

**FINANCIAL SERVICES
COMMISSION**

**FLORIDA OFFICE OF INSURANCE REGULATION
MARKET INVESTIGATIONS**

**TARGET MARKET CONDUCT
FINAL EXAMINATION REPORT**

OF

AMERICAN MERCURY INSURANCE COMPANY

AS OF

December 16, 2005

NAIC COMPANY CODE: 16810

NAIC GROUP CODE: 0660

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PURPOSE AND SCOPE OF EXAMINATION

Under authorization of the Financial Services Commission, Florida Office of Insurance Regulation (Office), Market Investigations, pursuant to Section 624.3161, Florida Statutes, a target market conduct examination of American Mercury Insurance Company (Company) was performed by RSM McGladrey, Inc., and Office personnel. The scope of this examination was January 1, 2002 through June 30, 2005. The examination began July 7, 2005 and the on-site work ended on December 16, 2005.

The purpose of this examination was to ascertain the Company's compliance with Florida Statutes and the Florida Administrative Code, and with Office of Insurance Regulation Directives and Emergency Orders when writing homeowners business in the State of Florida. The areas to be examined identified by the Office included, but were not limited to, the following:

- Claims
- Underwriting
- Complaint Handling
- Policyholder Service
- Forms and Rates
- Producers
- Required Reporting by the Company

The Company records were examined at its regional office located at 1901 Ulmerton Road, Clearwater, Florida 33762-2307. In reviewing materials for this report, the examiners relied primarily on records maintained by the Company. Some audits normally done using sampling techniques were performed instead by using electronic means for sorting, filtering and recalculating the total population of review areas during the scope of the examination. Procedures and conduct of the examination were in accordance with the Market Conduct Examiner's Handbook produced by the National Association of Insurance Commissioners, and with directions provided by the Office.

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

HOMEOWNER CLAIMS REVIEW

PAID HURRICANE CLAIMS

Sample Findings:

A total of one hundred (100) hurricane claim files were examined.

Twenty-three (23) errors involving twenty-three (23) claims were noted due to the Company's failure to handle pool cage claims appropriately.

DENIED HURRICANE AND NON-HURRICANE CLAIMS

Sample Findings:

A total of one hundred (100) denied hurricane and non-hurricane claim files were examined.

- 1) Eight (8) errors involving eight (8) claims (or 8% of the sample) were noted due to the Company's failure to handle pool cage claims appropriately.
- 2) A review of policyholder complaints revealed the Company had received reports of losses, but had not established claim files or assigned claim numbers. The failure of the Company to document and maintain the reporting of these losses is a violation of Section 626.9541(1)(i)3.c., d. and f., Florida Statutes.

The examination also revealed a large number of duplicate claim files.

UNDERWRITING REVIEW

UNDERWRITING MANUAL

The Company uses its Homeowner Agent Manual as its rate and underwriting manual. At the time of the examination, the Company was using several versions of the manual: a version filed with the Office, an unfiled version used for mailing, and an unfiled version posted on the Company's website for use by its agents. All versions of the manual contain provisions that violate Florida Statutes.

- 1) "1. The applicant must qualify for and purchase Automobile coverage from the Company. This automobile policy must be in place within 180 days of the inception of the Property policy...
3. At the Company's option the Property coverage may be discontinued should the Automobile coverage be canceled for any reason..."

This collateral business requirement is a violation of Section 626.9541(1)(x)3., Florida Statutes.

2) Page 6- Online Version

The Company revised this page but did not submit the revision to the Office. The revision included language about the Company's exclusion of mold and fungi coverage, and provided the rates by amounts of coverage if an insured elected to buy this coverage. These mold rates were unapproved by the Office, and their use is in violation of Section 627.062, Florida Statutes.

3) Page 18 – Online and Mailed Version

The online and mailed versions of the manual contain secondary residence language that varies from the language on the filed manual page. The filed manual page states: "...Liability coverage may be extended from the primary location to no more than one additional residence premises owned and occupied by the insured which are not covered as secondary residences by the company..." The unfiled online and mailed version manual pages state: "...Liability coverage may be extended from the primary location to no more than one additional residential premises (*sic*) owned by the insured..."

4) Page 27 – Online and Mailed Version

The revised online manual contains the following credit scoring language for insureds with a credit score of D: "Submit non-bound. May be unacceptable. (25% surcharge)". The words "May be unacceptable" are not on the filed manual page.

5) Page 30 – Online and Mailed Version

The revised page of the online manual contains references to other page numbers that are incorrect as a different numbering system was used for the table of contents in the filed version. Also, differences in pagination exist because page 30 in the filed version was duplicated, but was not duplicated in the unfiled online and mailed version.

The use of a manual other than that filed with the Office or failure to file revised pages with the Office violates Rule 69O-170.006(1) and (2)(a)(b)(c)(d), Florida Administrative Code.

POLICY FILE REVIEW

Sample Findings:

A total of twenty-five (25) homeowner policy files were examined.

Twenty-five (25) errors involving twenty-five (25) policy files (or 100% of the sample) were noted as follows:

- 1) Twenty-five (25) rating errors were noted disclosing that the Company's computer system used a different rating methodology than the one filed with and approved by the Office. The Company's failure to use its filed rating methodology is a violation of Section 627.062(2)(a), Florida Statutes.

COMPLAINT HANDLING REVIEW

COMPLAINT HANDLING PROCEDURES

A review of the Company's complaint handling procedures disclosed that a complete record of all complaints received during the examination period was not maintained. Although the Company did provide lists of complaints received through the Department of Financial Services (DFS) during the examination period, it was unable to provide any record of complaints made directly to the Company for the years 2002 through 2004, and only provided a list of two (2) complaints made directly to the Company in 2005. The Company's failure to maintain a complete record of all complaints is a violation of Section 626.9541(1)(j), Florida Statutes.

Sample Review of Maintained Complaints:

A total of fifty (50) complaint files were requested and forty-seven (47) were examined. The Company was unable to locate three (3) files requested.

Six (6) errors involving six (6) complaint files (or 16% of the sample) were noted as follows:

- 1) The Company was unable to locate three (3) complaint files requested by the examiners, in violation of Section 624.318(2), Florida Statutes, and Section 626.9541(1)(j), Florida Statutes.
- 2) Three (3) errors were due to the Company's failure to handle pool cage claims appropriately.

POLICYHOLDERS SERVICE REVIEW

POLICYHOLDER SERVICE PROCEDURES

A review of the Company's procedures revealed that the Company had instructed its agents to deliver policies to policyholders, instead of directly mailing or delivering the policies to policyholders. The Company's procedure does not provide evidence needed to demonstrate that policies were mailed or delivered timely. The Company's failure to demonstrate that it mailed or delivered policies to policyholders not later than sixty (60) days after the effectuation of coverage is a violation of Section 627.421(1), Florida Statutes.

CANCELLATIONS AND NONRENEWALS

Sample Findings:

A total of twenty-five (25) cancellations and nonrenewals were examined.

Four (4) errors (or 16% of the sample) were noted as follows.

- 1) Four (4) errors were due to the Company improperly cancelling policies after the ninety (90) day underwriting period allowed per statute. The Company's improper cancellation of these policies is a violation of Section 627.4133(2)(b).2, Florida Statutes.

FORM AND RATE FILING REVIEW

A review of the Company's form and rate filings and the forms and rates in use found the following errors:

- 1) On January 13, 2004, the Office conditionally approved the Company's Mold Coverage Endorsement P-98, Form #03-1575 (11/03), "subject to and conditioned upon the approval of the corresponding rate filing". The Company failed to file the corresponding rate filing, yet it implemented the Mold Endorsement at an unapproved rate. The Company's use of the Mold Coverage Endorsement Form without an approved rate is a violation of Section 627.410(1), Florida Statutes.
- 2) The Company failed to provide an approved rate filing for the rates used with Mold Coverage Endorsement P-98, Form #03-1575 (11/03). The Company's use of an unapproved rate is a violation of 627.062(1) and (2)(a), Florida Statutes.
- 3) The Company failed to provide proof of an approved policy declarations page. The Company's use of an unapproved declarations page is a violation of Section 627.410(1), Florida Statutes.
- 4) The Company was unable to provide proof of a 2003 base rate filing or a rate certification by an actuary. The Company's failure to file an annual base rate filing or a rate certification for 2003 is a violation of Section 627.0645(1), (3)(a)(b), Florida Statutes.
- 5) The Company did not implement a rate filing approved by the Office to be effective April 1, 2003, for new business and July 1, 2003, for renewals, until July 15, 2004, for new business and October 15, 2004, for renewals. The Company's failure to implement this filing on the approved effective dates is a violation of Section 627.062(2)(a), Florida Statutes, and Rule 69O-170.007(2)(a), F.A.C.

PRODUCER REVIEW

A review of twenty-five (25) underwriting files showed that twenty-three (23) policy applications did not display the producing agent's license identification number. The name of the producing agent was illegible on ten (10) of the applications. The failure of the Company to require the producing agent's license identification number and a legible producing agent name on all applications submitted is a violation of Section 627.4085(1), Florida Statutes.

DATA VALIDATION REVIEW

A review was conducted to determine compliance by the Company with the reporting requirements of Section 624.424 (10), Florida Statutes, in filing Quarterly Supplemental Reports (QUASR), Form OIR-DO-1185.

Findings:

- (1) The Company failed to file QUASR Reports, in violation of Section 624.424(10), Florida Statutes, and Rule 690-137.009, F.A.C.

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.

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May 2, 2006

VIA HAND DELIVERY

Mr. James Harris
Assistant General Counsel
Department of Financial Services
Office of Insurance Regulation
200 East Gaines Street
Tallahassee, FL 32399-0333

**Re: American Mercury Insurance Company - Market Conduct Examination
Report as of December 16, 2005
Mercury Insurance Company of Florida - Market Conduct Examination
Report as of December 16, 2005**

Dear Mr. Harris:

American Mercury Insurance Company and Mercury Insurance Company of Florida have reviewed the above-referenced examination reports. Although the companies disagree with numerous findings set forth in the reports as either factually or legally incorrect, in order to facilitate the prompt resolution of these matters and for the limited purposes of these proceedings, they have elected not to contest the reports.

Sincerely,



Edward L. Kutter