



THE STATE OF FLORIDA

OFFICE OF INSURANCE REGULATION MARKET INVESTIGATIONS

TARGET MARKET CONDUCT FINAL EXAMINATION REPORT

OF

**American Modern Home Insurance Company (Ohio domicile)
(NAIC #23469),**

**American Modern Select Insurance Company (Ohio domicile)
(NAIC#38652);**

**American Family Home Insurance Company (Florida domicile)
(NAIC#23450**

**American Southern Home Insurance Company (Florida domicile)
(NAIC#41998)**

**American Western Home Insurance Company (Oklahoma domicile)
(NAIC #35912)**

July 6, 2015

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EXECUTIVE SUMMARY

The Company wrote force-placed insurance policies without having sufficient or appropriate information systems, agent oversight, or rating review. The Company represents that its efforts to correct error-ridden data and records have been ongoing for over 24 months, with incurred costs to date in excess of \$18 million.

The following represent general and systemic findings regarding the Company's force-placed insurance products and are based on self-reported violations and examiner review. Specific details and findings are found in each section of the report.

Statute/Rule	Description
Section 627.062(2), F.S.	Failure to use filed rates. Company charged rates that differed from its filed and approved rates.
Rule 69O-170.004, F.A.C.	Discounts, credits, surcharges; failure to limit Individual Risk Premium Modification (IRPM) ratings to filed limits, resulting in overcharges and undercharges.
Rule 69O-170.004(5)(a), F.A.C.	Failure to maintain documentation supporting scheduled rate modifications.
Rule 69O-170.004(5)(b), F.A.C.	Exceeding the 25% maximum credit or debit permitted in a scheduled rating plan.
Section 627.318, F.S.	Failure to maintain records
Section 624.424, F.S.	Failure to file accurate financial reports
Section 626.451(3), F.S.	Company responsible for acts of its agents
Section 624.5092, F.S.	Administration of taxes; payments

PURPOSE AND SCOPE OF EXAMINATION

The Office of Insurance Regulation, (hereinafter "Office"), Market Investigations, conducted a target market conduct examination of American Modern Insurance Group, which includes American Modern Home Insurance Company, American Modern Select Insurance Company, American Family Home Insurance Company, American Southern Home Insurance Company, and American Western Home Insurance Company, (hereinafter referred to jointly as "Company") pursuant to Section 624.3161, Florida Statutes. The examination was performed by Jennan Enterprises, LLC. The scope period of this examination was January 1, 2008, and was extended to May 1, 2014. The examination began March 17, 2014, and ended June 30, 2014.

The purpose of this examination was to investigate issues relating to American Modern Group's notification to the Office in March 2013, that there were rating variances and overcharges with their lender-placed insurance programs, particularly blanket mortgage security (BMS), collateral protection insurance (CPI) and lender single interest (LSI). The examination was conducted to evaluate and confirm reported corrective actions taken by the Company.

The examination included the following procedures:

- Onsite visits and discussions with Company personnel, Frost Brown Todd personnel, and Deloitte & Touche (D&T) personnel regarding the discovery, remediation and restitution of overcharges.
- Review of data provided by the Company.
- Review of documentation provided by the Company, Frost Brown Todd and D&T.

In reviewing materials for this final report, the examiner relied on records provided by the Company. Procedures and conduct of the examination were in accordance with the *Market Regulation Handbook* produced by the National Association of Insurance Commissioners.

COMPANY OPERATIONS

The company writes property and casualty insurance coverage in the State of Florida through a pooling arrangement involving the following affiliates:

Company	State of Domicile	Date Licensed in FL	2011 Florida Direct Premiums Written	2012 Florida Direct Premiums Written	2013 Florida Direct Premiums Written
American Modern Home Insurance Company	OH	11/26/1975	\$5,559,099	\$3,937,715	\$6,345,925
American Modern Select Insurance Company	OH	02/16/2006	\$0	\$0	\$8,314
American Family Home Insurance Company	FL	04/02/1965	\$707,627	\$205,780	\$246,030
American Southern Home Insurance Company	FL	12/30/1982	\$34,106,434	\$29,588,423	\$23,227,333
American Western Home Insurance Company	OK	07/25/1991	\$3,409,128	\$496,421	\$2,348,759

BACKGROUND

The Company's Financial Institutions Division (FID) handles the force-placed lines of business. Between 2006 and 2008, there was an unexpected growth of the force-placed insurance business. Forced placed business included master policies (policies held by lending institutions) and certificates (issued to loan holders under the specification of a master policy). At that time, the Company was using an information system that was designed for personal lines residential products - one line of business, one rating state, one premium associated with the base coverage, and one expiration date, hereinafter "legacy" system. This legacy system was not designed for, or capable of, handling the functions needed to record and monitor master policies and related certificates. Despite the influx of new business, management chose not to enhance this existing system, continuing to input master policies into a framework designed for single policies. However, the Company realized the need for more technically sophisticated software and initiated a search and selection process in 2008. The search continued into 2009, focusing on finding a system capable of handling master policies, certificates, and rate verifications. The XYCOR product, XyberNet, was selected and a project started in 2010. The project name was Financial Institution Systems Integrated Solution (FISIS). The new system was configured by loading state approved rates into the system for rate validation whenever a new master policy was entered. Certificates were to be validated against the related master policy. Initial loading of master policies began in 2012. In March 2012, it was observed that policies being manually entered into the system were being rejected for rate differences. Attempts to load certificate information revealed additional issues. The effort to complete the implementation of XyberNet was put on hold due to the discovery of extensive inconsistencies and non-compliance of rates associated with master policies. The implementation of XyberNet was delayed approximately 18 months.

Management learned fully of the repercussions of entering master policies and related certificates into an information system as a single policy. The records and data associated with these lines of business were error-ridden and unreliable. The Company self-reported the situation to various state insurance departments, including Florida on date March 2, 2013. Ultimately, a Regulatory Settlement Agreement was issued by the state of Ohio and entered into by the Company on April 28, 2015, relative to the issues that were self-reported by the Company.

REVIEW AND FINDINGS

Examiner on-site visits included:

- Discussions and interviews with Company personnel, Frost Brown Todd (FBT) and D&T personnel regarding the discovery, systems review, remediation and restitution of overcharges
- Review of data provided by the Company
- Review of documentation provided by the Company, FBT and D&T

Based on these interviews and data and document reviews, examiners report the following findings:

1. Agents were allowed to issue their own master policies without oversight by the Company to ensure that rates and forms were in compliance with filed rates and forms. This resulted in coding and rating errors, both undercharges and overcharges. **Violations of Section 627.062(2), Florida Statutes, failure to use filed rates.**
2. Agents were permitted to implement IRPM (Individual Risk Premium Modifiers), credits and debits, to filed rates, without oversight by the Company. Research revealed that filed rates were modified up to 60%, which was not in compliance with the Company's filed modifications of +/- 25%. The Company is responsible for the acts of its agents pursuant to Section 626.451(3), Florida Statutes. **Violations of Section 627.062, Florida Statutes, failure to use filed rates; Rule 690-170.004(5)(b), Florida Administrative Code, exceeding the 25% maximum credit or debit permitted in a scheduled rating plan.**
3. The Company failed to maintain justification and support for the application of IRPM's. **Violations of Rule 690-170.004(5)(a), Florida Administrative Code, failure to maintain documentation supporting rating plan modifications.**
4. The Company made efforts to scan the master policies. However, indexing in the primary imaging system, FileNet, was difficult due to duplication of policies submitted in paper by the agents as coverages changed.
5. Master policies may have multiple products, contain multiple rates and forms for various states, and may not have a stated expiration date. The forced-placed, lender based line of business and the associated premium was recorded at the certificate level without any link to a master policy. Rates were to be determined by coverage type at the master policy level, but the legacy system was incapable of storing the master policy number. While the Company did maintain some of the master policy information in hard copy, it was not recorded electronically.
6. There was little organization, direction, or uniformity in the format of the files submitted to the Company by its agents. This resulted in the following errors and issues over the life of the Company's force-placed insurance program and the scope period:
 - a. The IT Department had to develop 58 separate interface programs to import data from 58 submitting agents and accommodate the different formats
 - b. Agents did not always submit complete or accurate information
 - c. Changes in information being calculated or determined were not kept current in the interface programs
 - d. Fields in the legacy system were utilized to store data that were not consistent with the file layout
 - e. The submission files did not include a master policy number
 - f. Minimal verification of data was performed by the Company on import into the legacy system
 - g. The Company reported that it was unable to match 2,000 Florida certificate holders to any master policy;

Violations of Section 627.318, Florida Statutes, Records - failure to maintain reasonable records so that such records will be available at all reasonable times to

enable the office to determine whether the insurer is in compliance with the provisions of Section 627, Part I, Florida Statutes, that are applicable to it.

Company Response: Subsequent to the on-site examination the Company reports that it has successfully matched all certificate holders to a Florida master policy and eligible borrowers will be able to submit claims in the resolution process.

7. Rating and coding errors resulted in the filing of incorrect financial statements and premium tax payments. **Violations of Section 624.424, Florida Statutes, failure to file accurate financial reports; and, Section 624.5092, Florida Statutes, failure to accurately administer taxes, payments.**

Company Response: Subsequent to the on-site examination the Company proactively filed Amended Premium Tax Returns for 2009-2012, reporting that it did not take credit for \$650,828 in overpayments but did pay an additional \$494,265.

Corrective action efforts by the Company to date:

The Company appointed a Senior Executive to oversee a corrective action project and engaged the legal firm of Frost Brown Todd as outside counsel to oversee the analysis, reporting, and remediation of the issues. FBT then engaged D&T to perform evaluation of the situation. The D&T staff included underwriting experts, actuaries and insurance regulatory experts. D&T procedures included:

1. Manual entry of all master policies in effect from January 1, 2009, through April 1, 2013. (The Company reported 502 master policies for Florida and 8,339 nationally.)
 - a. Not all data from each master policy was entered.
 - b. Only information needed for evaluating the premium mischarges was entered into a SAS database, a sophisticated database that requires significant IT knowledge to utilize.
 - c. The information regarding the master policies was imported from the SAS database to an Access Database called CMDB – Certificate Master Database, which was used to match the master policies to certificates. This database is still being used to verify rates for new certificates transmitted by the agents.
2. Matching of certificates to master policies was performed. Some work was performed by Company personnel, but D&T was responsible for the matching and analysis of premium accuracy. Following is an overview of those efforts:
 - a. Started in December 2012 the main effort continued until July 2013. A smaller team was maintained for the remainder of 2013.
 - b. Certificate data effective look-back period, January 1, 2009, through April 1, 2013, was imported into the SAS database using the Company's data warehouse data. Data prior to 2010, however, is not reconciled between the 2 systems.

Company Response: Subsequent to the on-site examination the Company

provided premium by product detail as filed in Statutory Financial Statements for the Company's look-back period, January 1, 2009, through April 1, 2013. This data was reconciled to the data in the SAS database.

- c. Certificate data did not contain the master policy number; therefore, matching was based on agent and lender numbers.
- d. The first effort was targeted for active policies; however, there was no indication in the data whether the policy was active or inactive. Therefore, policies were considered active if they had premium booked in 2012 and had no cancellation date.
- e. Company codes were not used as they were not reliable in the certificate data.
- f. There was no master list of agents. Some of the master policy declaration pages had inaccurate agent numbers as a result of agent numbers being reused or modified; agencies were purchased and merged with other agencies, further confusing identifying numbers. All agent numbers were typed into the Certificate Master Database as plain text fields, thus eliminating the ability to easily sort information within the database. These deficiencies in the control of the quality and consistency of data make it difficult to match agents to master policies.
- g. The effective dates associated with changes in agency numbers were not tracked or maintained by the Company, therefore, the dates could not be entered into the D&T database.
- h. Lender numbers were manually entered with no validation that the agent/lender number combination was valid.
- i. A separate read-only database was developed and used for quality assurance.
- j. When no matching master policy was found for a certificate, attempts to contact the agents were made.
- k. On November 26, 2012, agents were no longer allowed to issue master policies. The Company began to verify that premium rates were in keeping with filed rates using the CMDB information.
- l. Master policies and certificates issued after November 26, 2012, were not considered in the review process, although the review process was supposed to cover through April 1, 2013. Therefore, there is a gap of four months in the certificates that were reviewed.

Company Response: Subsequent to the on-site examination and based upon review and feedback from the Office, the Company proactively processed those transactions with effective dates of November 27, 2012, through March 31, 2013, on new master policies written on or after November 27, 2012, through CMD for verification. Four identified overcharges (a 0.10% dollar error rate totaling \$1,289) were credited by Company agents.

- m. If no match was found, further research may have been done in the legacy system. There is a program messaging function between the legacy system and the data warehouse. Some searches of the legacy system involved entering the certificate to attempt to locate a lender. If no match was found and no lender was found attempts were made to match the certificate based on the rate.

- n. The legacy system and the data warehouse, which contains the data that was used by D&T, were found to have discrepancies.
- o. The Company represents that the final match rate for certificates to master policies was approximately 99% for Florida.
- p. The Company has indicated that there appeared to be more data issues than overcharges, but projected overcharges in Florida are nearly \$6 million.

Complications encountered by the Company in executing the corrective action plan:

1. The agents have billing systems rather than policy administration systems. Agents may have an annual premium but often bill monthly, so the transactions are not an accurate picture at any point in time.
2. There is a long delay between the policy effective date and the initial billing, due to the requirements for notifications of forced-placed coverage.
3. Overcharges up to a certain amount were attributed to IRPM. Prior to the remediation, there was no requirement for the agent to document the IRPM applied.
4. Implied rate was calculated for each record that had an overcharge. High overcharges and outlying implied rates were researched first.
5. Agents used the state that was the location of the borrower's property as the risk location. While there were errors in reporting the risk location, this information was generally correct.

Correction of data and duplicate entry of the same data:

1. Issues resolved during the matching process were not recorded to allow the Company to make corrections in the legacy system. No data at the Company was corrected as a result of the D&T process.
Company Response: Issues resolved by D&T are now a part of the Company's records.
2. A small amount of data from the master policies was entered into the D&T database by D&T staff for the remediation process.
3. Following the process, the Company determined that all master policies would be reviewed and re-written. The paper master policies were again reviewed and the new policies created in MS Word documents rather than entered electronically into the new Xybernet system. The reason given was that the system did not yet have all of the forms associations set up.
4. The plan for implementing Xybernet is to again enter the master policy data into the system manually.

Current state of affairs:

1. The Xybernet system is not yet completely implemented; the projected completion is fourth quarter 2015. The process was on hold for several months due to resources being utilized in the remediation process.

2. Until implementation of the new system is complete, the rates are being verified using the mainframe version of CMDDB (Certificate Master Data Base) originally developed by D&T. This database does not contain complete master policy information but has fields needed for rate verification.
3. The Company has reported an estimated 155 mortgage fire master policies (25,702 certificate holders) with premium overcharges totaling \$5,769,278, and 8 collateral protection master policies (909 certificate holders) with overcharges totaling \$147,872. Verification is being done according to anniversary date – the policies do not have an expiration date.
4. The Company plans to correct rating errors by re-writing and re-issuing policies, starting first with Mortgage Fire Insurance policies and then, Collateral Protection Insurance policies. An underwriting team at the Company is re-issuing each policy using MS Word documents, a redundant and inefficient method that will still require re-entry to the new system when operational. The process began in December of 2013, and was scheduled to be completed by April 2015 for Mortgage Fire policies and by October 15, 2015, for Collateral Protection policies.
5. Certificates remain under the respective original master policy (overcharges were addressed with endorsements). Until renewal, the certificates are associated with the original master policy number. Though new certificates are reported monthly, there is a delay in premium development relating to required regulatory interactions and notifications. While stop-gap controls are in place to detect this, opportunities for inaccurate application of payments remain.

Company Response: The Company reports that it now has fully designed, drafted, and implemented permanent policies, procedures, and controls to detect and correct occasional inadvertent certificate errors.

6. Both old and new policies are in CMDDB along with the endorsements.
7. Underwriting rewrites are performed under the direction of a senior underwriter. The assistant underwriters have a limited delegation of authority and have all work quality controlled by a peer underwriter. A team of processors complete the policies.
8. Agents are converting to 1 of 4 basic submission formats. The Company is testing import into both the legacy system and Xybernet.

Company Response: The Company subsequently reported that agents are converting to 1 of 2 basic submission formats and are testing to import into both the legacy system and Xybernet. The transition to the Standard File Layout is almost complete with 1 agent remaining in the final stages of testing.

9. Efforts to execute refunds are hindered by the following issues:
 - a. Addresses are old and many of the properties have been foreclosed.
 - b. Certificate-level data is being reviewed again by D&T for verification of addresses.
 - c. The source of the premium payment is unknown.
 - d. According to the Company, the average refund is estimated at \$60 per certificate.
 - e. According to the Company, if 98% of the data is completed for a line of business, they will send those records to Garden City (contract firm) to pass addresses through NCOA (National Change of Address database) to check if this is the current address.

Company Response: The Company subsequently reports that it has now mailed claim forms to borrowers covering 18,465 of the 18,675 Florida transactions subject to mailing. To date the Company has received 5,280 Florida claims totaling \$2,152,000 and began mailing checks in February 2015.

- f. According to the Company, it is sending the remaining 2% to its agents to identify the address and may also reach out to lenders for address information. Agents are an integral part of record verification.
- g. According to the Company, it has contracted with an unaffiliated firm to process claims. Claim forms will be sent out to all borrowers who will have 90 days to respond. The claim form or request letter may include required information to document the claim. There will be an umpire (not yet selected) to adjudicate complex or contested claims. The remaining funds will escheat to the state of the covered property address.
- h. The Company has subsequently reported submitting amended premium tax returns to the Florida Department of Revenue.

CONCLUSION

In addition to using in-house personnel and other resources in the last two years, the Company has spent over \$18 million dollars on external vendors to gather and correct data, to improve recordkeeping and to determine potential refunds. Despite these efforts, the Company:

1. will not have a fully developed IT system implemented for this line of business until the 4th quarter of 2015, thus:
 - a. Issues remain relating certificates to master policies
Company Response: The Company subsequently reports that it is implementing a standard file layout to reduce or eliminate the risk of not matching certificates to master policies during the interim period until a new IT system is fully operational.
 - b. Risk of inaccurate rating still exists
Company Response: The Company subsequently reports that it has implemented sufficient front-end controls, underwriting changes, and system process advancements to reduce the risk of inaccurate rating to a minimal, correctable level.
 - c. While claims are processed out of a separate system and appear to be appropriately paid, they may be adversely impacted by inaccurate data elements such as effective dates of coverage and deductibles from other IT systems.
Company Response: The Company pays claims out of a separate system, has not detected any issues, and claims appear to be appropriately paid.
2. Does not have a system to track either the master policy or the certificate number.
Company Response: Subsequent to the on-site exam the Company reports that it does have a mainframe database which houses both certificate transaction and master policy numbers.
3. Is unable to match 2,000 Florida certificate holders to a master policy.
Company Response: Subsequent to the on-site exam the Company reports that it has now matched the previously unmatched Florida transactions.
4. Is unable to reconcile premium charges for each of these policies and cannot justify premium charges. Therefore, lack of information on premiums charged results in lack of justification and support for the rates used.
Company Response: The Company reports that it can now justify the rates used.

5. Lack of data accuracy and inability to match certificates, master policies, and agent numbers likely resulted in inaccurate commission statements and payments.

EXAMINATION FINAL REPORT

The Office hereby issues this report as the Final Report, which is based upon information from the examiner's draft report, additional research conducted by the Office, and additional information provided by the Company.