

2000 PROPERTY AND CASUALTY TARGET MARKET CONDUCT EXAMINATION

OF

PREFERRED NATIONAL INSURANCE COMPANY
(COLONY GROUP)

BY

THE FLORIDA DEPARTMENT OF INSURANCE

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I. INTRODUCTION

Preferred National Insurance Company (Company) is a domestic property and casualty insurer licensed to conduct business in the State of Florida during the scope of this property and casualty market conduct examination, September 1997 through December 1999. The examination began September 24, 2000 and ended December 23, 2000. The last property and casualty examination of this insurer, by the Florida Department of Insurance, was completed on October 14, 1997.

The 1997 examination report included the review of commercial packages and fidelity and surety. Violations cited included failure to follow filed rates, use of the unfiled forms, failure to maintain records, failure to comply with premium finance cancellation requirements, failure to return correct unearned premium, failure to cancel for allowable reasons, failure to affix fraud statements, failure to communicate timely, failure to provide explanation of replacement cost betterment, use of unlicensed adjusters, use of release form not conforming to policy provisions, failure to pay claims timely, and failure to properly adjust claims per policy requirements.

The purpose of the current examination was to ensure compliance with the Florida Statutes/Rules.

During this examination, records reviewed included policies, cancellations/nonrenewals, agent/MGA licensing, claims and consumer complaints for the period of September 1997 through December 1999, as reflected in the report.

This report contains examination results addressing all areas of noncompliance found during the course of the examination. In all instances, the Company was directed to take corrective action as required, issue appropriate refunds, make all necessary filings with the Department and immediately cease any activity that continues to place the Company in noncompliance with Florida Statutes/Rules.

As a result of the findings of this examination, \$7,454.87 was returned to Florida consumers due to overcharges of premium.

II. PRE-EXAM REVIEW OF COMPANY WRITINGS

A. CERTIFICATE OF AUTHORITY - AUTHORIZED LINES

1. General Comments

The Certificate of Authority/Renewal Invoices were reviewed for all years within the scope of the examination.

2. Exam Findings

The review included verification of the lines of business the Company was authorized to write during the scope of examination versus those lines actually being written. It also included verification that notification requirements were met for any line of business that was discontinued.

No errors were found.

III. COMPANY OPERATIONS/MANAGEMENT

A. PROFILE

Preferred National Insurance Company was incorporated on September 29, 1988 as a stock property and casualty insurer and commenced writing business on March 10, 1989. The Company was 100% owned by Preferred National Financial Corporation, a Florida holding company, which was 100% owned by Stephen Weicholz. On July 31, 1998, Front Royal, Inc. completed the acquisition of all capital stock of Preferred National Insurance Company. The Company was redomesticated to Virginia on December 11, 2000.

The Front Royal Insurance Group, which consists of Colony Insurance Company, Preferred National Insurance Company and Front Royal Insurance Company, is also known as The Colony Group.

Marketing is handled through a wholesale general agency system. Products are currently distributed through thirteen agencies. These agencies have authority to quote and bind business. Some agents are granted authority to issue policies, but this is generally handled in the Company's home office. All reinsurance placements occur at the Company level.

Claims are adjusted by company adjusters, often working with independent adjusters.

All operations of the Company are located in the home office in Richmond, Virginia.

B. MANAGEMENT

The Company's computer system is an Oracle-based client server processing system. A Microsoft SQL server data warehouse is employed as the reporting system.

Preferred National Insurance Company has engaged the services of Conroy, Simberg, Lewis and Ganon, P. A., to investigate fraudulent insurance claims pursuant to Section 626.9891(1)(b), Florida Statutes. The Company has a filed anti-fraud plans required by Section 626-9891, Florida Statutes.

The Company's Disaster Recovery Plan includes off-site storage of all processing systems back-up tapes. In the event of loss of power and/or phone service, plans are in place to use one of the other Company sites, Rockwood, Pennsylvania or Carey, North Carolina. The phone system is set to automatically switch to another office should power be lost for an extended period of time.

The Company is subject to an annual financial audit by Ernst and Young. As part of this audit, a review of internal controls is performed and areas noted for improvement are committed to management.

C. OPERATIONS

Preferred National Insurance Company markets several property and casualty programs such as: artisan contractor, commercial packages, preferred package restaurants/taverns, and certain miscellaneous professional insurance products throughout Florida. A majority of the business is written in South Florida. Plans are underway to expand to Central and Northern Florida.

Risk Purchasing Groups (for accountants, lawyers and title agents), are marketed by Colony Agency Services, Inc. Direct response marketing is utilized for these programs, as well as limited internet marketing.

IV. REVIEW OF POLICIES

A. COMMERCIAL MULTI-PERIL

1. Application of Rules, Rates and Forms

a. Rate/Rule Filings

Preferred National Insurance Company is a subscriber of Insurance Services Office (ISO) and as such ISO is authorized to file rules/rates on the Company's behalf in accordance with Section 627.062, Florida Statutes. In addition, the Company makes independent filings for certain programs, such as preferred package, restaurant package, artisan contractors, commercial property program, private investigators and pharmacists package.

b. Form Filings

Preferred National Insurance Company is a subscriber of ISO and as such ISO is authorized to file forms on the Company's behalf in accordance with Section 627.410, Florida Statutes. In addition, the Company does make some independent filings.

c. Statistical Affiliation

ISO acts the Company's official statistical agent.

2. 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>Policy Count</u>
1997	\$19,529,628	8,855
1998	\$16,240,384	10,831
1999	\$12,026,802	9,775

3. Exam Findings

One hundred (100) policy files were examined.

Seventy-three (73) errors were found.

Errors affecting premium resulted in fourteen (14) overcharges totaling \$1,045.00 and twenty (20) undercharges totaling \$1,799.00.

The errors are broken down as follows:

1. Fifteen (15) errors were due to failure to provide timely notice of renewal premium. This constitutes a violation of Section 627.4133, Florida Statutes.
2. Twelve (12) errors were due to failure to follow the filed rating plan with regard to protection classes, construction and classifications. This constitutes a violation of Section 627.062, Florida Statutes. These errors did not result in overcharges or undercharges.
3. Ten (10) errors were due to use of unfiled rates. This constitutes a violation of Section 627.062, Florida Statutes. The Company used ISO loss costs but did file to adopt the ISO advisory loss costs.

The Company took the position it was using rates in accordance with its approved rating plan. The prior management of Preferred National Insurance Company made the majority of its initial Florida commercial property and casualty filings in 1996. The Company's filing, as approved by the Department effective 11/1/96, included a rule that states, "PNIC will use the most current or loss cost in effect at the time coverage is bound." It was assumed by the Company that with this rule it would not be necessary to file the ISO advisory loss costs. Exhibit I.

4. Nine (9) errors were due to failure to follow filed rates on various construction types. This constitutes a violation of Section 627.062, Florida Statutes. Seven (7) of these errors resulted in overcharges totaling \$635.00, which have been refunded by the Company. Two (2) errors resulted in undercharges totaling \$246.00.
5. Eight (8) errors were due to failure to follow the filed medical payments rates and rules in the restaurant/tavern program. This constitutes a violation of Section 627.062, Florida Statutes.

The filed and approved rate was \$240.00, but the premiums reflect a rate of \$100.00. These errors resulted in undercharges totaling \$943.00.

Prior to the start of this examination, the Company recognized that a problem existed with the medical payments rates, and a new filing was made which eliminated the separate charge for medical payments. It was approved by the Department on August 15, 2000. Exhibit II.

6. Six (6) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. Incorrect rates, minimum premium and renewal credits were used in calculating the premium. Five (5) of these errors resulted in overcharges totaling \$146.00, which have been refunded by the Company. One (1) resulted in a \$7.00 undercharge.
7. Five (5) errors were due to failure to follow the filed deductible factors. This constitutes a violation of Section 627.062, Florida Statutes. The factors were either not applied or the incorrect factor was applied. Two (2) of these errors resulted in overcharges totaling \$177.00, which have been refunded by the Company. Three (3) of these errors resulted in undercharges totaling \$84.00.
8. Two (2) errors were due to failure to follow the filed rating plans. This constitutes a violation of Section 627.062, Florida Statutes. These consisted of premium calculation errors. One (1) error resulted in an overcharge totaling \$87.00, which has been refunded by the Company. One (1) resulted in an undercharge of \$8.00.

9. Two (2) errors were due to failure to follow the filed rating plan for non-owned automobile. This constitutes a violation of Section 627.062, Florida Statutes. The coverage was provided but no charge was made. These errors resulted in undercharges totaling \$270.00.
10. Two (2) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The policy provided coverage for Personal and Advertising Injury Liability and Additional Sign Coverage, but no premium charges were made for the coverage. These errors resulted in undercharges totaling \$228.00.
11. One (1) error was due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The premium was based on an incorrect classification. This error resulted in an undercharge of \$13.00.
12. One (1) error was due to failure to maintain a schedule rating worksheet in the file. This constitutes a violation of Section 627.318, Florida Statutes.

B. OTHER LIABILITY

1. Application of Rules, Rates and Forms

a. Rate/Rule Filings

Preferred National Insurance Company is a subscriber of Insurance Services Office (ISO) and as such ISO is authorized to file rules/rates on the Company's behalf in accordance with Section 627.062, Florida Statutes. In addition, the Company makes independent filings for certain programs, such as artisan contractors, private investigators, general liability products/completed operations, food vendors, liquor liability, special events, employment liability, and professional liability for accountants, lawyers, title agents, dentists and directors and officers.

b. Form Filings

Preferred National Insurance Company is a subscriber of ISO and as such ISO is authorized to file forms on the Company's behalf in accordance with Section 627.410, Florida Statutes. In addition, the Company does make some independent filings.

c. Statistical Affiliation

ISO acts as the Company's official statistical agent.

2. 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>Policy Count</u>
1997	\$3,911,288	3,358
1998	\$3,774,507	5,215
1999	\$3,436,670	5,012

3. Exam Findings

One hundred (100) policy files were examined.

Thirty-six (36) errors were found.

Errors affecting premium resulted in seven (7) overcharges totaling \$3,404.00 and twelve (12) undercharges totaling \$3,771.00.

The errors are broken down as follows:

1. Nine (9) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. Incorrect rates and minimum premiums were used to calculate the premium. Two (2) of these errors resulted in overcharges totaling \$174.00, which have been refunded by the Company. Seven (7) of the errors resulted in undercharges totaling \$961.00.
2. Three (3) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. Incorrect increased limits factors and deductible factors were used

to calculate the premiums. This resulted in one (1) overcharge of \$247.00, which has been refunded by the Company. Two (2) of these errors resulted in undercharges totaling \$65.00.

3. Two (2) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The Company used ISO loss costs that were not filed instead of the Company's filed rates for products and completed operations. One (1) of these errors resulted in an overcharge of \$2,222.00, which has been refunded by the Company. One (1) error resulted in an undercharge of \$1,555.00.
4. Two (2) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The premiums were calculated incorrectly. One (1) error resulted in an overcharge of \$168.00, which has been refunded by the Company. One (1) error resulted in an undercharge of \$669.00.
5. One (1) error was due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The premium was based on incorrect payroll. The error resulted in an undercharge of \$521.00.
6. One (1) error was due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The premium was based on receipts but no adjustment was made when the actual receipts were found to be lower than estimated. This error resulted in an overcharge of \$130.00, which has been refunded by the Company.
7. One (1) error was due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The premium was based on the wrong territory. This error resulted in an overcharge of \$463.00, which has been refunded by the Company.

8. Three (3) errors were due to failure to follow the filed rating plans. This constitutes a violation of Section 627.062, Florida Statutes. These errors did not result in overcharges nor undercharges.
9. Seven (7) errors were due to failure to provide timely notice of renewal premium. This constitutes a violation of Section 627.4133, Florida Statutes.
10. Four (4) errors were due to failure to document or substantiate credits. This constitutes a violation of Rule 4-170.004, Florida Administrative Code.
11. Two (2) errors were due to use of unfiled rates/loss costs. This constitutes a violation of Section 627.062, Florida Statutes.
12. One (1) error was due to failure to provide rates on an auditable policy. This constitutes a violation of Section 627.413, Florida Statutes.

C. FIDELITY AND SURETY

1. Application of Rules, Rates and Forms

a. Rate/Rule Filings

Preferred National Insurance Company is a member of Surety Association of America (SAA) and as such SAA is authorized to file rules/rates on the Company's behalf in accordance with Section 627.062, Florida Statutes. Company makes some independent filings.

b. Form Filings

Preferred National Insurance Company is a member of SAA and as such SAA is authorized to file forms on the Company's behalf in accordance with Section 627.410, Florida Statutes. In addition, the Company does make some independent filings.

c. Statistical Affiliation

SAA acts as the Company's official statistical agent.

2. Premium and Bond Counts

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

<u>Year</u>	<u>DPW</u>	<u>Bond Count</u>
1997	\$3,476,087	3,284
1998	\$3,307,521	3,255
1999	\$3,792,651	3,453

3. Exam Findings

One hundred (100) bond files were examined.

Thirteen (13) errors were found.

Errors affecting premium resulted in five (5) overcharges totaling \$2,792.00 and two (2) undercharges totaling \$3,507.00.

The errors are broken down as follows:

1. Five (5) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The Company used incorrect classifications. One (1) error resulted in an overcharge of \$1,000.00, which has been refunded by the Company. Four (4) errors did not affect premiums.

2. Four (4) errors were due to failure to follow the filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. The errors resulted in four (4) overcharges totaling \$1,792.00, which has been refunded by the Company.
3. Two (2) errors were due to failure to follow filed rating plan. This constitutes a violation of Section 627.062, Florida Statutes. Preferred rates, instead of standard rates, were used to calculate the premium. The errors resulted in undercharges totaling \$3,507.00.
4. Two (2) errors were due to failure to maintain records. This constitutes a violation of Section 627.318, Florida Statutes. The files did not contain worksheets or other sufficient information to verify the premiums charged.

V. AGENTS/MGA REVIEW

Thirty (30) applications/policies written during the scope of examination were examined.

Five (5) errors were found.

None of the errors affected policy fees.

The errors are broken down as follows:

1. Five (5) errors were due to failure to display agent's name on the application. This constitutes a violation of Section 627.4085, Florida Statutes.

VI. CANCELLATIONS/NONRENEWALS REVIEW

Fifty (50) cancelled/nonrenewed policies/bonds were examined.

Sixteen (16) errors were found.

Four (4) errors resulted in underreturns totaling \$213.87.

The errors are broken down as follows:

1. Eight (8) errors were due to failure to provide a specific reason for cancellation or nonrenewal. This constitutes a violation of Section 627.4091, Florida Statutes.
2. Four (4) errors were due to failure to correctly calculate unearned premium. This constitutes a violation of Section 627.062, Florida Statutes. These errors resulted in underreturns totaling 213.87, which has been paid by the Company.
3. Four (4) errors were due to failure to provide proof of mailing of notice of cancellation/nonrenewal. This constitutes a violation of Rule 4-167.010, Florida Administrative Code.

VII. CLAIMS REVIEW

Fifty (50) claims were examined.

Two (2) errors were found.

None of the errors affected payments.

The Company's internal claims handling procedures and reserving practices are described in Exhibit III.

The errors are broken down as follows:

1. One (1) errors were due to use of unappointed adjusters. This constitutes a violation of Section 626.112, Florida Statutes.
2. One (1) error was due to failure to provide a written explanation of claim denial. This constitutes a violation of Rule 4-166.026, Florida Administrative Code.

VIII. COMPLAINTS REVIEW

A complete record of all the complaints received by the Company since the date of the last examination has been maintained as is required by Section 626.9541(1)(j), Florida Statutes. Procedures for handling these complaints have been established by the Company. Complaint handling procedures are described in Exhibit IV.

A. INFORMAL COMPLAINTS

No informal complaints were found.

IX. EXHIBITS

<u>SUBJECT</u>	<u>EXHIBIT NUMBER</u>
COMMERCIAL PROPERTY & CASUALTY PROGRAM FILING LETTER DATED OCTOBER 24, 2000	I
RESTAURANT/TAVERN PROGRAM – MEDICAL PAYMENTS LETTER DATED OCTOBER 12, 2000	II
SYNOPSIS OF CLAIM HANDLING PROCEDURE	III
PROCEDURES FOR HANDLING COMPLAINTS	IV