

**FLORIDA DEPARTMENT
OF
FINANCIAL SERVICES**

**OFFICE OF INSURANCE REGULATION
BUREAU OF MARKET INVESTIGATIONS**

TARGET MARKET CONDUCT EXAMINATION REPORT

OF

DIRECT GENERAL INSURANCE COMPANY

AS OF

November 21, 2003

NAIC COMPANY CODE: 02876

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EXAMINERS:

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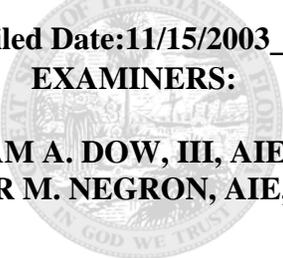


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PURPOSE AND SCOPE OF EXAMINATION

Under authorization of the Florida Department of Financial Services, Office of Insurance Regulation, Bureau of Market Investigations, pursuant to Section 624.3161, Florida Statutes, a target market conduct examination of Direct General Insurance Company (Company) was performed by William A. Dow, III, AIE, FLMI, and Victor M. Negron, AIE, FLMI, independent contractors. The scope of this examination was January 1, 2002 through November 14, 2003. The examination began September 15, 2003 and ended November 21, 2003. The last property and casualty market conduct examination of this insurer by the Florida Office of Insurance Regulation (OIR) was concluded in 2001.

The purpose of this examination was to review areas of the Company's operations that were cited most frequently in consumer complaints received by the Florida Department of Financial Services, to analyze open and closed claims with regard to claims handling procedures, and to verify the Company's compliance with Florida Statutes and Rules. Based on the consumer complaints filed against the Company, the OIR focused on claims delays, untimely return of unearned premiums due to cancellations, and rating issues.

In reviewing materials for this report, the examiners relied primarily on records maintained by the Company. The examination included, but was not limited to, a review of company operations/management, private passenger automobile policies, claims, consumer complaints and complaint handling. The files examined were selected systematically from data files provided by the Company using Microsoft Excel's "random sample" selection process. Some audits normally done using sampling techniques were performed instead by the use of electronic means for sorting, filtering and calculating the total population of review areas during the scope of the examination. The examination report is a report by exception. As a result, files or material reviewed containing no improprieties by the Company have been omitted from the examination report. Procedures and conduct of the examination were in accordance with the Market Conduct Examiner's Handbook produced by the National Association of Insurance Commissioners.

Error tolerance levels applied are as follows: monetary returns under \$5.00 were waived; zero tolerance levels were applied to all improprieties by the Company which were in violation of Florida Statutes and Rules.

COMPANY OPERATIONS/MANAGEMENT

Direct General Insurance Company (Company) is a foreign property and casualty insurer licensed to conduct business in the State of Florida. The Certificate of Authority and Renewal Invoices were reviewed for all years within the scope of this examination. The review included a verification of the lines of business the Company was authorized to write versus the lines actually written.

The Company was originally incorporated in the State of Florida in December of 1970, under the name of Independent Property and Casualty Insurance Company. In March of 1997, the Company was redomesticated to the State of Tennessee and then purchased by Direct General Corporation. In April of 1997, the name was changed to Direct General Insurance Company. Direct General Insurance Company was redomesticated in December of 2000 to the State of South Carolina. The Company is a wholly-owned subsidiary of Direct General Corporation.

The Company's home office is located at 424 Hayne Avenue, Aiken, South Carolina. The Company maintains an administrative office located at 1281 Murfreesboro Road, Nashville, Tennessee.

The Company is currently affiliated with the following companies (among others), all of which are direct or indirect subsidiaries of Direct General Corporation: Direct General Financial Services, Inc.; Direct Administration, Inc.; Direct Life Insurance Company; Direct Adjusting Company, Inc.; and, Direct General Consumer Products, Inc.

The following is a list of the Company's corporate officers:

Jacqueline C. Adair	President and Chief Executive Officer
Tammy R. Adair	Executive Vice President
Barry D. Elkins	Senior Vice President and Chief Financial Officer
J. Todd Hagely	Vice President-Finance and Treasurer
Matthew P. McClure	Secretary
Scott Johnson	Vice President Claims

COMPANY PROCESSES/STATISTICAL AFFILIATIONS

Computer System

The Company utilizes an IBM iSeries AS/400 operating system for centralized processing of policy and note management. Dedicated communication lines have been established for data connection to the Company's regional claims office. A virtual private network for connection to all of the Company's sales offices has been established through Bellsouth, MCI and other independent Internet service providers. This network uses a Windows NT operating program and allows for automated processing of new business, including creation of policy applications, loan agreements and other related documents at each individual sales office. Images of policy paperwork in the individual sales offices are scanned and transmitted to iSeries daily.

Anti-Fraud Plan

The Company has filed a Plan with the Florida Department of Financial Services as required by Section 626.9891, Florida Statutes. The Plan does meet the requirements by establishing a Special Investigation Unit (SIU). The SIU is comprised of five (5) investigators. Referrals to the SIU for investigation are made by Company adjusters based on mandatory referrals outlined by the SIU, as well as other indicators the adjusters identify during the claim process. The SIU investigates all suspected fraud cases. Any case suspected of fraud is then referred to the Florida Department of Financial Services, Division of Fraud.

Disaster Recovery Plan

The Company has developed a Disaster Recovery Plan for use with Florida business. The Company's business continuity plan has designated teams with certain responsibilities to ensure continued operations. The computer system and communication hub in the Company's Nashville, Tennessee, office is connected to an uninterruptible power supply. This is powered

by a generator capable of keeping the system functioning until power can be restored. A second AS/400 computer located in Baton Rouge, Louisiana, uses MiMiX software, which keeps it synchronized to the primary system located in Nashville, Tennessee. Backups of all local networks and the AS/400 are performed daily and stored off-site.

Internal Audit Procedures

The Company has developed Internal Audit procedures for use in reviewing Florida business. The Company utilizes the accounting firm of Faulkner, Mackey & Cochran located in Nashville, Tennessee, in the performance of its internal audits.

Privacy Plan

The Company has developed a Plan to meet the requirements of Rule 4-128, Florida Administrative Code. The Company includes a privacy notice with each new and renewal policy.

Statistical Affiliations

The National Independent Statistical Service (NISS) acts as the Company's official statistical agent for its private passenger automobile program.

Credit Reports

The Company does not use credit reports as an underwriting tool.

Tiering

The Company does not utilize tiers in the rating of its policies.

OPERATIONS/MARKETING

Marketing

The Company writes non-standard private passenger automobile insurance coverages in the State of Florida. The Company relies primarily on television advertising for the marketing of its products.

Agents/Agencies/MGA/Exchange of Business/Direct Response/Internet/Adjusters and Claims Handling/Customer Service Call Center

Agent and Agencies: In Florida, the Company's business is produced through Direct General Insurance Agency, Inc., a Tennessee corporation ("DGIA"), its affiliated agency. DGIA is licensed and appointed as a managing general agent (MGA). In March of 1998, DGIA acquired the assets of Florida No-Fault Insurance Agency, Inc. and hired its agents as salaried employees of DGIA. From August of 1999 through October of 2003, Maitland Underwriters, Inc., an unaffiliated, licensed and appointed MGA, acted as the Company's MGA for business written through its sub-producers referred to collectively as "Cash Register" insurance agencies.

Effective November 1, 2003, DGIA acquired certain of the assets of Maitland Underwriters, Inc. and its affiliate LR3 Enterprises, Inc., which assets included the Cash Register agents who wished to be so employed. Since November 1, 2003, all business written in Florida is being produced by DGIA, which now acts as the Company's MGA. DGIA commenced charging the statutorily prescribed \$25.00 MGA fee on November 11, 2003 for new business and on December 19, 2003 for renewal business.

Internet: The website of Direct General Corporation, the Company's parent, can be accessed at www.direct-general.com.

Claims adjusting: The Company uses an affiliated company, Direct Adjusting Company, Inc., for the processing of its claims. Direct Adjusting Company maintains a regional claims office at 5907 B Hampton Oaks Parkway, Tampa, Florida and uses licensed and appointed staff adjusters with the assistance of appraisers to handle off-site vehicle inspection and coordination of repairs with body shops.

Customer Service Center: The Company utilizes a centralized administrative center located at 10225 Florida Boulevard, Baton Rouge, Louisiana that is maintained by its affiliate Direct Administration, Inc. In addition to records storage, this location provides customer service on behalf of the Company and its affiliates.

Lines of Business

The Company currently writes only private passenger automobile insurance in the State of Florida.

REVIEW OF POLICIES

PRIVATE PASSENGER AUTOMOBILE

The current examination encompassed a complete review of private passenger automobile coverages, including bodily injury liability, property damage liability, personal injury protection, uninsured motorist, comprehensive, collision and accidental death benefit.

Premium and Policy Counts

Direct Premiums Written and in-force policy counts for the scope of the examination are as follows:

<u>Year</u>	<u>DPW</u>	<u>In-Force Policy Count</u>
2002	\$172,175,377	143,881
2003*	\$149,561,823	174,969

* The premiums and in-force policy count for 2003 reflect only the policies written through August 31, 2003.

The increase from 2002 to 2003 in both the premium and in-force policy counts is a direct result of the Company's efforts to increase writings in Florida.

PART A – POLICY REVIEW

Sample Review Findings

One hundred (100) policy files were examined.

No errors were found.

PART B - CALL CENTER EMPLOYEE LICENSING/APPOINTMENT REVIEW

A list of all employees who give Florida private passenger automobile insurance quotes was requested from the Company in order to verify licensing/appointment requirements.

Total Population Findings

The Company has twenty-one (21) employees designated as Florida specific quote call handlers. The Company has others who may assist on an incidental basis, as backups, when needed.

Nineteen (19) errors were found.

The errors are as follows:

1. Nineteen (19) errors were due to the use of unlicensed and unappointed Company employee agents. This constitutes a violation of Section 626.112, Florida Statutes.

Corrective Action: The Company has been requested to allow only employees who have been licensed and appointed as a Florida non-resident agent to give quotes to and discuss coverages with Florida consumers.

COMPLAINT HANDLING

Total Population Findings

The Company and its affiliates have procedures for handling and recording consumer complaints. During the period January 2002 through August 2003, the aggregate number of consumer complaints recorded by the Company and its affiliates, including Direct General Insurance Agency, Inc., Direct Adjusting Company, Inc. and Direct General Financial Services, Inc., totaled 1062. The Department's records reflect forty-four (44) letters sent directly to the Company or its affiliates from the customer that did not appear on the master complaint log.

Forty-four (44) errors were found.

Section 626.9541(1)(j), Florida Statutes requires that a person maintain a complete record of all complaints received since the date of the last examination. For purposes of the statute, "complaint" means any written communication primarily expressing a grievance.

Corrective Action: The Company has been requested to follow its written complaint handling procedures to insure all complaints are logged.

CLAIMS REVIEW

DESCRIPTION OF CLAIMS REVIEWED

This examination included the review of claims made under private passenger automobile insurance policies and included the following types of coverage: bodily injury and property damage liability, personal injury protection benefits, uninsured motorist, physical damage including comprehensive and collision, towing and rental.

Sample Review Findings

One hundred (100) private passenger automobile claim files were reviewed. The Company provided a list of all claim files closed during the scope of the examination. The claim files reviewed were selected systematically from this list using Microsoft Excel's "sampling" selection process and included claims closed with payment and claims closed without payment.

Forty-one (41) errors were found. Two (2) errors resulted in underpayments totaling \$1,081.91.

The errors are as follows:

1. Thirty-eight (38) errors were due to failure to adjust claims timely. These errors constitute a violation of Section 626.877, Florida Statutes. Two (2) of the thirty-eight (38) errors resulted in underpayments totaling \$1,081.91, which have been refunded by the Company to the consumers.

Sample Size	Number of Errors	Percentage to Sample
100	38	38%

Corrective Action: The Company has been requested to re-evaluate certain areas of its claim handling and to re-evaluate and re-emphasize procedures for proper investigation and timely processing of claims.

The Company has responded by developing and implementing an action plan specifically designed to reduce the number of consumer complaints received in connection with the investigation and processing of claims.

2. Three (3) errors were due to failure to communicate timely. These errors constitute a violation of Rule 69O-166.024, Florida Administrative Code. The errors were due to failure by the Company to communicate within fourteen (14) days of receipt of claims communications.

Sample Size	Number of Errors	Percentage to Sample
100	3	3%

Corrective Action: The Company has been requested to respond to all claims communications within fourteen (14) days of receipt of such communication.

The Company has indicated it has placed a priority on improving its claims service. To achieve this goal, the Company, and/or its claim handling affiliate, have initiated the following changes:

1. Meetings of the management team, work groups and individual adjusters have been held to re-emphasize the Company's commitment to appropriate levels of claims handling and customer service.
2. Re-emphasis has been placed on adjusters maintaining files on an active daily diary. The diaries are to be updated and maintained for the life of the claim. A procedure has recently been implemented which requires adjusters to print diaries weekly for management review.
3. A new integrated diary system, which should be in place by the end of the first quarter 2004. This system will automatically generate mandatory diaries of claim files in the name of the adjuster and associated supervisor. The system is being designed to allow greater ease of diary control while allowing for individual adjuster and supervisor monitoring. These diaries will not be able to be deleted until all file reserves have been successfully closed.
4. The Company has instituted new claim procedures for prompt request of police reports upon receipt of new claims where liability, coverage or damages may be in question. In addition, adjusters have been instructed to begin acquisition of required documentation for the proper processing and closure of total loss claims as soon as possible to expedite closure of the claim files. Efforts to make immediate contact with all parties involved in a reported accident have been enhanced by a re-emphasis of contact letters to consumers unable to be reached by phone. These letters are to be promptly sent upon the adjuster's failure to contact the consumer. Re-emphasis has been placed on a timely response by claim adjusters to all claims communications, and audits by the management group will be conducted to verify compliance.
5. A new phone system package has been recently installed, which will enable managers to monitor phone usage of adjusters, including real time adjuster activity, incoming, outgoing and abandoned calls. The new system will also allow managers to produce daily, weekly and monthly historical call reports. Individual adjuster audits are also to be conducted to support improvement in customer contact and satisfaction.
6. A plan had been previously implemented to provide for an adequate number of adjusters to process claims timely. Periodic evaluations between January 2002 and the present led to a 68.5 percent increase in claims adjusters. In addition, the Company added twenty-one (21) new adjusters/adjuster trainees in December of 2003. The claims office in Tampa, Florida, has relocated to a larger space designed to allow all departments to be in one location that will afford better supervision of adjusters by management and supervisors. To plan for future growth, a full-time trainer is being specifically hired for the Tampa, Florida, claims office to provide a continual training program for new and existing adjusters.

REPORT SUMMARIZATION

A sample of two hundred (200) files was examined for this Company. One hundred four (104) errors were found. The following represents general findings; however, specific details are found in each section of the report.

Sample Files Reviewed -- 200

- One hundred (100) private passenger automobile files
- One hundred (100) claim files

Findings

- Private Passenger Automobile
Part A – Policy Review
No errors
Part B – Call Center Licensing/Appointment Review
Nineteen (19) errors – page 5 of the report
 - Use of unlicensed/unappointed employee agents
- Complaints – forty-four (44) errors – page 5 of the report
 - Failure to maintain a complete record of all complaints received by the Company.
- Claims – forty-one (41) errors – page 6 of the report
 - Failure to adjust claims timely – thirty-eight (38) errors
 - Failure to communicate timely – three (3) errors
- Refunds – As a result of the claims review, two (2) underpayments totaling \$1,081.91 were returned to Florida consumers

Corrective Actions

- Allow quotes for Florida private passenger automobile insurance to be given only by licensed and appointed individuals.
- Follow written complaint handling procedures.
- Maintain an on-going process of reviewing existing procedures to properly investigate and handle claims as the situation warrants.
- Re-emphasize procedures to respond to written claims communications within fourteen (14) days of receipt of such communication.

As a result of the findings of this examination, the Company, and/or its affiliates, have implemented procedures for the training of new employees and on-going training of its present staff, established procedures to monitor responses to incoming telephone calls and established random audit procedures for the purpose of reviewing claim files. The Company has further established procedures to maintain an on-going process of reviewing and changing procedures to properly investigate and handle claims.

EXAMINATION REPORT SUBMISSION

The courtesy and cooperation of the officers and employees of the Company and its affiliates during the examination are acknowledged.

The undersigned examiners conducted the examination and prepared the draft report.

Respectfully submitted,

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Victor M. Negrón, AIE, FLMI

Independent Market Conduct Examiners