) Commercial Package**

The universe of 33 commercial package policies which were cancelled mid-term during the experience period was selected. All 33 files were received for review.

No violations were noted.

**(c) Businessowner**

From the universe of 295 Businessowner property policies, which were cancelled mid-term during the experience period, 50 files were selected for review. All 50 files requested were received and reviewed. There were 2 files identified as 60 day cancellations. The 2 violations noted were based on 2 files, resulting in an error ratio of 4%.

The following violations were noted.

*2 Violations Act 86, Section 4(b) [40 P.S. §3404(b)]* Requires that unearned premium must be returned to the insured not later than 30 days after the effective date of termination where commercial property or casualty risks are cancelled in mid-term by the insured. The files noted show no evidence the unearned premium was returned to the insured within 30 days.

## **VI. RATING**

The primary purpose of this portion of the review was to measure compliance with Act 246, The Casualty and Surety Rate Regulatory Act, Sections 4(a) and (h) [40 P.S. §1184], which requires every insurer to file with the Insurance Commissioner every manual of classifications, rules and rates, every rating plan and every modification of any rating plan, which it proposes to use in the Commonwealth. Also, no insurer shall make or issue a contract or policy except in accordance with filings or rates, which are in effect at the time.

The Company processes and issues homeowner policies using an automated system. In order to verify the automated system, several policies were manually rated to ensure the computer had been programmed correctly. Once the computer programming had been verified, only the input data needed to be verified. By reviewing territory assignments, fire protection classifications, dwelling construction and base premiums, the examiners were able to determine compliance with the Company's filed and approved rating plans.

### **A. Homeowners**

#### **1. New Business**

New business, for the purpose of this examination, was defined as policies written for the first time by the Company during the experience period.

From the universe of 4,756 homeowner policies written as new business during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed.

No violations were noted.

## 2. Renewals

A renewal is considered to be any policy which was previously written by the Company and renewed on the normal twelve-month anniversary date.

From the universe of 21,326 homeowner policies renewed during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed.

No violations were noted.

## 3. Renewals with Surcharges

From the universe of 523 homeowner policies with surcharges renewed during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed.

No violations were noted.

## **B. Farmowners**

### 1. New Business

New business, for the purpose of this examination, was defined as policies written for the first time by the Company during the experience period.

From the universe of 79 Farmowners policies written as new business during the experience period, 25 files were selected for review. All 25 files selected were received and reviewed.

No violations were noted.



## 2. Renewals

A renewal is considered to be any policy, which was previously written by the Company and renewed on the normal twelve-month anniversary date.

From the universe of 419 Farmowners policies renewed during the experience period, 50 files were selected, received and reviewed.

No violations were noted.

## C. Earthquake

### 1. New Business

New business, for the purpose of this examination, was defined as policies written for the first time by the Company during the experience period.

The universe of 11 homeowner policies written as new business with earthquake coverage during the experience period was selected, received and reviewed.

No violations were noted.

### 2. Renewals

A renewal is considered to be any policy, which was previously written by the Company and renewed on the normal twelve-month anniversary date.

From the universe of 120 homeowner policies renewals written with earthquake coverage during the experience period, 25 files were selected, received and reviewed.

No violations were noted.

## **D. Dwelling Fire**

### **1. New Business**

New business, for the purpose of this examination, was defined as policies written for the first time by the Company during the experience period.

From the universe of 194 dwelling fire policies written as new business during the experience period, 50 files were selected, received and reviewed.

No violations were noted.

### **2. Renewals**

A renewal is considered to be any policy, which was previously written by the Company and renewed on the normal twelve-month anniversary date.

The purpose of the review was to measure compliance with Act 86, Section 1 [40 P.S. §3401], which requires 30 days advance notice of an increase in renewal premium.

From the universe of 3,305 dwelling fire policies written as renewal business during the experience period, 75 files were selected, received and reviewed.

No violations were noted.

## **E. Commercial Renewals**

A renewal is considered to be any policy, which was previously written by the Company and renewed on the normal twelve-month anniversary date.

- The purpose of the review was to measure compliance with Act 86, Section 1 [40 P.S. §3401], which requires 30 days advance notice of an increase in renewal premium.

#### 1. Commercial Property – Tenant occupied dwelling policies

From the universe of 3,050 commercial policies renewed during the experience period, 100 files were selected for review. All 100 files selected were received and reviewed.

No violations were noted.

#### 2. Commercial Property

A sample of 31 commercial property policies renewed within the experience period was identified in the selections of commercial lines policies being reviewed for other segments of the examination. The sample consisted of fire, business owners and package policies. The 3 violations noted were based on 3 files, resulting in an error ratio of 10%.

The following violations were noted.

*3 Violations Act 86, Section 1 [40 P.S. §3401] requires 30 days advance notice of an increase in renewal premium. The policies noted were renewed at a higher rate and no notice was given.*

## VII. CLAIMS

The primary purpose of the review was to determine compliance with Title 31, Pa. Code Pennsylvania Code, Chapter 146, Unfair Claims Settlement Practices. The files were also reviewed to determine compliance with Act 205, Section 4 (40P.S. §1171.4) and Section 5(a)(10)(vi) (40P.S. §1171.5(a)(10)(vi), Unfair Insurance Practices Act.)

### **A. Homeowner**

From the universe of 1,748 homeowner claims reported during the experience period, 100 were selected for review. All 100 files selected were received and reviewed. The 5 violations noted were based on 5 files, resulting in an error ratio of 5%.

The following violations were noted.

*5 Violations Title 31, Pa. Code , Section 146.6* – Every insurer shall complete investigation of a claim within 30 days after notification of claim, unless such investigation cannot reasonably be completed within such time. If the investigation cannot be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected. The files noted did not provide either a 30 day or 45 day status letter.

### **B. Farmowner**

The universe of 34 Farmowner claims reported during the experience period were selected and received for review.

No violations were noted.

### **C. Dwelling Fire**

From the universe of 153 dwelling fire claims reported during the experience period, 75 were selected for review. All 75 files selected were received and reviewed.

No violations were noted.

### **D. Property Damage Liability**

The universe of 53 Property Damage Liability claims reported during the experience period, was selected, received and reviewed. The 1 violation noted resulted in an error ratio of 2%.

The following violation was noted.

*1 Violation Title 31, Pa. Code, Section 146.7(a)(1).* Standards for prompt, fair and equitable settlements applicable to insurers.

(a)Acceptance or denial of a claim shall comply with the following. (1) Within 15 working days after receipt by the insurer of properly executed proofs of loss, the first-party claimant shall be advised of the acceptance or denial of the claim by the insurer. An insurer may not deny a claim on the grounds of a specific policy provision, condition or exclusion unless reference to the provision, condition or exclusion is included in the denial. The denial shall be given to the claimant in writing and the claim file of the insurer shall contain a copy of the denial. Claim was received and immediately recognized as a coverage issue. Coverage was not accepted nor denied in the time required

## **E. Inland Marine**

The universe of 44 Inland Marine claims reported during the experience period was selected and received for review. The 5 violations noted were based on 5 files, resulting in an error ratio of 11%.

The following violations were noted.

*5 Violations Title 31, Pa. Code , Section 146.6* – Every insurer shall complete investigation of a claim within 30 days after notification of claim, unless such investigation cannot reasonably be completed within such time. If the investigation cannot be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected. The files did not evidence status letters were sent as required.

## VIII. FORMS

Throughout the course of the examination, all underwriting files were reviewed to identify the policy forms used in order to verify compliance with Insurance Company Law, Section 354 (40P.S. §477b), Approval of Policies, Contracts, etc., Prohibiting the Use Thereof Unless Approved. During the experience period of the examination, Section 354 provided that it shall be unlawful for any insurance company to issue, sell, or dispose of any policy contract or certificate covering fire, marine, title and all forms of casualty insurance or use applications, riders, or endorsements in connection therewith, until the forms have been submitted to and formally approved by the Insurance Commissioner. All underwriting and claim files were also reviewed to verify compliance with Act 165 of 1994 (18 Pa. CS §4117)(k)(1) which requires all insurers to provide an insurance fraud notice on all applications for insurance and all claims forms.

No violations were noted.

## **IX. CONSUMER COMPLAINTS**

The purpose of the review was to determine compliance with the Unfair Insurance Practices Act, No. 205 (40P.S. §1171). Section 5(a)(11) of the Act requires a Company to maintain a complete record of all complaints received during the preceding four years. This record shall evidence the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints and the time it took to process each complaint. No violations were noted.

The Company was requested to identify all consumer complaints received during the experience period and provide copies of their consumer complaint logs for the preceding four years. The Company provided all consumer complaint logs as requested. The universe of 59 consumer complaints were selected, received and reviewed. There were 6 complaints where the Department lacked jurisdiction. No violations were noted in the Company's handling of these consumer complaints.

The following violations were found in consumer complaints relating to cancellations.

*12 Violations Act 205 Unfair Insurance Practices, Section 5(a)(9) (40P.S. § 1171.5) Unfair Methods of Competition and Unfair or Deceptive Acts or Practices Defined. - (a) "Unfair Methods of Competition" and Unfair or Deceptive Acts or Practices" in the business of insurance means:*

(9) Canceling any policy of insurance covering owner-occupied private residential properties or personal property of individuals that has been in force for sixty days or more or refusing to renew any such policy unless 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 company; or there has been a substantial change or increase in hazard in the risk



assumed by the company subsequent to the date the policy was issued; or there is a substantial increase in hazards insured against by reason of willful or negligent acts or omissions by the insured; or the insured has failed to pay any premium whether such premium is payable directly to the company or its agent or indirectly under any premium finance plan or extension of credit; or for any other reasons approved by the Commissioner. The policies noted were cancelled mid-term for reasons not permitted. Many cancellations were due to an increase in hazard when no substantial change or increase since policy inception had been established and the policy file contained no evidence the policyholder was put on notice to correct the alleged hazardous conditions. Others were for reasons which were not in compliance with this statute.

*1 Violation Insurance Company Law, Section 506.1(40 P.S. §636.1). – After-Death Continuation of Basic Property Insurance.*

(a) Basic property insurance shall be continued one hundred and eighty (180) days after the death of the named insured on the policy or until the sale of the property, whichever event occurs first, provided that the premiums for the coverage are paid. The policy was cancelled mid-term after the death of the name insured without providing the required basic property insurance.

The following synopsis reflects the nature of the 59 complaints that were reviewed.

• 54	Cancellations/Nonrenewal	92%
• 3	Claims Related	5%
• <u>2</u>	Premium Related	<u>3%</u>
59		100%

## **X. ADVERTISING**

The purpose of this review was to determine compliance with Act 205, Section 5 (40P.S. §1171.5), which defines unfair methods of competition and unfair or deceptive acts or practices in the business of insurance, as well as Title 31, Pa. Code Pennsylvania Code, Section 51.61.

The Company was requested to provide copies of all advertising, sales material and Internet advertisements in use during the experience period. The Company provided 17 pieces of advertising, which included brochures, agency appointment kits and magazine advertising. Internet advertising was also reviewed.

No violations were noted.

## **XI. LICENSING**

In order to determine compliance by the Company and its agency force with the licensing requirements applicable to Section 605 (40P.S. §235) and Section 623 (40P.S. §253) of the Insurance Department Act, the Company was requested to furnish a list of all active agents during the experience period and a listing of all agents terminated during the experience period. In addition to these lists provided by the Company, underwriting files and rating files were checked to verify proper licensing and appointment.

*4 Violations Insurance Department Act, Section 623 (40P. S. §253) Doing Business with Unlicensed Brokers.* Any entity or the appointed agent of any entity accepting applications or orders for insurance or securing any insurance business through anyone acting without a license commits a misdemeanor of the third degree.

The following producers could not be verified as having a Certificate of Qualification or a Broker's License.

William Clark Insurance Agency, Inc  
Rice and Associates, Inc  
Daisy F Combs  
Vicki L Geiber

## **XII. RECOMMENDATIONS**

The recommendations made below identify corrective measures the Department finds necessary as a result of the number of some violations, or the nature and severity of other statutory or regulatory violations, noted in the Report.

1. The Company must review Act 205, Section 5(a)(9) [40 P.S. §1171.5] to ensure that violations of the types noted in the Report do not occur in the future.
2. The Company must reinforce its internal underwriting controls to ensure that notices of premium increase are provided to the named insured and meet the requirements of Act 86, Section 1 (40 P.S. §3401).
3. The Company must review and revise internal control procedures to ensure compliance with Act 86, Section 2 (40P.S. § 3402) and permitted reasons for cancellation at mid-term.
4. The Company must review and revise internal control procedures to ensure compliance with cancellation notice requirements of Act 86, Section 3(a)(3)(ii) and 3(a)(6) [40 P.S. §3403(a)(3)(ii) and §3403(a)(6)] so that the violations noted in the Report do not occur in the future.
5. The Company must review and revise internal control procedures to ensure compliance with Act 86, Section 4(b) [40 P.S. §3404(b)] requirements regarding the return of unearned premium to the insured upon cancellation by the Company.
6. The Company should review and revise internal control procedures to ensure compliance with the claims handling requirements of Title 31, Pa. Code

**Pennsylvania Code, Chapter 146, Unfair Claims Settlement Practices so that the violations noted in the Report do not occur in the future.**

- 7. The Company must ensure all producers are properly licensed and appointed, prior to accepting any business.**

**XIII. COMPANY RESPONSE**



*Founded 1888*

# *Lititz Mutual Insurance Company*

2 North Broad Street, P.O. Box 900, Lititz, PA 17543-7007

August 24, 2004

Mr. Chester A. Derk, Jr., AIE, HIA  
Market Conduct Division Chief  
Commonwealth of Pennsylvania  
Insurance Department  
Bureau of Enforcement  
1321 Strawberry Square  
Harrisburg, Pennsylvania 17120

Dear Mr. Derk:

Re: Examination Warrant Number: 03-M17-032

Reference is made to your report of examination dated August 2, 2004 received in our office on August 3<sup>rd</sup>, 2004. I offer below any comments or appropriate remedial action that was taken as a result of this examination.

## **Comments:**

In that the covered period of this examination was for the period July 1, 2002 to June 30, 2003, many of the procedures that lead to the recommendations had already been put in place. As violations were noted during the examination, corrective steps were taken or reinforced with staff.

## **Recommendations:**

1. The Company has and will continue to review audit procedures to ensure that future Act 205 (all sections) violations do not occur. The majority of violations came as a result of the requirement of supporting lines on tenant occupied dwellings. This policy was established as a positive approach to keep the marketplace open to policyholders on a market segment that was being placed in excess and surplus lines markets with the resulting excess rates producing limited coverage forms. The interpretation of this Act, as it related to coercion, was an opinion that it applied to automobile/homeowners carriers. We feel that there is a definite advantage to the policyholder to have both homeowners and dwelling fire coverages with the same company. All agents and staff have been advised of the elimination of the requirement for supporting coverage on tenant occupied dwellings.
2. Lititz Mutual Insurance Company has had in place the premium increase notices since the implementation of the Act. The three violations occurred on policies scheduled for renewal well in advance of the 30-days requirement.

Mr. Chester A. Derk, Jr., AIE, HIA

August 24, 2004

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3. Compliance of Act 86, Section 3(a)(3)(ii) and 3(a)(6)[40 P.S. § 3403(a)(3)(ii) and §3403(a)(6)] that produced the recommendations on three accounts has been addressed to eliminate future violations.
4. Our Company has reinforced the already existing procedures to meet the 60+ mail delivery time requirement of the Act.
5. The four Act 86 violations occurred when agents could not locate old files that dated back to 2002 to confirm the 15 or 30-day return premium requirement. This requirement has now been added to our return premium notices to our few remaining account-current agents.
6. Lititz Mutual had already enhanced the controls on claim handling procedures. An analysis of the violations indicated that most occurred in 2002 when status letters were sent out, but not within the 30-day advance required.
7. The four violations that occurred on agency licensing have been noted and steps taken to enforce already existing programs.


**Conclusion:**

As a Company, since 1888, we have built a solid reputation for fulfilling our obligations to our policyholders and agents along with a dedicated awareness and compliance to insurance regulations. Your records will indicate same-day response on policy appeals by policyholders to your Department.

In closing, I would be remiss if I did not recognize the professionalism displayed by your Market Conduct Examiners, Katherine Sutton and James Myers; they represented your Department well.

If I can be of further assistance, please advise.

Sincerely,



C. A. (Arch) Michael  
Vice President, Underwriting